<u>Loudoun's Formidable Fiscal Challenge - An Action Agenda</u>

- **Adopt a Medium-Term Fiscal Strategy**
- **Adapt it to Annual Decision-Making …… Beginning with the FY2022 Budget**

<u>FIRST – Facing four inconvenient facts about Loudoun's data center revenue bonanza</u>

Our data center taxes have become a *revenue "bonanza"* out of the aggressive growth of the data center space capacity in Loudoun. Such taxes are estimated to <u>*increase*</u> <u>by</u> <u>$193 million</u> in FY2022 over FY2021 – they added only <u>$17 million</u> to revenue growth in FY2016!

It is fortunate the County can benefit from an industry that presents low demands on the County while it helps materially to meet the costs of LCPS and County services. However, it is fast becoming *"too much of a good thing"* in County financial management:

1. <u>*We have developed a high single industry risk exposure*</u>, as we depend on data center taxes for nearly 100% of County local tax funding revenue growth – no growth is expected in FY2022 real property taxes – our mainstay for more than 200 years!

    - This is a *drastic transformation* from only 5 years ago in FY2016, when data center taxes represented only about <u>one-fifth</u> of the total revenue growth.

2. <u>The data center tax revenue growth path is *very unstable and highly unpredictable*</u> for FY2022 and thereafter – in fact, *this future growth path itself is far from assured* and dependent upon a variety of assumptions internal and external to the County.

    - Consequently, in FY2022, the *computer equipment tax revenue forecast varies by $85 million between the downside and upside scenarios.*

3. While future data center capacity growth is largely guesswork, <u>*it is certain that its large tax revenue growth is temporary* and will virtually end as land space limits are hit.</u>

    - While this endpoint is unclear, at the capacity expansion of about 6 million ft2 per year in 2020, *buildout may reach this zoned land availability limit by 2024.*

4. <u>*Unfortunately, we have no alternative revenue sources to fall back on*</u> near-term or to replace data center tax growth longer-term. For example, new annual cigarette and plastic bag taxes of some $5 million are <u>less than 3%</u> of the FY2022 estimated *growth* in data center computer revenue ($193 million). This leaves Supervisors the choices of:

    - *Hiking Loudoun's traditional homeowner real property taxes* - the only tool we have to make significant revenue adjustments; and / or

    - *Cutting operating expenditures of the LCPS and County budgets*.

SECOND – Adopting - as part of the FY2022 budgeting cycle - a medium-term Fiscal Transition Strategy for FY2022 – FY2025 to help guide our now isolated annual budgeting process

In order to meet this new, formidable fiscal challenge, *Loudoun's BOS should adopt a FY2022-25 Fiscal Transition Strategy concurrently with deliberations on the draft FY2022 budget,* which will be presented on February 10, 2021. This Strategy would be intended to reinforce Loudoun's traditionally sound financial stewardship and to guide with a medium-term view the County's now isolated annual budgeting decisions.

This Strategy should include the following four core points:

1. *Maintain a moderate and sustainable long-term fiscal contribution of the data center industry within land areas defined by the 2019 Comp Plan*, through regular monitoring and adjustments as needed, to recognize its County comparative advantage and to ensure a role compatible with other business, residential, heritage and ecological goals;

2. *Guard against consuming all of a unique, one-time County tax resource surge* by not spending it all on high growth operational *and* new CIP project expenditures;

3. *Anticipate and mitigate significant downside revenue shocks* by providing a deeper reserve buffer in order to more readily adjust to strong fluctuations without jarring expenditure and tax policy changes; and

4. *Maintain the purchasing power of Loudoun's homeowner real property tax base* with at least *inflation-corrected tax rates* rather than invoking the 'equalized rate' that only *depreciates* real property tax revenues and supplants them with *unsustainable and removable* computer property taxes from the exuberant data center revenue surge.

THIRD – shaping this strategy into annual decision-making - starting with the FY2022 Budget

Implementation of this Fiscal Transition Strategy would begin with the adoption of the FY2022 budget and be applied by including the follows measures:

1. *Undertake a fully transparent analysis – now and annually thereafter - that clarifies data center development prospects and its rewards and risks for Loudoun County.*

   This analysis should include:

   - A description of data center industry technical, commercial and ecological trends that will influence industry development in Loudoun in the coming 1-5 years;

   - An assessment of Loudoun's competitive position and vulnerabilities in the US and global data center industry marketplace;

- Clearly justified projections of *land use build out* (vs. building up and densification), by Place Types and Zoning under the 2019 Comp Plan, defining (1) current capacity, (2) expected capacity limits, and (3) when those limits are likely to be reached; and

- An assessment of the external impacts of the local data center industry on other local businesses, the residential community and Loudoun's environment.

For example, updating industry rewards and risks to Loudoun County over March – June 2021 would enable the Board to thereafter (i) re-consider proposed changes in the personal property computer tax rate and regulatory rules with a clearer understanding of data center development trends and Loudoun's competitive position, (ii) make risk-adjusted assessments of projected industry annual tax revenue growth and potential shortfalls, and (iii) define policy and programmatic steps needed to counteract any damage to business and residential sectors by the industry's local economic impacts.

2. *A ceiling on the total annual operational expenditure growth rate.* This target rate would be shaped by a trajectory toward the expected sustainable long-term revenue growth of Loudoun's real property tax base of about 3-4% per year.

   For example, for FY2022, by setting a target of 5.5% annual growth in operational expenditures - down from the past five-year average of 6.8% per year - rather than the 8.5% growth rate implicit in the Final Budget Guidance staff memo of January 5, 2021 to the Board, [1] the annual budget growth ("variance") would be limited to an increase of $131 million instead of $203 million, or $72 million less.

3. *An order of priority and amounts for the application of an annual surge in data center tax revenues* in excess of the total operational expenditure growth rate target; that is:

   - *First*, an amount set aside in a newly established and *temporary* Data Center Tax Revenue Reserve Fund to reinforce existing reserves and provide a cushion for unexpected shortfalls in revenues needed for annual operational expenditures; and

   - *Second,* an allocation for capital projects in the already approved six-year CIP for the purposes of (1) covering shortfalls in non-local tax funding (LTF) sources, and (2) reducing new or existing debt.

     For example, continuing from the example in item 2 above, (i) an amount of $49 million would be placed in the Data Center Tax Reserve Fund, and (ii) the remaining $23 million of the $72 million in savings from limiting operational expenditure growth would be allocated to the CIP.

[1] FY2022 operational expenditures are estimated based on a derivation from Table 2, page 4 of the above-mentioned January 5, 2021 memo on use of local tax funding, using a real property tax rate of $1.025.

4. *A floor for real property tax revenues*. This implies real property tax rates would be adopted so as to at least maintain the FY2021 purchasing power of County real property tax revenues (a baseline for the future) – that is, *compensate annually for price inflation*.

   This policy would also help, along with the new reserve fund, to mitigate annual risks of unexpected downturns in computer tax revenue and avoid drastic homeowner real property tax increases. Over the next years as the surge in computer taxes abates, it also addresses the fact that Loudoun has no other adequate new revenue alternatives.

   For example, with the annual rise by 1.4% over 2020 in the Washington DC area consumer price index,[2] the total FY2021 real property tax revenues (adopted budget) of $972.5 million would need to rise by $13.6 million in FY2022 to maintain its purchasing power.

   This would mean (per the staff budget paper of January 5, 2021) that the real property tax rate would need to be set at $1.025 (the current FY2021 level is $1.035) instead of the overall equalized rate of $1.015. The average homeowner tax bill for FY2022 would then be $5,495 instead of $5,441 - <u>$54 more per year</u> - to maintain the purchasing power of real property tax revenues.

Budget and Finance Committee of the
Loudoun County Preservation and Conservation Coalition

January 8, 2021

[2] Source: US Bureau of Labor Statistics.