

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

A Review of

The Proposed Loudoun County FY2023 Budget

Key Conclusions and Recommendations

The Budget Committee has reviewed the proposed FY2023 Budget and, based upon the attached note on “Budget Trends and Analysis,” has reached the following key conclusions and recommendations:

We applaud the Board’s FY2023 budget guidance of December 2021 for squarely confronting the County’s over-dependency on data centers for revenues. The proposed new budget marks an important transition. Reflecting the declining availability of new land parcels for development, it initiates a shift in funding County Government and LCPS expenditures from (a) heavy dependence on new development to (b) a greater reliance on existing residential and business property assets. In this regard, the new budget signifies a move toward more sustainable and stable County finances.

- **In practical terms, this means that the share of real property taxes in General Fund revenues will no longer decline**, but rather stabilize at 51.5% in FY2023 and rise progressively thereafter to regain 60%. It further means that the “equalized tax rate” is no longer utilized as a target for tax rate setting.
- **The positive impact of these changes is already apparent in the FY2023 budget** – (1) the share of *total* data center revenues in local tax funding (LTF) is stabilized at 34%; (2) its *incremental* contribution to budget growth accounts for less than half of total LTF - down from 100% in FY2022 and the lowest since FY2018; and (3) strong LTF funding of the FY2023-2028 CIP will enable a reduced level of County indebtedness.
- **These shifts require a rise in the average homeowner tax bill of \$257 in 2023**, or nearly 5% above 2022. While significant, taxpayers may recall that last year’s average tax bill, when inflation-adjusted, was equivalent to the amount paid in 2014 under earlier tax policies. In addition, the FY2023 bill increase represents less than 1% of the recent sharp rise in real property.

- However, this step forward carries a risk of stalling or even backsliding without a clear medium-term fiscal vision and annual guidance from the Board. This should include:
 - **Moderation in operational spending growth.** Hikes in both County government – particularly general administration - and LCPS expenditures continue to be very high. The proposed budget calls for a \$ 256 million or 7.8% increase over the FY2022 adopted budget. Contrary to the common impression, the County’s annual population growth (1.6% in 2021) only accounts for a small part of this hefty increase. Spending per resident carries a far higher rate of growth that far exceeds neighboring counties and is not sustainable.
 - **Moderation in the rate of data center industry development.** This is essential to reduce the risk of single industry revenue concentration in Loudoun’s fiscal affairs and to make progress toward the 60% RPT / Total General Fund revenue target.
 - **Stronger support for economic diversification.** In parallel, it is also critical to address the County’s *dire need to diversify its business employment and tax base*. Data centers already account for 43% of Loudoun’s commercial real property valuation at January 1, 2022. Pre-pandemic trends for business development over 2016-2019 show very low average annual growth in space for low density office (0.8% per year), flex industrial (2.4% per year) and retail (1.8% per year) – versus 30.2% per year in the growth of data center industry space.
 - **Appropriate management of Business Personal Property Tax (BPPT) policy.** The proposed FY2023 budget entails a small decrease in the BPPT rate in calendar 2023 from \$4.20 to \$4.15. While this may help vehicle owners, any rate decreases, now or in the future, will overwhelmingly benefit the data center industry. The only realistic way to compensate for revenue decreases from BPPT rate changes would be to increase homeowner real property taxes or decrease expenditures. Thus, we recommend that the Board carefully review this option, as this rate has not changed since 1987, and the BPPT is of pivotal importance in future fiscal management.
 - **Improved communication with residents on Loudoun’s fiscal future and key budget decisions.** Public information now needs to go well beyond discussion of changes in real property tax rates from year to year. County staff and the Board need to explain why fiscal policy changes are needed to ensure sound fiscal responsibility and sustainability.

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The Proposed Loudoun County FY2023 Budget

Budget Trends and Analysis

Loudoun County Administrator Tim Hemstreet presented to the Board on February 9, 2022 the proposed FY2023 Budget for its consideration. Public comment opportunities are on Thursday, February 24 at 3pm and 6pm, and on Saturday February 26 at 9am. Board work sessions will continue through March, with adoption scheduled for April 5, 2022.

The Budget Committee has reviewed this proposal and offers the following on budget trends and analysis as an aid to understanding and discussion.

• **Expenditures**

- **Overall expenditure growth continues to be high and unsustainable in the long run.** As in previous years, the FY2023 budget has been built to meet – in order of priority - (1) capital and debt obligations of the County Government and LCPS, (2) employee compensation, (3) base budget operating and maintenance requirements to maintain service as population rises, (4) opening new facilities, and (5) new resources requests, including aligned with the Board’s budget priorities.

Two key points arise from proposed expenditures:

- Appropriations total \$3,545 million for the Government and LCPS operations, debt service and the Capital Improvement Program (CIP) - about \$255 million *or 7.8% above the FY2022 adopted budget. This increase is consistent with a high growth trend over the last two decades, with both County government and LCPS rising at similar rates; and*
- Contrary to commonly held understanding, it is *not* driven primarily by County population growth (estimated at 1.6% in 2021), but an ongoing aggressive per resident spending of over 6 % per capita in the FY2023 proposed budget) – which has been the case for many years.

Loudoun County Budget Expenditures for FY2022 - FY2023 (US\$ Millions)			
	Adopted	Proposed	
	FY2022	FY2023	Difference
County General Operating Expenditures	697	794	97
School Operating Fund	1,556	1,657	101
Other Operating	48	55	7
Debt Service Appropriations	246	251	5

Total Operating and Debt Appropriations	2,547	2,757	210
% Annual Growth over previous year			8.3%
Capital Appropriations	741	788	47
Total Appropriations	3,290	3,545	255
% Annual Growth over previous year 1/			7.8%
Source: Loudoun County FY 2020 Adopted Budget and FY2021 Proposed Budget			

The expansion of the proposed budget includes

- \$15 million in base budget adjustments to continue to provide current services levels as County population grows;
- \$15 million for a 3 percent merit increase in employee compensation for the general workforce and step increase for public safety and a 3 percent adjustment to the pay scales;
- Addition of 253 positions in 22 departments to open new capital facilities, maintain service levels or enhance services in support of the Board’s strategic priorities, including additional body-worn cameras, administration of collective bargaining, equity and inclusion, housing, the transition to a locally administered health department, and HIPAA oversight.
- \$38 million to fund the debt service and capital needs of the Government and LCPS, and \$54 million increase in the local government transfer to LCPS.
- **Expenditure growth by departmental function varies significantly.** Within the strong overall spending growth trend, the medium-term growth over FY2018-22 and for FY2023 by departmental function shows prominent expansion of general government administration – especially the County Administrator’s office, General Services and the Board of Supervisors – and in Parks, Recreation and Culture. Within other functions, Community Corrections, Fire and Rescue and the Juvenile Court Service Unit show especially large growth rates. Proposals for FY2023 show ongoing strong rises in General Administration, the Commonwealth Attorney and the Juvenile Court Unit, and Family Services and Health.

Loudoun County Government Expenditures		
Annual Growth Rates by Departmental Function		
	FY2023	FY2018-22
	Proposed	5-Year Avg
General Government Administration	9.9%	12.4%
Public Safety and Judicial Administration	5.7%	7.3%
Health and Welfare	10.3%	5.3%
Parks, Recreation and Culture	3.3%	9.0%
Community Development	1.9%	4.2%
County Total of Departments	6.7%	7.9%
County Total (includes non-departmental)	8.6%	8.0%
Sources: Loudoun County adopted budgets, FY2018-2022 and proposed FY2023 budget.		

- Spending on the new FY2023-2028 CIP has stabilized and is increasingly funded by local taxes.** The new six-year CIP totals \$3,027 million – falling by \$142 million below the FY2021-26 CIP (as amended in FY2022). Within this total are some shifts in priorities, with significant growth in the Intersection Improvement Program in transportation and to the Sidewalk and Trails Program. The CIP of the LCPS is almost fully funded with ongoing priorities of capital facility renewals, alterations and enrollment-driven needs.

Loudoun County Capital Improvement Program – FY2019-2024 and FY2021-2026 (US\$ millions)								
	FY2019-2024	FY2021-2026 1/	FY2023-2028	FY2023-28 -FY2021-26		FY2022	FY2023	Difference
Expenditures								
General County Projects	724	1,166	1,124	-42		165	176	11
Transportation Projects	1204	1,173	1,083	-90		93	162	69
	522	830	820	-10		164	85	-79
Total CIP	2,450	3,169	3,027	-142		422	423	1
Funding Sources								
Local Tax Funding (LTF)	526	840	942	102		151	157	6
Debt	1,179	1,864	1672	-192		216	203	-13
Inter-governmental aid	675	269	321	52		17	20	3
Proffers and other	60	196	92	-104		38	43	5
Total Funding	2,450	3,169	3,027	-142		422	423	1
• LTF / Total	21%	27%	31%					
• Debt / Total	48%	59%	55%					
• Aid,other / Total	31%	14%	14%					
Sources: Adopted FY2020 Budget and Proposed FY2022 Budget. 1/ Includes amendments approved in FY2022.								

Funding of the FY2023-28 CIP reflects a growing reliance on local tax funding (LTF) that is *substantially* above the County Fiscal Policy minimum of 10% LTF of the CIP – \$942 over six years, or 31% of the total – for FY2023 alone it rises to 42% of the annual total. This reflects

- the declining availability of non-County revenues – federal and state NVTA aid and proffers, and
- more fundamentally, the limitations imposed by the Loudoun County annual new debt issuance guidelines - set at \$250 million over FY2023-25 and \$260 million over FY2026-2028 – that drive the total debt for the CIP of \$1,672 million.

Contrary to general impressions, *proffers* continue to represent a negligible portion of the CIP funding, amounting to a mere \$53 million or 1.8% of the six-year Plan.

- **Revenues and Tax Rates**

- **Funding of budget expenditures incorporates first steps to reduce dependence on new development to pay the bills and to reduce the risk of single industry dependence in revenue sources.** The first step recognizes a progressive *slowing* of new residential and commercial development as the number of new parcels available for development declines. This leads to a need to *refocus tax policy* toward property revaluation rather than growth of the residential and commercial tax base – as the County considers that such growth “will not be a sufficient factor to fund new programs and program expansions”

In addition, under the FY2023 Budget Guidance adopted in December 2021, the Board has embraced *tax policy change* to rebalance the real property tax (RPT) and personal property tax (BPPT) proportions to mitigate the risk of single industry dependence in revenue composition. Thus, the FY2023 revenue scenario requires that least 51.5% of the General Fund local tax revenue is generated from the RPT, halting the ongoing rise of the BPPT share and leading in future years to a ratio approaching 60%.

- **The real property tax base jumps from the rise in residential housing and data center values, eclipsing change in other Loudoun business.** The County’s real property tax base rose last year by a net 18.3%, partly from a buoyant 14.6% rise in existing residential property values driven by low mortgage rates and robust home sales. Commercial and industrial property values rose by 23.5% due to a strong and growing dependency on data center in the Loudoun business community, where valuation rose by 54%. *Data centers moved from about one-third to nearly one-half* of Loudoun’s total real property commercial tax base in just one year!

Countywide Taxable Commercial Real Property Trends over 2021-2022					
	Valuation (billions of \$)		Growth	Composition	
	2021	2022	2021 to 2022	2021	2022
Data Centers	7.7	11.8	+54%	34%	43%
Other 1/	14.7	15.9	+8%	66%	57%
Total Taxable	22.4	27.7	24%	100%	100%

Source: 2022 Real Property Assessment Update. 1/ Includes multi-family, flexi industrial, retail, office, general commercial, land and hotel.

- The average homeowner tax bill will rise nearly 5% under the modified tax policies – but still a lower level than 2013 when inflation-adjusted and a tiny fraction of increasing home values.** The real property tax rate proposed for FY2023 is \$0.895 per \$100 of assessed value. This is 5 cents above the benchmark equalized rate (rather than *target tax rate*). This average homeowner’s tax bill would rise by \$257 to \$5,694 which, when adjusted for inflation, *would be equivalent to the amount paid prior to 2013.*

What’s more, the hike in average homeowner real property taxes in relation to the growth in homeowner assessed valuation represents not only substantially less in incremental growth terms but, in absolute terms, less than 1% of the increase in valuation.

Loudoun County – Net Impact of Change in Homeowner Real Property Tax				
	2021	2022	\$	%
Change in average home valuation	\$ 554,800	\$ 636,200	\$ 81,400	14.7%
Change in average homeowner tax bill	\$ 5,437	\$ 5,694	\$ 257	4.7%
Net Valuation gain after tax increase			\$81,143	
Increase in tax / Increase in home valuation				0.3 %

Source: data from Loudoun County proposed FY2023 budget.

- Data center industry business property tax revenues (BPPT) continue to grow, but their concentration in the revenue structure is – for now - stabilizing.** Revenues from data center computer equipment BPPT continues its upward march, albeit at a much slower pace – possibly due in part to more conservative estimating practices. Built, structures under development and land owned rose from 26.4 million ft² to 27.7 million ft² (+4.9%). These changes are reflected in industry BPPT estimates, though it must be noted that reporting updates of its computer equipment continue to not match the budget development cycle and may again pose an ‘April surprise’ as the \$60 million mis-estimate of last year. Incorporating both data center industry RPT and BPPT shows that they will account for an estimated 34% of total local tax funding (LTF) in *the proposed FY2023 budget.*

Loudoun County - Trends in Data Center Real Property and Personal Property Taxes, FY2016-2023 (US\$ millions)								
	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022	FY2023
Data center real property taxes 1/	20	22	27	35	52	72	77	111
Data center personal property taxes	83	151	195	258	313	395	550	576
Total data center revenues	103	173	222	293	365	467	627	687
Other sources – RPT, BPPT, non-tax	1,061	1,046	1,208	1,228	1,197	1,259	1,246	1,337
Total Local Tax Funding (LTF)	1,164	1,219	1,428	1,521	1,562	1,726	1,874	2,024
% Data center revenues / LTF	9%	14%	16%	19%	23%	27%	33%	34%
Sources: Adopted Budgets of FY2016-2022 and Proposed FY2023 Budget. 1/ Committee estimate.								

- Data center revenue *annual increases* for FY2023 will account for an estimated 40% of total tax local funding, down from 100% in FY2022 and the lowest share since FY2018.** The remainder in FY2023 are sourced primarily from the increase in residential and commercial real property taxes – reflecting the County’s new policy of rebalancing revenue sources – as well as some non-property taxes and federal aid. This is based upon personal property tax rate of \$4.20 per \$100 of assessed value for calendar year 2022, which would decrease to \$4.15 for calendar year 2023. This rate decrease, while small, would represent the first change in this rate since 1987 and *should be examined at a broader policy level before approved.*

Loudoun County – Sources of Growth in General Fund Revenues, FY2016-2023 (US\$ millions)								
	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022	FY2023	
Data center real & property taxes	70	49	71	73	102	160	60	
All other GF revenue sources 1/	-15	160	22	-32	62	-12	90	
Total annual increase in LTF	55	209	93	41	164	148	150	
% Data center share of total GF revenue growth 2/	>100%	23%	76%	>100%	62%	>100%	40%	
1/ Includes residential real property taxes, other personal property taxes, other non-property taxes, other local revenues and state and federal aid.								
2/ “>100%” indicates that data center revenues compensated for net decrease in other General Fund revenues.								
Sources: Adopted Budgets of FY2016-2020 and Proposed FY2021 Budget and author’s estimates.								

- County debt**

- Debt financing of the next CIP will fall in absolute and relative terms in relation to the current CIP, while debt service is estimated to rise at roughly 5% per year.** The FY2023-2028 CIP shows six-year debt financing *falling* from \$1,864 million in the FY2021-2026 Plan to \$1,672 million and *falling* as a share of the total program from 59% to 55% of total financing. Debt service (actual and projected) for FY2022 will rise about \$5 million above the current FY2022 payments from \$246 million to \$251 million. It is expected to rise at about 5% per year through the CIP period to reach \$304 million in FY2026, a rate likely to be in line with overall revenue and expenditure growth rates.

- **Debt ratios for the FY2023 budget appear well within current Loudoun Fiscal Policy targets**, that is: (1) debt to estimated property value (1.4% versus a <3% ceiling), (2) debt to per capital income (4.8% versus a <8% ceiling) and debt service to total expenditures (7.3% versus a <10% ceiling). Projections through FY2028 portray stability in these indicators. However, it is important to recall that they are predicated on continued buoyant growth trends in property values, personal income and expenditures, *which some might consider overly optimistic.*
- **Even so, consideration should be given to allocating some data center tax revenues to the annual LTF funding of the CIP to reduce the need for new County debt.**

Budget Presentation and Strategic Framework

- **The FY2023 budget’s “Proposed Budget Overview” (page E-16) continues again this year to show numeric strength and analytic inadequacies**, particularly with regard to a clear trend analysis of overall and individual expenditure categories - see, for example pp E22-E23 on Comparison of Appropriations and pp E72-E73 on the history of expenditures and FTE.
- **More importantly, the “Forecast Discussion and Analysis” section on pp R36-R40, which primarily states assumptions about the proposed budget, needs an upfront section synthesizing key issues and the medium-term future context.** While consideration of the future is discussed in various budget development documents prepared earlier in the fiscal year, the *annual budgeting needs to incorporate a medium-term strategic framework and build in sections on stress testing, risk analysis and affordability analysis for the proposed tax rates changes.*

Prepared by:

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

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