FY 2021 Loudoun County Budget Preparation[1]

Still Hooked on Growth?

Discussion Note

Introduction

How does the BOS keep approving galloping growth in Loudoun County public expenditures, averaging 9% annually over the last 10 years, and lower your property taxes at the same time? ***The last time Loudoun's real property tax rate was $0.99 was 25 years ago in 1995!***

Is it magic? Is it a good idea? The 2019 Comprehensive Plan Review Committee of Loudoun's Preservation and Conservation Coalition met in June 2019 with Loudoun's Administrator and management staff to discuss this and other County fiscal policy and performance matter. They agreed to address them further in the context of the FY2021 budgeting process. [2]

The FY2020 budget adopted in March 2019 illustrates some key issues like to arise again. Adopted expenditures rose an eye-popping 23% over FY2019 to $3.2 billion - the largest annual increase in 15 years. This was more than double the galloping long-term average annual expenditure growth of 9% since FY2000, nearly triple the average rate since FY2011, and it perpetuated the long-term government operational spending growth spiral per resident. On the revenue side, it deepened the dependency on data centers – over FY2017-FY2020, *data center personal property taxes accounted for 71% of the total growth in County General Fund revenues*. It then extended the "equalized tax policy", which depends on high annual rates of new residential and commercial development, to continue its decade-long of granting a decline in residential and commercial real property taxes while imposing on the community the very real experiential 'indirect growth tax' on Loudoun's quality of life.[3]

1. The FY2021 budget development process – well underway

We are midstream in the following sequence of steps in Loudoun's annual budget preparation:

- July 2019 - Staff initial budget preparation – economic outlook, residential and commercial real estate trends, and initial budget issues.

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[1] Questions and comments on this note may be addressed to Jim Hanna, SWAT team member, Loudoun Preservation and Conservation Coalition, at jimhanna12@gmail.com or via mobile (301)-717-5889.

[2] These discussions focused on the paper "Envision Loudoun: Break the Hooked on Growth Cycle" of April 14, 2019. https://loudouncoalition.org/wp-content/uploads/2019/04/Envision-Loudoun-Break-the-Hooked-on-Growth-Cycle-Make-the-1-Growth-Choice-FINAL-4_18_2019.pdf

[3] Fuller analysis is contained in separate notes entitled "Loudoun County FY2020 Budget – Overview and Long-Term Context" (March 17, 2019), available on request addressed to jimhanna12@gmail.com .

- October 2019 - Initial memo to the FGOEDC then the BOS for Initial Budget Guidance on priorities, service levels and expenditures, revenue forecasts and tax rate parameters.
- December–January 2020 - Prior year budget closeout report and LCPS budget request.
- January 7, 2020 - Final Budget Guidance from BOS (completed).
- February 12 – Administrator's budget presentation and budget public hearings.
- March – April - Budget work sessions and adoption.

2. FY2021 expenditures – more upward pressures

Loudoun County Government (LCG) staff have identified a range of areas which will place substantial growth pressures on FY2021 budget expenditures as summarized below.[4] [5] [6] [7] [8]

Public services and LCG staffing levels – staff report that service delivery pressures experienced by LC departments will continue as Loudoun continues to add some 11,000 new residents per year. Service plans, based on its 2020 Program Review and incorporating service levels, performance measures and other indicators, will be presented in late fall. Over the past 3 years, the County government has added a total of 518 net new full-time employees. The current FY2021 estimate for LC base budget growth (apart from salaries), based upon requests received from County departments, needs "significant" growth to staff programs in human services, community development and internal operations.

LCG staff costs – an LCG staff classification and compensation study has been completed on a market analysis of more than 900 unique staff positions, development of a new market competitive pay plan that used between 95 and 105 percent of market benchmarks, a new classification system, and related items. The study consultants (Evergreen) have estimated the County's overall salary market position at 95.1 percent of market on average. This reflects significant salary growth as approved by the BOS 'catch-up' increases in FY2019 and FY2020, totally five percent and merit increases totaling 6.5 percent. For FY2021, staff is currently assuming a 2% market adjustment for all staff and a 3.5% merit increase.

LCPS budget – additions to the school population of 1,993 students is expected for FY2021. Applying global costs per pupil, this means some additional $19.0 million to maintain current service levels, including class sizes at lower levels according to staffing standards. The staff's Initial Guidance memo of October 2019 noted at about $5.0 million will be required for new schools; an additional $24.1 million to provide a 2.4% average step increase for all eligible employees; $41.6 million more as a teacher salary adjustment to increase competitiveness (the same amount as provided in FY20); and $32.5 for other compensation and other initiatives. Total additions sought, net of estimated state and federal contributions - $96.4 million.

The CIP – staff re-estimations of previously funded projects in the CIP have revealed [unspecified] increased costs and adjusted schedules for certain projects.

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[4] See FGOEDC FY2021 Budget Development: Preliminary Budget Guidance, October 8, 2019,
[5] See LCPS FY21 Preliminary Fiscal Outlook, August 13, 2019.
[6] See Capital Improvement Program: FY2020 Amendments and FY2021 Guidance, October 17, 2019.
[7] See FGOEDC Phase 2 Classification and Compensation Study, October 8, 2019.
[8] See FY2021 Budget Development: Final Budget Guidance memo of Janiuary 7, 2020 to the BOS.

Unaccounted expenditures and revenue effects. Loudoun's spending growth levels are a complete anomaly in the DC Metro area, running at two- to three-fold those of other county jurisdictions. Yet, projections for FY2021 and beyond may still not account for important looming budget impacts. With the coming startup of the Metro Silver Line will come Loudoun's obligation to contribute to coverage of 4.8% of its operating deficit of the Metro. Over 2016-2018, Federal and jurisdiction subsidies have amounted to roughly $1 billion a year, or at least one-third of operation expenses --- Loudoun's share of this would be some $ 50 million per year from the startup date. In addition, workforce housing initiatives on the horizon will aim to diversify the housing options with a range of affordable dwellings. This is to be done within the adopted 2040 Plan land use plan, and thus will likely supplant higher cost detached and attached residential units, with a considerable downside real property tax revenue effect.

INITIAL EXPENDITURE IMPLICATIONS

Initial staff estimates of FY2021 total expenditures are approximately $3,346 million. Increases over the current adopted budget are summarized in the table below and total $189.1 million.

a. This initial estimate is about **6.4% above the FY2020 total budget of $3,157 million**, though LCG staff have warned of a variety of stronger upward pressures on spending**,** including those now undefined operating subsidy obligations to the Washington Metro.

b. Spending per resident [9] for this budget would rise about **1.4% above FY2020 and be a moderation to the 3.4% in FY2020 and the 20-year average trend of 2.0% p.a.**

c. Staff report that, even with this spending increase, the FY2021 budget **would not be able to accommodate all new capital projects in the six-year CIP**. This constraint is exacerbated by other pressures like the start of the Silver Line, Loudoun Towns requests ($13.4 million so far) and new or accelerated priorities of Board members.

FY2021 Budget Estimates [10] Projected Expenditures and Variances from the FY2020 Approved Budget (in millions of US$)			
	FY2020 (adopted)	FY2021 (initial)	Variances
County general operating expenditures – of which	**$679**	**$736**	**$57**
LC personnel base budget growth		20.4	20
LC personnel merit increase (3.5%)		12.3	12
LC other base budget growth		10.0	10
LC resource requests		15.0	15
LCPS request	**1,322**	**1,418**	**96**
LC debt service	**224**	**234**	**10**
LC School and LC CIP and CAPP	**933**	**971**	**39**
Total projected changes in expenditures	**$3,157**	**$3,359**	**$202**

[9] Assumes 11,000 new residents (2.6% above FY2020) and adjusts for expected annual inflation of 2% per year (mid-Atlantic CPI was 0.9% through September 2019).

[10] Author's estimates from Staff Initial and Final Budget Guidance notes and applied to the FY2020 Adopted Budget.

3. FY2021 revenues – more data center dependence and a budget shortfall

The LCG's FY2021 preliminary budgeting is predicated on a forecast of continued moderate growth of the US and world economies. It reflects no cautionary steps for the downside risks of an economic recession that may arise from government fiscal policies, trade restrictions, debt levels and interest rate trends.

LCG reports that sales of newly constructed homes were down 18% in the first half of 2019 and that of existing homes down one percent.[11] Residential property sale by October 2019 were only 2.1% higher than the previous October, less than half the 5-6% of the previous three years reported by the Dulles Area Association of Realtors. It takes as currently given a commercial property market of buoyancy of data centers and low vacancy rates in categories other than office space. [12]

LCG reports that commercial property development in Loudoun remains at a 'healthy pace', with vacancy rates on a generally downward direction through September. About 3.8 million ft2 of new commercial space have been permitted in 2019, including 1.7 million ft of flex space (including data centers), roughly a total growth in space of about 4% this year.

INITIAL REVENUE IMPLICATIONS

Staff have presented a number of revenue estimates for FY2021. The first set base real property taxes on rates at the current level ($1.045 per $100 of assessed valuation) and at the so called "equalized rate" ($1.02). The latter represents the BOS policy applied for nearly the past decade in which the tax rate would yield for homeowners and businesses the same average annual real property tax payment as the previous year.

a. **Neither revenue scenarios would be adequate to cover all expenditure needs –**
    i. For the government, between 80% and 1000% of the operations and maintenance budget could be accommodated;
    ii. No Departmental requests or only first priority requests could be addressed;
    iii. For LCPS, where the gap would be an estimated $40 – 52 million.

b. **Neither revenue estimate anticipates or adjusts for the potential impact of economic recession** that would affect Loudoun and the US economy.

c. **Both revenue strategies would increase data center industry dependence** with an 18% increase in personal property tax revenues.

d. **The "equalized tax rate" option would decrease the average real property tax** by about 2% after adjusting for inflation.

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[11] Staff Quarterly Report/FY2020 First Quarter Financial Update, Cash Proffer and Debt Report, November 12, 2019.

[12] FY2021 Budget Development: Economic Outlook and Budget Issues, July 9, 2019; and FGOEDC Personal Property Tax Rates for Tax Year 2020, October 8, 2019

Initial FY2021 Budget Guidance [13] Projected General Fund Revenues and Variances from FY2020 Approved Budget (in millions of US$)			
	FY2020	Additional revenue at a real property tax rate of:	
		Current rate $1.045	Equalized rate $1.02
Real property taxes	909	$59.2	$35.8
Personal property taxes	465	95.7	95.7
Sales, utility and other local taxes	300	2.8	2.8
Use of prior year Fund balance		0.4	0.4
Other County revenues	96	2.8	2.8
Total – projected changes in revenue	**1,778**	**$160.9**	**$137.5**
Total – projected change in expenditures		**$202.0**	**$202.0**
Projected budget shortfall		**($41.1)**	**($64.5)**

4. FY2021 Final Budget Guidance - the BOS debate

Initial Guidance was presented by staff to the BOS on October 17 seeking Preliminary guidance on its spending priorities and real property tax rate options. Supervisors passed by 9-0 with nearly no debate the Initial Budget Guidance proposed by the FGOEDC, which instructed staff to prepare a budget using the "equalized real property tax rate" ($1.02) + / - $0.02 cents (i.e., $1.00 to $1.04). Comments were made by (a) Messrs. Letourneau and Higgins, who said that they saw no reason to approach the equalized real property policy differently, as it has "*worked well"*, while (b) Supervisor Umstaadt wanted to know where the money would come from if the BOS were to fully fund schools, and about reliance on data center revenues for core needs like school and staff compensation.

At its January 7, 2020, the BOS gave staff final guidance for the FY2021 Budget at the current real property tax rate of $1.045 per $100 of assessed valuation, with a higher option at $1.055 and a lower option at $1.035. The BOS is showing complete support to fund the compensation and classification plan. Concerns were expressed about the FY2020 tax rate, first priority Departmental requests to ensure current services levels to a growing population, second level priorities and the funding of the LCPS request. The Chair recalled that, with the approval of additional housing, comes the obligation to ensure adequate services for the growing population.

On the "equalized tax rate policy" while there was emphasis on it as a tool to discipline the budget development process, there was also recognition that starting "low" actually has resulted in further lowering tax rates. Little precision came from calls for a "reasonable" rate, showing that this policy has little objective rationale. However, there was some recognition that (a) many decisions to adopt the equalized tax rate each year may have done damage to County government, (b) taxes should be as low as possible, while providing needed county services, and (c) the starting point for any tax policy should be fiscal responsibility and ensuring the "flexibility" needed to address changing economic circumstances in Loudoun in coming years.

[13] Derived from Staff Final Budget Guidance memo and applied to expenditure estimates enumerated above.

5. Issues and Actions

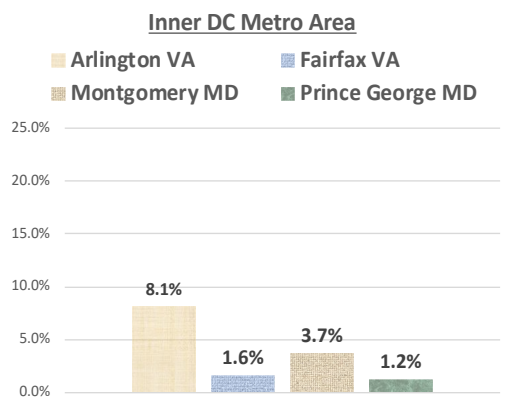
The budget, in process, approach and content, appears to be shaping up in a fashion similar to past years. The paper "Envision Loudoun: Break the Hooked on Growth Cycle" of the 2019 Comprehensive Plan Review Committee of Loudoun's Preservation and Conservation Coalition called for the County to *address Loudoun's high budgetary dependence on new development and significant exposure to fiscal risks.* The following raises some – certainly not all - issues and possible actions pertaining to the FY2021 budget and beyond.

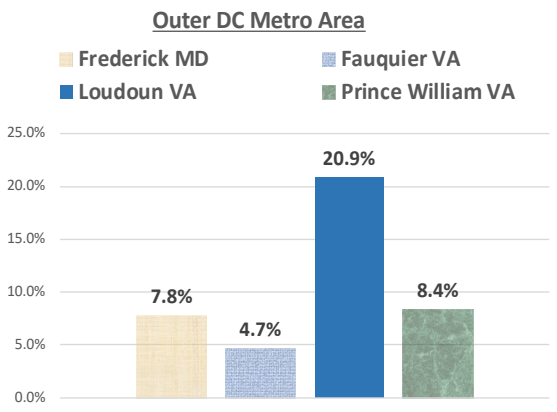
1. Are County expenditure growth rates too high and tax revenues too reliant on new residential and commercial development?

Loudoun's fiscal affairs have been heavily driven by its housing development policies and have generated an exceptional profile in the DC Metro area. New housing development in Loudoun has been 2-3 times the rates of *both* the Inner DC Metro area and Outer DC Metro area Counties over 2010-2017 – such as Frederick, Montgomery, Prince George, Arlington, Fairfax and Prince William.

Total Growth in Housing Units
Selected Counties in the DC Metro Area, 2010 - 2017

Loudoun - More than Triple the Rate of Other Counties



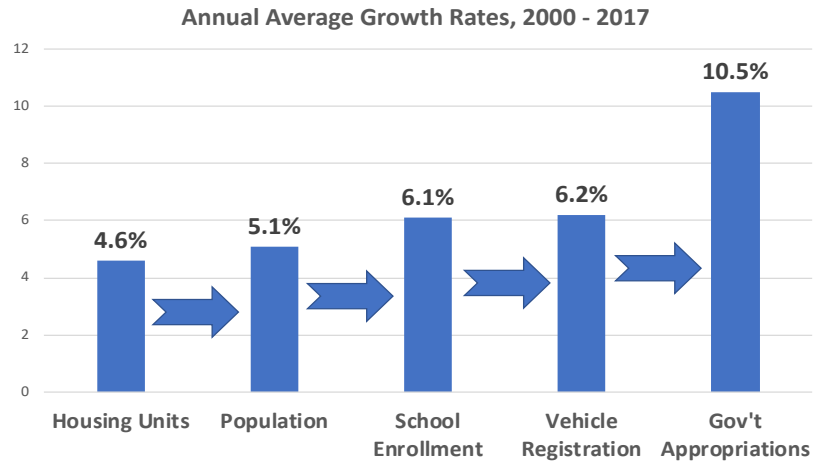


Increase in Housing Units	Per County Avg.	Loudoun Co.
Total 2010--2017	7,784	23,014
Annual Avg Growth 2010-2017	0.8%	2.8%

Sources: US Census Bureau, Population Division, 2019.

Driven by this housing boom, Loudoun's demographic development experience has consequently been chaotic. Population growth of about 5% per year over 2000-2019 has been more than 3 times the Washington metro regional rate and created a doubling of population density in its suburban area (now comparable to Fairfax and Montgomery Counties). School enrollment has tripled and, with the large segment of Loudoun residents commuting outside the County, daily vehicle miles traveled doubled by 2017 as 244,000 more vehicles were registered within Loudoun County during that time.

Loudoun Housing Policy Drives Impacts
On Population, School Enrollment, Traffic and Gov't Spending 2000-2017



Relative to the year 2000:

72,000 more housing units

223,100 more residents

50,000 more school pupils

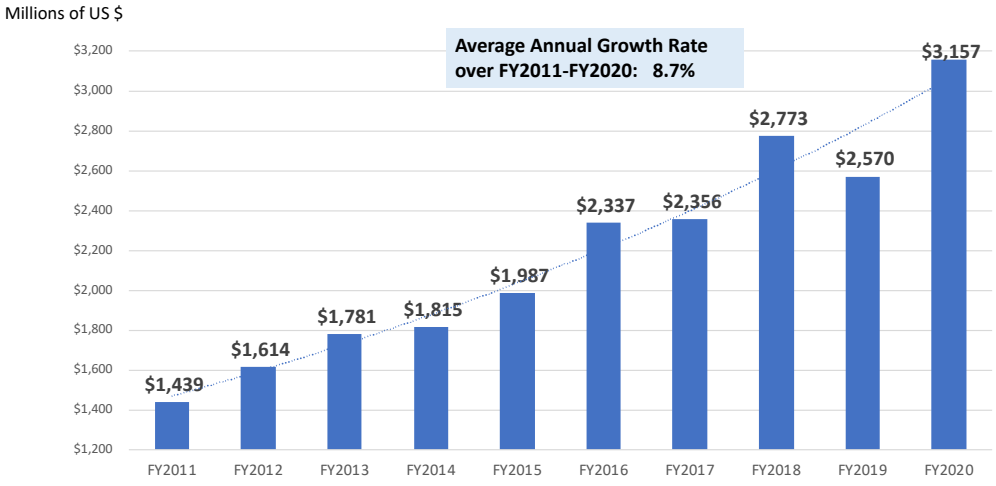
244,000 more vehicles

$1,967 million more spending

Source: Various Loudoun County Government Reports and Budgets, 2000 – 2017,

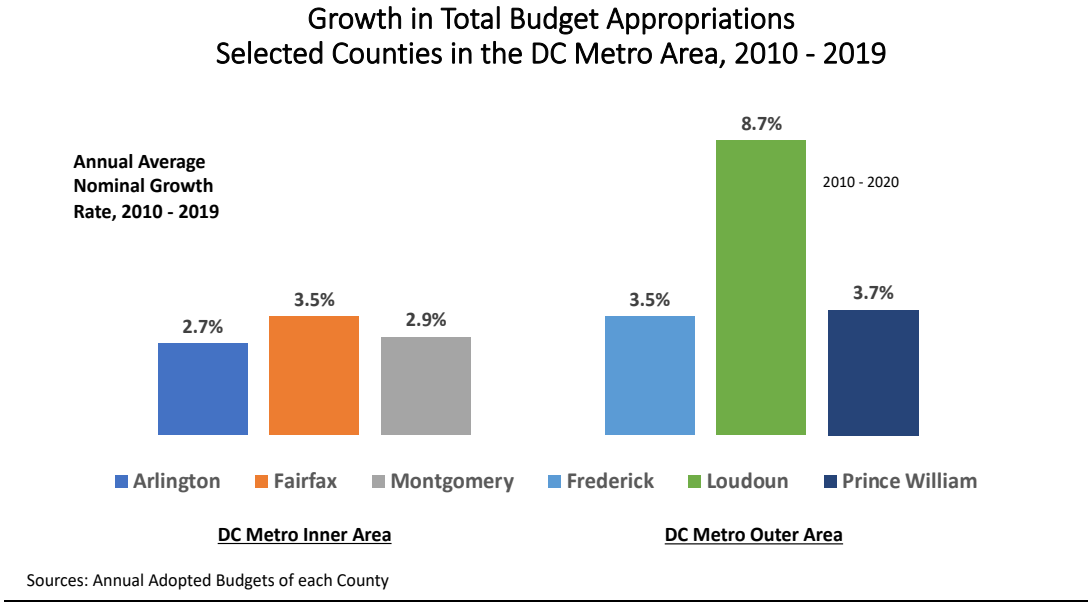
This has led to extraordinarily high rates of government spending. Overall, the County's total appropriations budget rose at about 9.7% per year on average over FY2000-2019. And spending pressures are accelerating not relenting, as the FY2020 budget reveals an eye-popping 23% increase over FY2019 in total budget appropriations ($587 million more than last year's $2,570 million) and the largest annual increase in 15 years.

Loudoun County Total Appropriations Budget
Values and Growth Rate, FY2011 - FY2020



Sources: Loudoun County Adopted Budgets, FY2011-FY2020

Loudoun's total budget record over at least the past 10 years is clearly an outlier in the Washington DC Metro region, running at more than twice to threefold other major counties --- not only in the inner DC area jurisdictions but those in the outer DC area.



This practice creates *important negative effects*, including

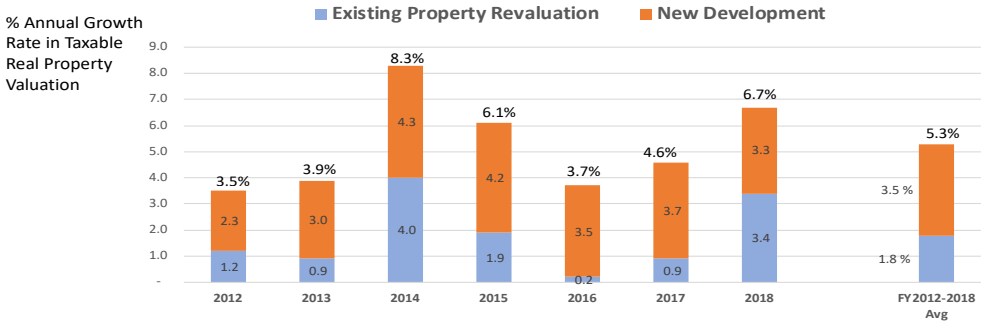
- *Elevating unsustainable levels and growth rates in County operating and capital expenditures* over the longer term and *raising the exposure to economic and business risks* of County finances in the near term that lead to abruptly cuts in expenditures; and

- *Depressing the growth of homeowner equity of existing residents.* The flood of new housing development in Loudoun has been 2-3 times the rates of *both* the Inner DC Metro area and Outer Metro area counties over 2010-2017. The annual revaluation rate of existing real property in this area tends to be higher than in Loudoun. For example, Loudoun reflects about a 1% per year lower revaluation rate in relation to Fairfax and Arlington Counties, creating a penalty on home-equity building for Loudoun residents under the expansive County new housing policies.

- *Promoting a high fiscal revenue dependence on new development. An average of only 34% of the growth in Loudoun's real property tax base has come from the revaluation of existing property over the last decade.* Two-thirds to three quarters of the increase in County real property tax base and revenues has come from a reliance on *new residential and commercial property development*.

- *Generating a tax revenue strategy that is "hooked on growth" and at substantial variance with regional fiscal policy practices*: *neighboring Fairfax and Arlington Counties have over this period derived 74% - 78% of their property tax base growth from the revaluation of existing property*.

Hooked on Growth – Expansion of Loudoun's Real Property Tax Base
Mostly From New Development not Existing Property, 2012 - 2018



% Existing Property Revaluation / Total Valuation Growth	2012	2013	2014	2015	2016	2017	2018		2012-2018 Avg
	34%	23%	48%	31%	5%	20%	51%		34%
							Fairfax		74%
							Arlington		78%

Benchmarks

Sources: Loudoun County Adopted Budgets, FY2011-FY2020 Budget

<u>Action 1</u> – Restrain the growth rates of total budget expenditures to progressively reach parity with long-term sustainable levels of the growth in County fiscal revenues:

1.1 Institute budgeting for FY2022 with stronger and transparent reference to Washington DC Metro area regional long run tax base growth rates, which have been approximately 3% – 4% annually, of which revaluation of existing property would account for 2% -3%; and

1.2 Adopt budget indicators in FY2022 that reflect progressive significant reductions over FY2020-FY2024 in the annual rate of new residential housing permits.

2. <u>What is the County's long-term sustainable fiscal revenue policy framework?</u>

Neither the Comp Plan nor the annual budget provide a long-term sustainable revenue policy framework that clearly defines the best sources and mix of County revenues.

The 2019 Comprehensive Plan contains a single (vague) strategy and action in the regard:

- Chapter 6 Section 8.1 (strategy) – "Maintain a diversified and stable revenue structure by balancing residential and non- residential development"; and

- Section 8.1 A (action) – "Seek further revenue diversification to increase fiscal stability and thereby mitigate tax burdens on Loudoun County taxpayer."

The County's Fiscal Policy, adopted December 17, 1984 and revised through January 6, 2016, provides similarly couched policy goals, policies and guidelines related mainly to internal prudential financial revenue-expenditure balance, reserves, procedures for cost allocation, accounting, controls.

In practice, the central approach to revenue management demonstrated by the BOS has been two-pronged: (1) a passion over the past decade for cutting real property taxes, and (2) taking advantage in an *ad hoc* fashion over the past five years of the windfall personal property taxes resulting from the local and global growth of the data center industry. "Diversification", *de facto,* has been a process of the County prioritizing new residential development and enabling the unfettered pursuit of a concentrated sources of commercial revenues from data centers. There seems to be a complete absence of a clearly defined and broadly agreed policy framework that addresses the following strategic questions which heavily influence annual land use management:

(i) What is the appropriate balance between residential and business tax support?
(ii) What is the right balance between existing property and new development to expand the real property tax base?
(iii) What is the appropriate level and means of fixing the real property tax rate?
(iv) What are the best alternatives to further diversify County revenue sources?

<u>Action 2</u> – Articulate a long-term sustainable fiscal revenue policy framework within which land use policies of the 2019 Plan and County budgeting are prudently executed:

2.1 Review *over March – May 2020* County revenue policies and practices, and benchmark them against experience elsewhere in the Metro region and the United States; [14]and

2.2 Make recommendations *by June 2020* and adopted before the FY2022 budget development begins a fiscal revenue policy framework focusing in particular on:

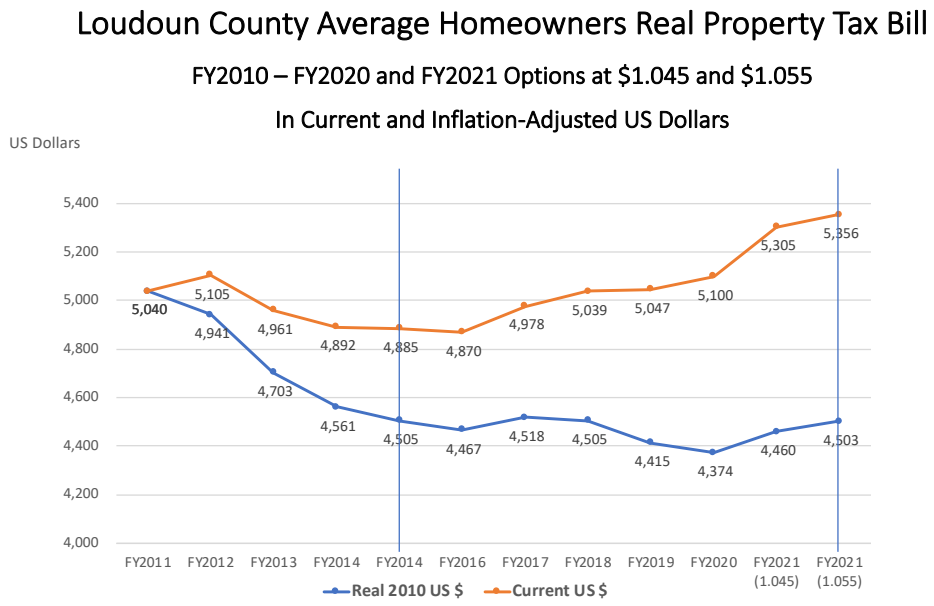
(i) How much of budget revenues should rely upon new development versus revaluation of existing property?
(ii) How much of budget revenues should rely upon residential homeowners versus the business community?
(iii) Should real property taxes be higher for risk management or affordability goals?
(iv) Should the taxes on business be lower to help strengthen its development?
(v) How much of tax revenues should rely on a single concentrated business sector?
(vi) How should real property tax rate and personal property tax rate be set?
(vii) Should the County diversify its tax base through more sales and use taxes and fees, based more on ability to pay, than wealth-based property taxes?

3. <u>Is the equalization tax rate policy in the best interest of Loudoun residents?</u>

Real property tax policy has changed dramatically since 2010. In the first decade after 2000, to meet growing County public expenditures, Loudoun's tax revenues were driven primarily by a "pay-as-you-go policy", with increases in residential real property tax rates moving from $1.08 to $1.30 per $100 of assessed value over FY2000 - FY2010. Since FY2010, however, the BOS has decisively changed this fiscal strategy*:* it has kept the average homeowner's real property tax

[14] See, for example, "A Budgeting Guide for Local Governments (Third Edition), Robert L. Bland, 2013". https://www.transformgov.org/sites/transformgov.org/files/308758_A_Budgeting_Guide_print_43706.pdf

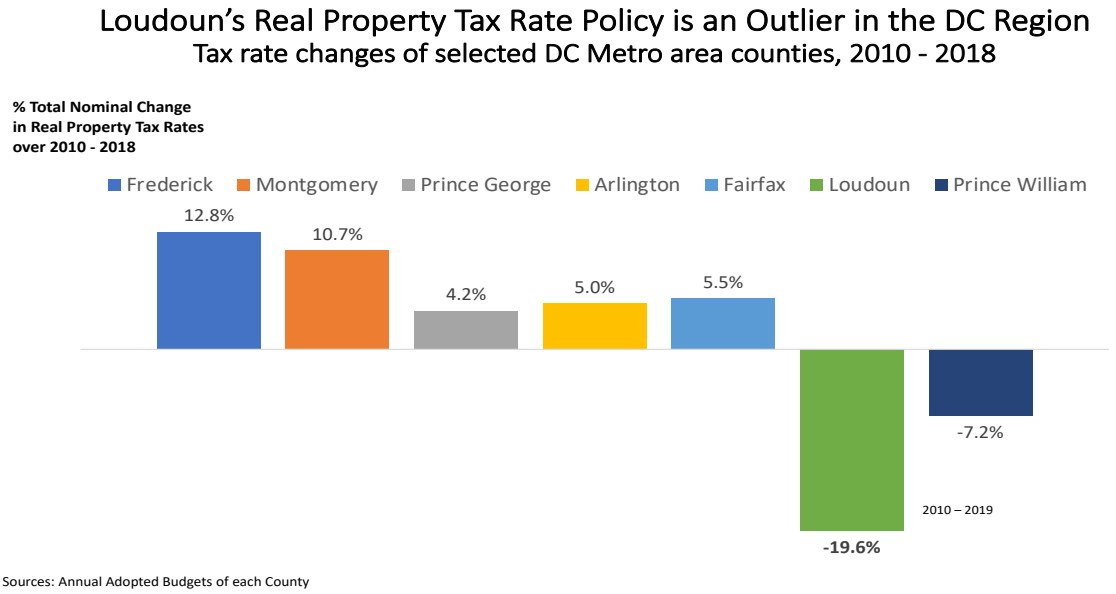
bill stable in current terms --- from $5,071 in FY2010 to $5,100 in FY2020. But, accounting for inflation, *the average homeowner's tax bill has actually fallen by nearly 13%*.



Source: Loudoun County FY2000 – FY2019 Adopted Budget (current) and model calculations (real).

For FY2021, the average property tax bill when inflation adjusted would be equivalent to that paid in FY2014 or FY2015 (see graph above).

This is at variance with common practices in US counties, in which real property tax rates tend to rise so as to at least compensate for annual consumer price inflation. And it is prominent in real property tax rate trends over 2010-2018 in the DC Metro area, as shown below.



Sources: Annual Adopted Budgets of each County

While appealing to taxpayers at first glance, this "equalized tax rate policy"

- *is highly growth-dependent and imposes an indirect "growth impact tax" on residential quality of life.* Heavy reliance on new residential and business development to expand the tax base imposes a daily experiential "growth tax" felt in widespread housing sprawl, massive traffic congestion and waiting times, school crowding, air pollution and other environmental degradation, and diminished green space;

- *has become over the decade the singular overriding fiscal revenue priority* in the BOS fiscal revenue management, at the expense of Loudoun's quality of life and driving media headline announcements by some of having consistently "cut taxes for four years"; and

- *overlooks the willingness of County residents to pay more taxes*, as reflected in annual Loudoun resident opinion surveys in which the *majority* express a willingness to pay more taxes to address specific issues (e.g., school quality, roads and health and welfare services) and some even to ameliorate high growth and development rates.[15]

<u>Action 3</u> – Employ real property tax rates that take account of price inflation to ensure they maintain their purchasing power of public services over time and help to fully fund well-founded operating and capital budget needs:

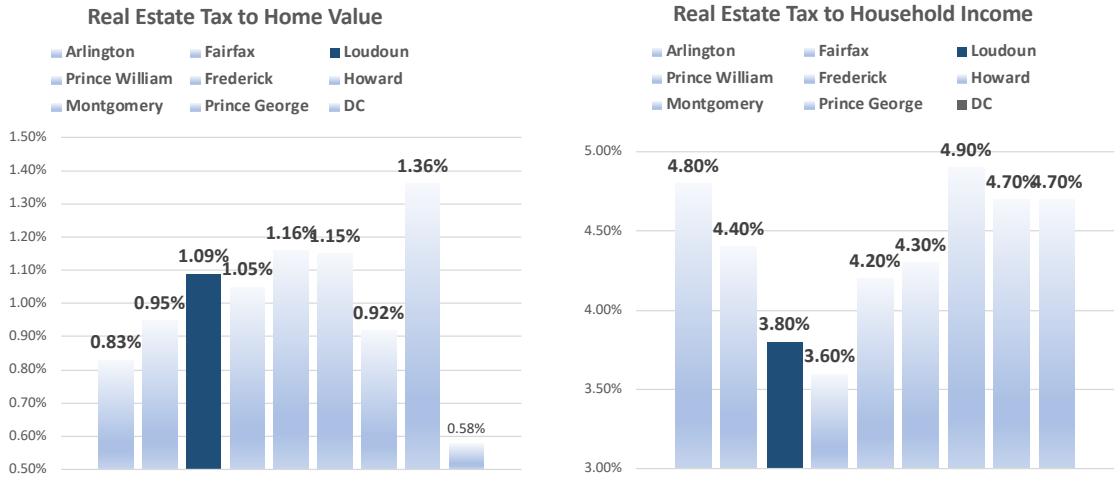
3.1 For FY2021, adjust the real property tax rates, so as to ensure funding of (i) the new classification and compensation structure, (ii) other base budget operations and maintenance, (iii) Departmental first and second priority requests, (iv) substantially the LCPS budget request; and

3.2 From FY2022, ensure that, as a minimum, real property tax revenues are inflation-adjusted annually to maintain their purchasing power.

This step would also make Loudoun's fiscal management more consistent with the policies of other major jurisdictions in the DC area, while maintaining Loudoun's current regional standing as a county with one of the more affordable real estate tax rates.

[15] See, for example, pages 26-27 of the 2016 Survey of Residents and page 18-19 of the 2018 Survey of Residents.

% Real Property Taxes to Home Value and Household Income
Selected Counties in the DC Metro Area, 2016

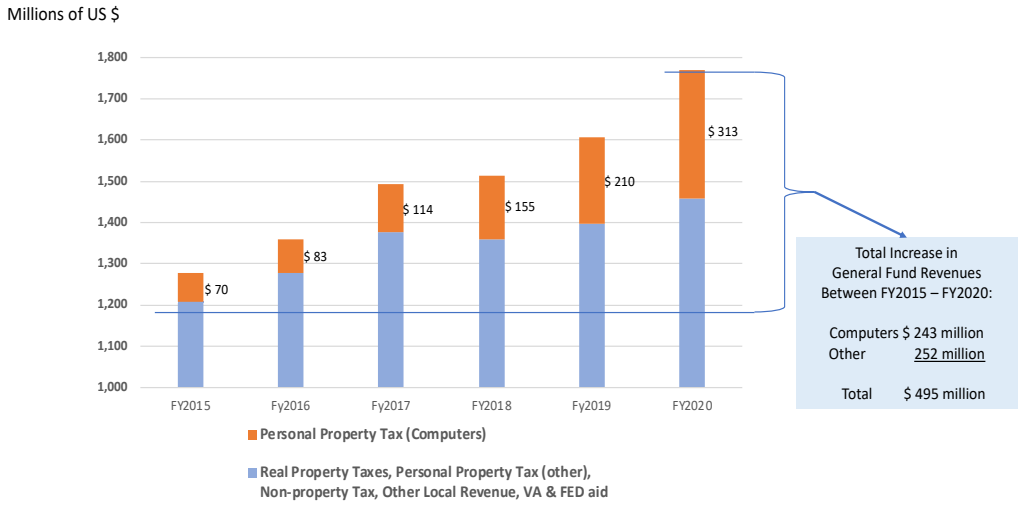


Sources: National Association of Home Builders (taxes and home values), 2016; County Health Rankings and Roadmaps (median household income), 2016.

4. <u>Does the County rely too heavily on the tax revenues of the data center industry?</u>

Data center personal property tax revenues are moving from initially being a source of tax revenue diversification to now becoming a source of revenue concentration. Loudoun is now substantially dependent upon them to finance its budget revenue growth. Between FY2015-FY2020, data centers real property tax and personal property tax payments have provided a phenomenal *one-half ($243 million) of the total growth in budget revenues, rising from 7% to 21% of total General Fund revenues.*

Loudoun County – Additions to General Fund Revenues
From Personal Property Taxes (computers) and Other Sources, FY2015 - FY2020

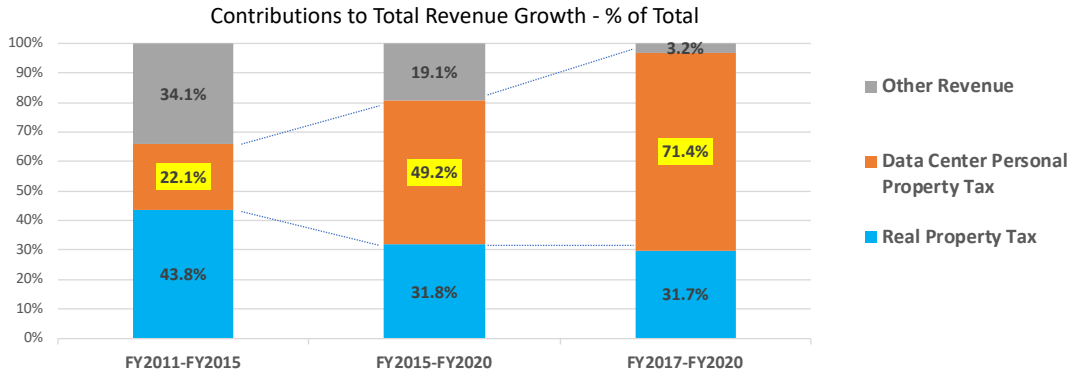


Sources: Loudoun County Adopted Budgets, FY2011-FY2019 and proposed FY2020 Budget

This dependency for revenue growth trend has continued to accentuate. Over just FY2017-Fy2020, a phenomenal 71% of the growth in Loudoun's General Fund revenues has originated from the computer category of personal property taxes (nearly all from data centers). And this understates this trend, as it does not include real property taxes from the data center sector.

Sources of County Revenue Growth Over FY2011 - 2020

Trending from Diversified to Mostly Data Centers



Sources of Loudoun Government Budget Growth – Dollar Values (millions $US)				
	Real Property Tax	Data Center Computer Property Tax	Other Local Revenue & Aid	Total Budget Revenue Increase
FY2011-FY2015	89.0	45.0	69.2	203.2
FY2015-FY2020	157.2	243.4	94.5	495.1
FY2017-FY2020	88.2	198.5	-8.8	277.9

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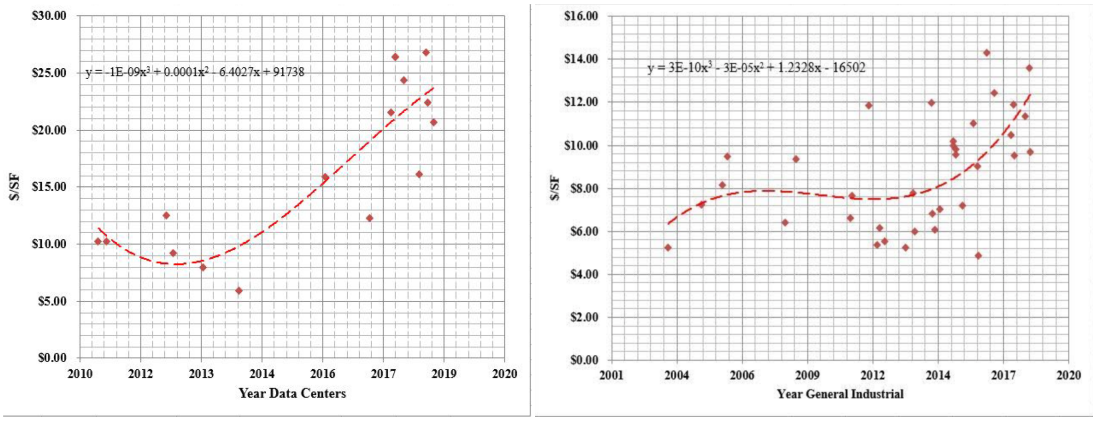
In the absence of budget and tax policy changes, this trend is like to continue to further increase the dependence on data centers for revenue. There are several concerns connected with these trends and tax revenue practices, in that they:

- *Now pay the bills for a very meaningful level of government and school operational costs and County debt service obligations,* supporting about 14% of total operational and debt service costs of the government and school system;

- *May be undermining, for the sake of short-term Government revenue gains, the competitiveness, investment and employment generation of other local (particularly smaller) businesses* by driving up the costs of land (by some 50% for non-data center industries – see right graph below) and development, and displacing other economic, cultural and social uses that build quality of life in the County.

Trends in Loudoun Land Prices, 2004 – 2019

Emphasis on data center tax revenues disadvantages other Loudoun business



Source: Myers Appraisal Service. Land sales are before adjustments for location, floodplain and terrain. Data is market representative and excludes outliers.

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Like "Dutch Disease" impacts elsewhere,[16] heavy data center revenue reliance is likely to raise land, construction and other factor costs and depress business investment and employment of other business sectors, which already face heavy skill and wage competitiveness in the DC Metro region.

- *Contain concentrated business, technological and regulatory risks* – including their conceivable withdrawal from Loudoun - that diminish them as predictable and diversified long-term revenue streams, unlike those represented by real estate property taxes; and

- *Are unsustainable and unlikely to continue beyond the medium term to enable aggressive growth in budget operating and capital expenditures* - as the rate of new establishment and expansion will tend to stabilize over time with land use constraints.

<u>Action 4</u> – Strengthen fiscal management practices in using of data center revenues by

4.1 Increase in the FY2021 budget the practice initiated in FY2020 of channeling a greater share of yearly personal property tax revenues from the data center industry to fund the County's local tax contributions to cover Capital Improvement Program (CIP) spending and lower the dependence of County and school operating expenditures on this source;[17] and

[16] The term "Dutch Disease" refers in economic analysis to a phenomenon of the causal relationship between growth of a specific sector, such as the mining industry and the IT industry in parts of the USA, and a consequent decline of other sectors as it makes them less competitive through a variety of impacts on the pricing of land, labor, capital and exchange rates affecting business and consumers. It is often accompanied by a growing and high government reliance on related tax and export revenues and volatility associated with the sector in question.

[17] In the current FY2019—FY2024 CIP costing $2.4 billion, $527 million is slated to come from local tax funding, of which $78 million from FY2020. The remainder comes from debt financing ($1.2 billion) and intergovernmental assistance ($0.7 billion). In FY2020, $15 million of personal property taxes was assigned to the CIP.

4.2 Establish by June 2020 a transparent long-term policy framework that replaces current *ad hoc* fiscal practices to fill revenue gaps with new data center revenues and defines (i) land use for data centers within the 2019 Comp Plan and (ii) the share of local tax revenues that may paid by this or any other single industry source to cover annual operating costs of LCPS schools and government services and the cost of debt service.

This step would (i) reduce the use of data center taxes that now finances LCPS and LCG operating expenses, (ii) help to ensure that the CIP is fully implemented as planned, and (iii) reduce the level of new external debt needed to finance the CIP.

5. Is Loudoun recession ready, especially given its fast-lane fiscal management?

Loudoun's fiscal profile generates considerable risks to County residents, particularly due to its (i) high fiscal revenue dependency on buoyant overall economic growth (ii) its dependence on concentrated data center industry taxes and the prospect reportedly that it will be out of land space for new data centers by the mid-2020s, (iii) its rising future debt service obligations and limited new borrowing capacity - projections to FY2024 are now maxed out at the BOS $225 million annual ceiling, (iv) the County's 4.8% portion of Metro operating costs it must assume from startup, and (v) a policy of reducing the levels of cash reserve balances.

Moody's latest Investor Service Credit Opinion of June 5 ,2019 (see its "GO Scorecard Factors" in Annex 1) rates the County's economy and tax base as "very strong". However, its *financial management operating history (operating revenues / operating expenditures) is rated two steps down as "Moderate" and debt and pensions also rated mostly as "Moderate".* Moody's Opinion singles out three of these factors that could lead a credit rating downgrade:

1. Use of reserves resulting in a decline the General Fund balance,
2. Substantial deterioration in the tax base and demographic profile, and
3. A sizable increase in debt burden beyond what is expected.

The County is credited (by Moody's) with sound management of its cash reserves, though continued care is needed given a County policy of reducing cash reserves if and when it uses them specially to finance deficits of future budgets.

The County incurs debt to finance the CIP within a framework defined by its Fiscal Policy. The FY2020 budget reported an initial net tax supported debt as $1,714 million. This amounts to about 1.8% of estimated total County property value, a level relatively stable over time and within the Policy guideline of 3%. Nevertheless, among jurisdictions rated by Moody's as Aaa overall, it is noted as "slightly elevated" and given a lower "A" rating. It gives a similar description and rating to the County's government and school net pension liabilities. The County has reached its binding debt issuance ceiling of $225 million per year, and would have to enter into a debate to raise the ceiling.

The debt service level in FY2020 of $224 million falls within the 10% of total expenditure guideline at 7.7%. This share has been enabled in part by the rapidly growing rate of the

County's residential and commercial tax base. Debt service payments are currently projected to rise an average of 6.6% per year through FY2024. Continued close attention is required over the coming years as the County faces the need for new borrowings and likely rising interest rates in economically uncertain waters.

A national economic recession in particular could transform these risks into sharp public service and budget adjustments for the Loudoun community. How does Loudoun's experience in the last major recession illuminate this future prospect?

First, the last recession over 2008-2010 demonstrated that, notwithstanding Loudoun's underlying strengths, it is far from bullet-proof and quite exposed like other localities to the national and international economic upheavals of a recession - credit crunches, declining property values, weakening employment markets, and still rising costs of living particularly for energy and health care. *More than three-quarters of economists recently polled by the Wall Street Journal predicted a recession in either 2020 or 2021.*

Second, the LCG has been the first to point out two key facts: (i) these same recessionary trends "increase demand for public safety, human services, public recreational facilities, libraries and public schools", [18] and (ii) recession does not slow the County's population growth - it continued over 2008-2010 to grow by about 22,000 new residents (of which about 9,000 new school entrants) and service demands continue to mount. Both make fiscal adjustment more difficult. *The current County demographic growth rate continues at about 11,000 per year.*

Third, recession creates agonizing and costly choices for the BOS – sometimes repeatedly within a budget year - as it must reconcile government and school service costs with stagnating and declining tax revenues. In the course of the 2008-2010 recession:

- *The County cut operational spending* in FY2010 by $183 million (12%) against the FY2009 level. It reduced staff by 85 full-time positions, cut government services, maintenance and transfers to the School system (by 6.5%). In FY2011, the County imposed a further 4.2% budget cut, with more reductions in services, programs, staffing and transfers to the school system. It also cut the Capital Improvement Program in FY2010 by 75% from $239.7 million to $57.9 million.

- *But it also had to meet outstanding debt service payment obligations* to external creditors that were "increasing dramatically" [19], in doing so exceeding the Fiscal Policy Guideline of 10% of total expenditures in FY2011. Over FY2020 – FY2024, while debt ratios are better positioned than during the last recession, *current and projected debt service obligations by LCG reflect a rise by $55 million per year.*[20]

- *Homeowners experienced plummeting property values,* as the average assessed value of a home in Loudoun decreased from $511,420 in 2007 to $387,720 by 2010. Loudoun's total taxable real property value, after rising an average of 23% per year on average over FY2003

[18] Administrator's July 1,2009 Transmittal Letter, p E-2, of the FY2010 Adopted Fiscal Plan.
[19] Administrator's Transmittal letter, page E-2 of July 1, 2008 in the FY2009 Adopted Fiscal Plan
[20] Loudoun County FY2020 Adopted Budget, Volume 2.

– FY2006, contracted by a total of -14% over FY2008 – FY2011. Commercial property values were less affected than residential values.

- *The BOS increased the real property tax rate in FY2009 by 24%* (from $0.917 to $1.14 per $100 of assessed value), *raising the average homeowner's tax bill from $4,843 to $5,307, or 9.6% during the recession.* This was followed by two more tax rate hikes of 9% in FY2010 and of 4.4% in FY2011.

The depth of the next recession cannot be known in advance, but preparation in anticipation of it can help to moderate its impacts. Now more than ever, the County *rows its own boat, as* aid from the Commonwealth of Virginia and Federal Government continues to dwindle from the 9% of General Fund revenues at the outset of the last recession in FY2009 to only 5% in FY2020.

Action 5 – The County should become "recession ready", beginning with analyses to be included in the FY2021 budget:

5.1 Incorporate a budget stress test analyzing the main sources of tax revenues, fixed and variable expenditures, levels of service and indebtedness, and reviewing the effectiveness of tax incentives programs; and

5.2 Incorporate in its reserves funding, expenditure, debt and revenue projections *specific recession risk-adjustments* to reduce the probability of future jarring cuts in spending and hikes in residential and business property taxes.

6. Do residents have adequate participation and representation in the budgeting process?

Loudoun resident involvement in the annual LCG budgeting begins at the end - when the Administrator presents it to the Board of Supervisors. For example, For FY2020, the draft budget was presented on February 13, 2019, then three public meetings were held in late February and early March. The County reported that "hundreds" of phone calls and emails were also received before the Board approved the FY2020 budget on April 2.

But this is much too late to understand – let alone introduce meaningful citizen-involved change to - a lengthy and complex budget. The options and tradeoffs in budgeting LCG expenditures and its revenue strategy could be usefully illuminated and debated beyond staff and the BOS with resident individuals or groups earlier during the preceding Fall and Winter.

Action 6 - Build more transparency and citizen participation into the budget process to ensure residents' full support for spending levels, priorities and a revenue strategy:

6.1 Preparing a series of focus groups and designing an interactive website on the County budget; and

6.2 Utilizing these tools in October or November 2020 to get public reaction and view on the BOS Initial Budget Guidance for FY2022.

Annex 1

Exhibit 3

Loudoun (County of) VA

Rating Factors	Measure	Score
Economy/Tax Base (30%) [1]		
Tax Base Size: Full Value (in 000s)	$92,321,203	Aaa
Full Value Per Capita	$229,335	Aaa
Median Family Income (% of US Median)	207.0%	Aaa
Notching Factors:[2]		
Regional Economic Center		Up
Finances (30%)		
Fund Balance as a % of Revenues	23.8%	Aa
5-Year Dollar Change in Fund Balance as % of Revenues	6.7%	A
Cash Balance as a % of Revenues	66.2%	Aaa
5-Year Dollar Change in Cash Balance as % of Revenues	47.7%	Aaa
Management (20%)		
Institutional Framework	Aaa	Aaa
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures	1.0x	A
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	1.6%	Aa
Net Direct Debt / Operating Revenues (x)	0.8x	A
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	2.9%	A
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	1.4x	A
	Scorecard-Indicated Outcome	Aaa
	Assigned Rating	Aaa

[1] Economy measures are based on data from the most recent year available. [2] Notching factors are specifically defined in the US Local Government General Obligation Debt Methodology dated December 16, 2016. [3] Standardized adjustments are outlined in the GO Methodology Scorecard Inputs updated for 2018 publication

Source: Loudoun County, VA CAFRs, US Census Bureau, Moody's Investors Service