Loudoun County

The Proposed FY2021 Budget - Observations

Loudoun Government staff have presented with exacting detail the Proposed FY2021 Budget, reflecting the recognition it has received in the past from various professional organizations, such as the Government Finance Officers Association (GFOA) and the International City/County Management Association (ICMA).

Top Line Trends

This two-volume document as read by this observer[1] reflects the following main trends:

- Continued rapid annual growth in operating and debt service expenditures – totaling $2,378 million for the Government and school system, about $153 million or 6.9% above FY2020. *This is apace with a two-decade trend,* as a consequence of ongoing aggressive housing development and – as much - by mounting per resident costs;

- Buoyant but constrained growth in the new six-year FY2021-2026 Capital Improvement Program – the cost will rise to an estimated $2,941 million, a substantial 22% over the FY2019-2024 CIP, driven by projects across government, schools and transportation for new development and renewal of existing facilities. However, it accommodates a very limited number of new projects given stress on local tax funding and debt capacity; and

- A real property tax increase for the first time in a decade – notwithstanding continued dramatic growth in taxes paid by the data center industry, the County has proposed a rise in the average homeowner real property tax bill by about $110, or 2.1% over FY2020 – this in order to extend services to new residents, fund staff compensation and 1st and 2nd priority County resource requests, cover the LCSP budget request, meet debt service needs and compensate for debt capacity constraints with more local tax funding.

Conclusions

Looking at these trends in a broader context and with an eye on Loudoun's fiscal future, they:

- Reflect a County still "hooked on growth" in a cycle driven by aggressive housing development, strong demographic and elevated budgetary pressures, with a growing reliance on more new development for tax revenues;

[1] This note was prepared by Jim Hanna, Chair of the Budget and Finance Committee, Loudoun Preservation and Conservation Coalition, February 19, 2020.

- Pose near-term fiscal risks of service disruptions and abrupt tax hikes, given high operational costs, significant growth in debt service in the coming years, and an apparent absence of budgetary recession readiness;

- Reinforce the current fiscal path and fail to mitigate the heavy concentration of data center revenues, let alone provide a medium-term vision of how to sustain County fiscal responsibility as the data center boom levels off in the mid-2020s; and

- Should encourage the new Board to develop a Vision for Transition, including medium-term projections and a package of measures for the coming 4 years to ensure sound management of near-term risks and progress toward longer term fiscal sustainability.

Key Details

- Continued spending pressure from robust housing development. In 2019, Loudoun issued building permits for 3,035 new residential dwelling units – the 8th year of 3,000 or more, producing a further heavy demographic and spending push in FY2021 and later. The Proposed FY2021 Budget is proposed to grow by 6.9% over FY2020.

- County Government: "significant pressures" shaping expenditure growth. Government operational cost increases for FY2021 are driven by (1) implementation of a new staff classification and compensation system (+ $25 million), (2) a 3.5% step and merit salary increase (+ $12 million), and (3) expansion of the "base budget" to just maintain current services levels with the annual growth in the County's population (+ $13 million).

  The school system budget is adding $95 million to FY2021 total appropriations, and annual debt service will add another $11 million. *In a surprise,* primarily to maintain continuing implementation of capital projects, the budget contains a rise in local tax funding of the CIP in FY2021 by $38 million due to restraints imposed by the current debt capacity ceiling and limitations on external assistance (mainly the NVTA).

Loudoun County Budget Expenditures for FY2020 and FY2021 (US$ Millions)			
	Adopted FY2020	**Proposed FY2021**	**Difference**
County General Operating Expenditures	597	645	48
School Operating Fund	1,320	1,415	95
Other Operating	84	82	-2
Debt Service Appropriations	224	235	11
Total Operating and Debt Appropriations	2,225	2,378	153
% Annual Growth over previous year	**8.6%**	**6.9%**	
Capital Appropriations	937	646	-291
Total Appropriations	3,162	3,024	-138
% Annual Growth over previous year	**20.3%**	**-6.4%**	
Source: Loudoun County FY 2020 Adopted Budget and FY2021 Proposed Budget			

- Administrator proposes a $1.035 real property tax rate. The $1.035 recommended by the Administrator covers service maintenance for a growing population, additional 1st and 2nd priority resource requests, nearly all the LCPS request, debt service and additional local tax funding for the CIP. Here are the below / above options:
  - 1 cent less would fully fund employee pay increases, opening of new facilities and cover base budget needs but would not meet 1st and 2nd level resource requests;
  - 1 cent more – will eliminate the LCPS gap of $2.5 million and enhance government service levels, going beyond 1st and 2nd level priorities to 3rd level.

- The "equalized tax rate" doesn't work this time. The proposed FY2021 budget departs from a 10-year practice of setting tax rates at the "equalized tax rate" so as to keep the average homeowner tax bill at substantially the same Dollar level: for FY2021, that level would be $1.010 per $100 of valuation. The proposed tax rate is $1.035.

  Though this rate would be below the current FY2020 rate of $1.045, with the annual revaluation of existing real property, the average homeowner tax bill would rise from $5,162 to $5,272 - $110. Though this would be 2.1% more than in FY2020, **it would be equivalent to that paid five years ago in FY2016 when inflation-adjusted.**

- Surging data center real property tax base helps. The County's real property tax base (and therefore real estate taxes) continued strong growth in 2019, rising 7.6% over a year earlier. This was driven in part by continued new housing construction and revaluation of existing property, but mostly by heavy new construction of data centers (8.7% higher) and related rising revaluation of land and existing property (6.8%). The largest single property transaction in FY 2019 totaled a whopping $462 million, a data center! Data centers have extended and accelerated the surge seen since 2018, but office and retail valuation have flat-lined in valuation year-over-year in 2019.

Loudoun County - Trends in Growth Rates of Real Property Taxable Valuation, 2015-2020. (% increase) 1/						
	2015	**2016**	**2017**	**2018**	**2019**	**2020**
All Real Property	6.1%	3.7%	4.6%	6.7%	6.7%	7.6%
Of which:						
Residential Property	6.3%	2.8%	3.5%	5.8%	6.0%	5.5%
Commercial and Industrial Property	5.8%	6.9%	9.7%	9.9%	9.7%	15.6%
1/ Includes both equalized value (revaluation of existing property) and new development Sources: Adopted Budgets of FY2016-2020 and Proposed FY2021 Budget.						

- But surging data center personal property taxes are shifting from a source of diversification to one of concentration. Four million square feet of new data center space came online in 2019, bringing total to about 18 million square feet. Data centers developers were also issued building permits for another 3.4 million ft2 in the course of the year. Total real property valuation of the data center industry soared by 48% over

2018. The computer equipment category of personal property taxes has increased by over 20% each year over the past seven fiscal years, ranging from 23% to 38%. The FY2021 budget anticipates data centers will pay personal property taxes totaling $390 million (+26%) and real property taxes of $72 million, or $462 million in all. **This represents overall about 24% of General Fund revenues, triple the 8% share of five years ago in FY2016.** In an effort to mitigate the risk of this single industry concentration of revenue*, staff have proposed to allocate (only) $16.4 million of personal property taxes to the CIP for renovation, alteration, renewal and land.*

Loudoun County - Trends in Data Center Real Property and Personal Property Taxes, FY2016-2021 (US$ millions)						
	FY2016	**FY2017**	**FY2018**	**FY2019**	**FY2020**	**FY2021**
Data center real property taxes	20	22	27	35	52	72
Data center personal property taxes	83	151	195	258	313	390
Total data center revenues	103	172	222	292	365	462
Total General Fund Revenues	1,361	1,493	1,580	1,688	1,779	1,952
% share data center revenues in GF	**8%**	**12%**	**14%**	**17%**	**21%**	**24%**
Sources: Adopted Budgets of FY2016-2020 and Proposed FY2021 Budget and author's estimates.						

- <u>And data center taxes have since FY2016 accounted for **over half** of the sources of annual growth in General Fund revenues.</u> *The data center industry has provided an average of 62% of the total annual growth in General Fund revenues between FY2016 - FY2021!*

Loudoun County – Sources of Growth in General Fund Revenues, FY2016-2021 (US$ millions)						
	FY2016	**FY2017**	**FY2018**	**FY2019**	**FY2020**	**FY2021**
Annual Growth in all data center property taxes	17	69	50	70	73	98
Annual growth in all other GF revenue sources 1/	68	64	37	38	18	74
Total annual increase in GF revenues	85	133	87	108	91	172
% Data center share of total GF revenue growth	**21%**	**52%**	**57%**	**65%**	**80%**	**57%**
1/ Includes residential real property taxes, other personal property taxes, other non-property taxes, other local revenues and state and federal aid. Sources: Adopted Budgets of FY2016-2020 and Proposed FY2021 Budget and author's estimates.						

- <u>The FY2021-2026 CIP - continued buoyant overall growth rate.</u> The proposed CIP is developed biennially, with the six-year period moving out by two years every other fiscal year. The proposed total six-year CIP totals $2,941 million, rising substantially by 22.4% over the FY2019-2024 Plan of $2,450 million adopted two years ago. This growth rate is consistent with the average of the previous three CIPs approved since FY2013 (20.9% average biennial growth).

Loudoun County Capital Improvement Program – FY2019-2024 and FY2021-2026 (US$ millions)							
	FY2019-2024	**FY2021-2026**	**Difference**		**FY2020**	**FY2021**	**Difference**
Expenditures							
General County Projects	724	958	234		77	130	53
Transportation Projects	1204	1,178	-26		248	119	-129
School Projects	522	805	283		167	87	-80
Total CIP	**2,450**	**2,941**	**491**		**492**	**336**	**-156**
Funding Sources							
Local Tax Funding	526	650	124		111	149	38
Debt	1,179	1,848	669		183	127	-56
NVTA and other	745	443	-302		198	60	-138
Total Funding	**2,450**	**2,941**	**491**		**492**	**336**	**-156**
Sources: Adopted FY2020 Budget and Proposed FY2021 Budget.							

- Driven by government, schools and transportation demands. All segments of government and LCPS present capital development needs:

  - As compared with the FY2019-2024 CIP, County government and rising from $724 million to $958 million and as a share of the total from 26% to 33%. The largest amounts for General Government are for new office space ($125 million), a CIP "Contingency" ($90 million), storm water management ($43 million) and capital project 'management' and 'support positions' ($46 million). Health, welfare, parks, recreation and culture are provided $119 million;

  - School projects have risen from $522 million to $805 million, rising as a share of the total from 20% to 27%. This includes 5 new schools (2 elementary, 2 middle, 1 high school), and other school facilities mainly related to LCPS facility renewal and alterations, bus replacement, and security improvements; and

  - Transportation projects have remained largely stable - $1,204 million to $1,178 million and diminished from 54% to 40% of the total CIP. $981 million are for roads, and the remainder for sidewalks, signals and traffic calming, and the Metro capital contribution ($29 million).

- But there is very limited scope for new capital projects. The programming of the FY2021-26 CIP, while it accommodated $242 million for 13 new projects requested by Board Members, departments and towns, 7 other projects were deferred or removed and this six-year plan was substantially unable to add new projects (see Volume 2 pp 7-16 and 7-17). The budget document states: "Overall stress on available local tax funding and debt capacity continues to make it difficult to accommodate new County or School projects or to accelerate existing projects." (Volume 2, page 7-12).

  In addition, the following factors have also influenced the proposed CIP: (1) changes in project cost estimate methods, resulted in "a significantly increased overall cost for some projects"; (2) emerging needs for renovation, alteration and renewal of County and school facilities – some $60 million per year for Schools and $12 million for County projects; (3) adjustments in LCPS funding requests to accommodate LCPS accelerated new school construction, which requires accelerated land acquisition for sites for about $47 million; and (4) a revised Metrorail Silver Line funding schedule – which lowers Loudoun's share of capital funding for Phase 2 to a total of $22 million, with the first year contributions beginning in FY2021 for $3 million.

- Even so, it's based on presumptions to expand debt capacity limits. Local tax funding climbs from $386 million to $650 million with its share rising from 16% to 22%. The role of proffers continues to be negligible at only $47 million – only 1.6% of the total six-year program. However, though it has not yet been discussed or approved by the Board, the presentation of the CIP on February 11 stated that *projects already funded have been kept in the CIP by assuming a rise in the new borrowing debt capacity ceiling from $225 million currently to $250 million in FY2023 and $260 million already in FY2025. If this had not been done, "a lot of projects would have been taken out."*

  Based on this, the FY2021-2026 CIP shows six-year debt financing climbing from $1,259 million to $1,848 million and growing as a share of the total program to 63%, rising from 52% for the previous plan. Accordingly, debt service (actual and projected) for FY2021 will rise about $8 million above the current FY2020 payments from $212 million to $220 million and is expected to rise rapidly throughout the CIP period to reach $291 million in FY2026. It rises at an annual average rate of 5.5%.

  Debt ratios shown are well within current fiscal policy targets regarding debt to estimated property value (<3%), debt to per capital income (<8%) and debt service to total expenditures (<10%). However, these are predicated on buoyant growth trends in property values (4.8% average p.a. over 2021-2026), per capita income (3.4% p.a.) and expenditures (4.5% p.a.) and do not take into account any effects of a recession during this period.

- Creditworthiness – strong but a mixed picture. Notwithstanding various references to the County's Aaa bond ratings, the FY2021 budget proposal presents a mixed picture: operating performance – strong upward cost pressures necessitating a change of course in real property tax rates; a sizable and diverse tax base, yet which shows strong leanings toward industry concentration; moderate long-term liabilities, which now constrain capital development; and an integrated financial management system, yet which does not display a long-term revenue planning framework to match spending .

- The fiscal future – unclear. The forecasting of future expenditures and revenues, apart from the FY2021-26 CIP and associated indebtedness, is not presented in the budget. The "Forecast Discussion and Analysis" section (Volume 1, pp R-34-37) does not extend beyond FY2021, nor does it include any stress testing, risk analysis or any affordability analysis for the proposed tax rates changes.