

**The Loudoun County Preservation and Conservation Coalition  
Budget and Finance Committee**

**The FY2023 Budget Development Cycle - Four Recommendations**

August 25, 2021

**1. Executive Summary**

**1.1. The FY2022 Budget - high growth, high risk.** The Budget and Finance Committee issued in January 2021 a note detailing actions for inclusion in the FY2022 budget that it considers are essential to help manage Loudoun’s formidable fiscal challenges.<sup>1</sup> While in isolation the FY2022 budget approved in April may appear reasonable, it retains the aggressive growth posture of recent years and lacks provisions that we consider essential to manage Loudoun’s over-dependence on data center revenues.

**1.2. Short-term complications have already arisen.** A \$60 million shortfall in data center revenues is already foreseen for the implementation of the FY2022 budget.<sup>2</sup> County staff have suggested that additional County debt, service cuts or additional taxes may be needed to plug the gap. **Longer-term**, if customary high annual budget expenditure growth rates persist, they may increase *pressure to develop new data center and housing on suburban, transition and rural lands beyond those agreed in the 2019 Comp Plan* to pay for them.

**1.3. FY2023 Budget development – recommendations to improve fiscal outcomes.** To address these risks, this note urges the Board to take action *by September 30, 2021* to:

**1.3.1. Adopt four fiscal guidelines to explicitly recognize and to help manage Loudoun’s over-dependence on data center industry tax revenues;**

**1.3.2. Upgrade budget presentation and Board review processes to strengthen strategic fiscal direction and make more results-based budget decisions;**

**1.3.3. Undertake a Policy Updating Study to promote a sustainable data center industry policy that is compatible with the 2019 Comp Plan; and**

**1.3.4. Undertake a Fiscal Risk Management Study aimed to establish a new Budget Stabilization Fund that will help reduce budget volatility.**

We believe that these steps will provide a clearer, more transparent sense of strategic focus to the County’s annual budgeting exercise and alleviate critical fiscal risks.

---

<sup>1</sup> See <https://loudouncoalition.org/wp-content/uploads/2021/01/Loudouns-Fiscal-Challenge-an-Action-Agenda.pdf>

<sup>2</sup> See Item #7 of July 13, 2021 discussed by the Finance Committee on July 15.

## 2. **Four Fiscal Guidelines to Help Manage the Digital “Resource Curse”**

- 2.1. Loudoun's fiscal affairs are now categorically different from less than 5 years ago. The dependency and risks associated with data center industry tax revenues – *Loudoun’s ‘digital riches’* – call for a *new approach that moves beyond the conservative budgeting and reserve practices that have served the County well in the past.*
- 2.2. Why? Because these ‘digital riches’ are akin to the revenue bonanzas that governments have realized during commodity booms - for instance, from the oil and gas industry. Historically, this sudden wealth has often damaged local fiscal and economic conditions, hence the so-called “resource curse”. Experience, however, has produced a set of lessons on how to mitigate these effects that could be beneficial in Loudoun’s case:<sup>3</sup>
- 2.2.1. **Avoid setting budget spending levels based on full use of this resource – *instead of* budgeting all data center revenues for operations and the CIP;**
- 2.2.2. **Avoid reducing other sources of tax revenues – *instead of* using the ‘equalized’ real property tax rate and cutting the business personal property tax;**
- 2.2.3. **Allocate a large share of the growth in such revenue to increase reserves and reduce debt – *instead of* depending only on reserve levels set in a past era; and**
- 2.2.4. **Invest funds from this resource to mitigate community impact from this industry – *such as* helping to further diversify the local business economy.**
- 2.3. **Recommendation:** We believe strongly that the Loudoun’s Board should *wait no longer* to explicitly build these four guidelines into FY2023 budget development policy.

## 3. **Upgrading Budget Presentation and Board Review**

- 3.1. **Atomized annual focus.** Despite the massive *900+ pages* of micro detail, the draft FY2022 budget for operations substantially lacked multi-year context and analytical explanation. This is contrary to County Fiscal Policy calling for financial monitoring to examine fiscal trends from the preceding 5 years and long range (3-5 year) financial forecasting, both updated annually, to support fiscal decisions by the Board.<sup>4</sup>
- 3.2. **Micro-level deliberations.** Consequently, the Board’s budget review over six working sessions in February and March was a micro analysis, often in extreme detail about departmental operational matters. While there was laudable scrutiny on proposed new staff positions and new initiatives, this process included little examination of broader “non-departmental” issues.

---

<sup>3</sup> See “Updating the Role of Loudoun’s Data Center Industry and Managing the Digital “Resource Curse” by the Budget and Finance Committee, Loudoun County Preservation and Conservation Coalition, August 15, 2021.

<sup>4</sup> See Loudoun County Fiscal Policy, page 3 - Fiscal Policy Guidelines, bullet points 11 and 12.

Notably, the deliberations did not address the extensive budget analytics presented by staff in various papers over October – December 2020, for example, on the County’s growing reliance on data center revenues (though the Board did adopt a minor data center tax allocation to fund the CIP).

3.3. **Input- rather than results-oriented decisions.** The focus was also quite input-oriented, centering on the property tax rate impact of each individual budget item. In the Committee’s view, a focus on a set of monitorable results and outputs could better guide the deliberations.

3.4. **Recommendations.** To address these issues, the Committee recommends that the Board upgrade the budget presentation and Board review by September 30, 2021 with steps to:

3.4.1. **Include in the FY2023 draft budget a section on “Strategic Fiscal Direction” that is linked with the implementation of the 2019 Comprehensive Plan.** To do so, the current “Forecast Discussion and Analysis” section of the budget (p R36 in FY2022 doc) would be replaced with a separate section after the Executive Summary that includes (1) a recent years’ trend analysis, (2) a 5-year extended budget vision, and (3) strategic fiscal issues for Board’s annual consideration;

3.4.2. **Strengthen Board focus on strategic fiscal direction in its budget deliberations.** To do so, the Board should add one working session, “Strategic Fiscal Issues”, that would be followed by the six usual budget work sessions on each line item; and

3.4.3. **Make more results-based budget decisions according to a set of selective performance metrics.** To do so, a Fiscal Health Scorecard would be established to guide *overall* budgeting affecting expenditure and revenue management, and new development and debt dependencies, and a *limited* set of operational result indicators prepared for each Department to better focus Board deliberations.<sup>5</sup>

#### 4. **Promoting a Sustainable Role for the Data Center Industry in Loudoun**

4.1. **Industry benefits.** Loudoun has reaped considerable tax benefits as the world’s leading site of the data center industry and “Home of the Hyperscalers.” The County government has understandably welcomed these facilities since they require little in new public infrastructure investment, provide significant tax support for additional operational expenditures, and enable lower residential tax obligations.

4.2. **Costs to residents and business.** However, the Loudoun community incurs significant indirect costs for these benefits: (1) data centers are generally large, noisy, physically unappealing and demand large tracts of land for siting – all incompatible with Loudoun’s residential character; (2) they require major power line and substation support to supply

---

<sup>5</sup> See, for example, the Maryland Department of Budget and Management’s “FY2022 Managing for Results Strategic Plans” [https://dbm.maryland.gov/Pages/MFR\\_StrategicPlansFY22.aspx](https://dbm.maryland.gov/Pages/MFR_StrategicPlansFY22.aspx)

their huge energy appetite, as well as large volumes of water for cooling - which have raised concerns about the industry's environmental impact from many residents: and (3) they generate sharp spillover effects for *other* Loudoun businesses - including spiraling land, construction and trade services costs - which diminish their competitiveness, crowd out economic diversification, and stunt employment generation.<sup>6</sup>

- 4.3. Fiscal risks.** Data center industry tax revenue increases are paying for 100% of the FY2022 budget growth of 7.8% in County and LCPS operational spending. This choice has further increased the industry's share in total General Fund revenues to 31% (up from 8% just six years ago) and eroded Loudoun's core revenue base over its 250-year-old history - the real property tax. Without changes in fiscal policies, these diverging trends will exacerbate the County's dependence on the industry and exposure to its risks.
- 4.4. Business property tax cuts.** The proposed cut in the business property tax rate would in our view be counterproductive, as it would very likely (1) be a gift mostly to the affluent data center industry without increasing Loudoun's competitive position, (2) lead to a loss of revenue and budget deficits that would require higher homeowner real property taxes, and (3) inspire pressure to cut residential taxes when strengthening their revenue role is needed now.
- 4.5. Recommendation:** As the world's largest data center host, Loudoun needs to go beyond the current incentives regime to define how it will manage these issues. The Committee recommends that the Board undertake *by September 30, 2021* a Policy Updating Study that will frame transparent policy guidelines for data center development that is sustainable and compatible with land uses prescribed in the 2019 Comp Plan. It would focus on:
- 4.5.1. The current footprint and future prospects for land use of data centers in Loudoun.** This would include current horizontal space used by the industry, projections of likely further buildout and its timing, and estimates of when horizontal space capacity limits may be reached under the zoning and place types defined in the 2019 Comp Plan;
- 4.5.2. The industry's rewards, negative impacts and risks to the County.** This would include impacts on other business sectors in Loudoun, the implications of industry technological changes and product innovation, and vulnerabilities to security issues and competition from data center sites elsewhere; and
- 4.5.3. The County's fiscal and economic development policies applicable to the data center industry.** This would include an analysis of both positive and negative impacts of changes to the business tangible property tax rate now applied to the industry and other policies and practices to ensure that they are of mutual and sustainable benefit to County residents and broader business community.

---

<sup>6</sup> Discussion of July 27 with the Loudoun Co. Department of Economic Development. It estimates that about 7 million ft<sup>2</sup> of flex-industrial space demand, one-fourth the current total, is being crowded out by such cost rises.

## 5. Improving Budget Risk Management

- 5.1. Spending it all.** In the Committee’s view, the FY2022 budget displays undue optimism about the sustainability of the County’s unique fiscal situation and falls short of an adequate risk management strategy when it spends all its annual data center revenues: this year, 96% of data center taxes support school and County operational staff, maintenance and program costs; the remaining 4% go to “one-time” CIP purposes.
- 5.2. Recurring vulnerability to revenue shortfalls.** Despite careful County forecasting,<sup>7</sup> data center industry tax revenues are very hard to accurately predict. With this comes *significant vulnerability to short-term resource gaps*, as there is a strong imbalance at any given time between the large downside data center revenue potential and the meager compensating revenue available from other non-tax sources. This is clearly shown in staff estimates of July 2021 of a \$60 million data center revenue shortfall versus only \$15-30 million that may be found from other revenue sources without raising the real property tax rate.<sup>8</sup> While some consider the current gap to be a one-time problem, *we believe that it is essential to anticipate its recurrence.*
- 5.3. Inadequate liquidity protection.** In our opinion, an effective risk management strategy should *include an additional liquid buffer against possible shortfalls in future data center revenues above and beyond the 10% reserve provisions called for in the County’s Fiscal Policy.* Budget stabilization funds (BSFs), also known as “rainy day” funds, help mitigate budget ups and downs, allowing jurisdictions to set aside surplus revenue for times of unexpected revenue shortfall or budget deficit. BSFs are found in over 16 cities and nearly all U.S. states, including Virginia’s own Revenue Stabilization Fund, and are often in addition to separate emergency reserve funds. Research shows that BSFs do indeed reduce budget volatility.<sup>9</sup>

---

<sup>7</sup> See Staff Paper #16 of October 13, 2020 on the “Analysis of Business tangible Personal Property Taxes on Computer Equipment”.

[https://loudoun.granicus.com/MetaViewer.php?view\\_id=77&clip\\_id=6434&meta\\_id=183635](https://loudoun.granicus.com/MetaViewer.php?view_id=77&clip_id=6434&meta_id=183635)

<sup>8</sup> See Item #7 of July 13, 2021 discussed by the Finance Committee on July 15.

<sup>9</sup> For more, see

Urban Institute – “How States Save for a Rainy Day” November 17, 2017

<https://www.urban.org/research/publication/budget-stabilization-funds>

Tax Policy Center “The State of State (and Local) Tax Policy”

<https://www.taxpolicycenter.org/briefing-book/what-are-state-rainy-day-funds-and-how-do-they-work>

Pew Charitable Trusts “Why States Save”

<https://www.pewtrusts.org/~media/assets/2015/12/whystatessavereport.pdf>

Pew Charitable Trust “How Rainy Day Funds Help Cities Prepare for Revenue Volatility”

<https://www.pewtrusts.org/en/research-and-analysis/articles/2018/10/11/how-rainy-day-funds-help-cities-prepare-for-revenue-volatility>

The Volker Alliance “Rainy Day Fund Strategies – A Call to Action”

<https://www.volkeralliance.org/rainy-day-fund-strategies>

**5.4. Recommendation:** To bolster fiscal risk management in this extraordinary situation, the Board should commission by September 30, 2021 a Fiscal Risk Management Study aimed in particular to review experience elsewhere with budget risk mitigation mechanisms, with a view toward establishing a new Budget Stabilization Fund that will provide an additional liquidity buffer to current reserves. The Study would focus on:

**5.4.1. Purpose.** The mechanism would be a *temporary* line of defense to help ensure annual balance in the budget by providing deeper reserves to buffer future revenue shocks. It would also help to *contain (if not reduce) data industry dependency, mitigate pressures to spend temporary surpluses, and encourage further use of the real property tax to raise revenue*, thereby facilitating a smooth transition to a future when the surge in data center growth has subsided;

**5.4.2. Deposit rules.** The mechanism would define rules for revenue intake, such as how much revenue to contribute and maintain in the BSF annually, whether to do so as an automatic or discretionary share of general fund balances, whether to earmark specific revenue streams, and whether the balance should be capped as a percentage of revenues or expenditures; and

**5.4.3. Use mechanisms.** The fund would delineate clear withdrawal rules to determine what level of funds can be spent, under what conditions, through what process they can be approved for use, and the conditions for replenishment.

---

**Prepared by:**

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

Chair - Jim Hanna

Members – Al Van Huyck, Mitch Diamond and Robert Pollard

Contacts - comments and questions on this paper should be addressed by email to [jimhanna12@gmail.com](mailto:jimhanna12@gmail.com)