BETTER COMMUNITIES THROUGH SOUND GOVERNMENT

2027 ~~2026~~ Finance Policy Statement

In recent years, counties, cities, and towns have dealt with an unprecedented worldwide pandemic that wreaked havoc on our communities. The federal government during the first Trump and Biden Administration flooded state and local governments with cash to address the fallout from the pandemic; those additional resources also contributed to inflationary pressures.

Last year, federal officials signaled with HR 1, commonly referred to as the "One Big Beautiful Bill", that the fiscal relationship with states and localities would undergo a substantive change, resulting in fewer resources and more responsibilities for state and local governments.

In fact, the most recent state budget provided more than $600 million during the biennium to minimize the impact of federal policy changes on state and local governments. Even with the additional resources, the budgetary and administrative burden on localities from historic changes to SNAP and Medicaid as well as others remain uncertain.

~~As we continue to move another year away from the start of an unprecedented and devastating worldwide pandemic, local governments continue to navigate the road back to "normalcy."~~

~~That path has become rocky as the federal government embarks upon unprecedented changes in the scope and financing of its own operations and resets its fiscal relationship with state and local governments, creating unknown challenges for cities, counties, and towns in Virginia.~~

To maximize the ability of ~~state and~~ local officials to navigate these uncharted financial waters, it's imperative that state officials provide as much specific information as possible to inform the development of a viable and affordable fiscal plan ~~in the years ahead~~.

To that end, these principles are essential:

- Local government representatives should be included on any "blue ribbon" commission or other body established by the state that has as its purpose changes to state and local revenue authority or governance.
- State-imposed changes to local tax structures should account for disparate impacts in localities, be simple to administer and revenue neutral to local governments.
- State-mandated tax relief programs should rely upon state dollars and not local revenues to implement.
- The State should refrain from creating additional mandatory real estate tax relief programs until the General Assembly quantifies the current cost of tax relief programs and unless it is willing to pay for the cost of the programs.
- Local revenue sources should be balanced and diversified over three broad bases – assets (property), consumption (sales), and income.
- The local tax system should be logical and professionally administered. Taxpayers should be treated fairly, and compliance costs should be minimized.

- The burden of taxation, as well as the benefits of services, should be shared and enjoyed by all whether they are residents or local businesses.
- Tax policy should recognize the different economic, demographic, and service demands among localities, and should foster local control to develop tax policies best suited for their communities.
- Tax policy should recognize and be responsive to the competitive nature of the free market, should refrain from enacting policies that are too generous for one group, and should not place undue burdens on particular groups, including business and manufacturers.
- Local tax dollars should not be claimed by the state to cover the Commonwealth's revenue needs. This includes, but is not limited to, local fines and forfeitures, recordation fees, and revenues tied to the Communications Sales and Use Tax.
- Any legislation with local fiscal impact should be introduced no later than the first week of any General Assembly session. Such legislation should be pre-filed prior to the convening of a regular session. Further, the local fiscal impact process should be prioritized by the Governor and General Assembly to ensure accurate and timely analyses are completed as policymakers recommend legislative changes. If necessary, the Department of Planning and Budget should provide guidance based on their experience overseeing the Commonwealth's fiscal impact process.

FISCAL CHALLENGES CONFRONTING LOCAL GOVERNMENTS

The existing local tax structure is overly dependent upon general property taxes, specifically real estate taxes, which are regressive to many taxpayers. Local governments should be given the opportunity to diversify their revenue base to address needs identified in their communities (i.e., a one percent local option sales tax for school renovations and construction).

Unfunded and inadequately funded state mandates and commitments strain local government budgets and place additional pressures on the real estate tax. State-initiated services and programs should be supported by state funds and not rely on local funds to supplant state dollars. Line of Duty benefits for First Responders is one such example.

Demands for public services continue to increase. These services include education, behavioral health, other human services programs, juvenile programs, environmental initiatives, economic development, recreation, and public safety. These services have both operating and capital costs and must be funded.

Local revenue collections and service demands are also influenced by variables outside the control of councils and boards of supervisors. These include changes in state and federal tax policy; state and federal budget decisions; local economic conditions and long-term economic trends; the aging of our citizens; and global events.

STRENGTHENING THE LOCAL TAX BASE

Depending on the particulars of any given proposal, possible options to broaden local tax bases include reserving a portion of the state income tax for locally-delivered programs, authorizing a local option “piggy-back” income tax for both general and special purposes, increasing the local option sales tax rate, reducing the number of sales tax exemptions, expanding the sales tax base, and reducing the number of exemptions from the business license tax.

The state can also take actions to prevent further erosion of local revenues by not restricting local tax authority, imposing new spending requirements, or expanding existing mandates on services delivered by local governments, shifting state funding responsibilities onto local governments, expanding retirement and other healthcare benefits, and placing administrative burdens on local governments for state or joint programs.

SPECIFIC TAX ISSUES

VML opposes the repeal or restriction of locally administered BPOL, machinery and tools, or excise taxes unless dynamic and reliable revenue-neutral replacement sources are provided.

VML opposes the exemption of groceries and hygiene products from the local option sales tax unless the General Assembly can establish a viable revenue replacement to local governments.

VML supports permissive local authority to levy an excise tax on vaping and cannabis products.

The state and federal government should make payments-in-lieu-of-taxes for tax-exempt properties in amounts equal to the cost of the local services provided as well as related infrastructure improvements.

State-imposed changes to the real estate tax must be a “local option.” The state should not impose changes to processes governing assessments and appeals for real estate taxes that further degrade this revenue source.

VML supports current state statutory requirements governing the setting of real estate tax rates and the integration of this process with the budget development process. Changes to these processes cannot be addressed separately without placing undue hardship and increased costs on local taxpayers. Any future state legislative change should be simple to administer and not contradict, impede, or hinder the others.

The Virginia Communication Sales and Use Tax was enacted to establish a statewide tax rate and to preempt local taxes on communication sales and services. As such, the revenues from this tax must be distributed exclusively to eligible local governments. VML supports setting the tax rate on par with the state sales tax rate and broadening the coverage of the tax to include digital streaming services.

In taking state action to regulate private enterprises employing a business model that emphasizes the use of the internet to either provide retail or facilities or ride-sharing services, local government interests should be acknowledged, and localities should be included in the decision-making.

As general principles, VML believes state and local policies should 1) encourage a level playing field for competing services in the market place; 2) not provide a tax preference or tax policy advantage for one group at the expense of another group in the competitive field; 3) seek to preserve state and local revenue; 4) ensure safety, reliability, and access for consumers, providers, and the public; and 5) protect local government's ability to regulate businesses whether they are traditional, electronic, Internet-based, virtual or otherwise.

VML also believes that the state should not prohibit the sharing of financial information between the Commonwealth and appropriate local authorities that is normally treated as part of the public domain. VML further believes that the state should not prohibit a locality from exercising its authority to enter into voluntary collection agreements provided that such agreements include provisions to protect the public's interest.

Article X of the Virginia Constitution mandates that all real and personal property be assessed at fair market value and that all property not constitutionally exempt be taxed.

Taxpayers have the right to contest property assessments through administrative and legal means. Taxpayers pay no local fees to challenge real property and personal property assessments. If taxpayers are displeased with the determinations made by their local commissioner of the revenue or other local assessing official, additional real property appeals can be submitted to the local Boards of Equalization. Taxpayers can also appeal real and personal property assessments in the Circuit Courts and, if still aggrieved, may appeal to the Virginia Supreme Court.

Reforms enacted in the 2011 Session of the General Assembly lowered the level of proof required by the taxpayer (from "clear preponderance" to "preponderance") to prove property is valued at more than fair market value or that the assessment is not uniform in its application and that it was not developed in accordance with generally accepted appraisal practices and applicable Virginia law relating to property valuation.

In 2017, there were more than 3.1 million taxable parcels and 20,777 appeals of which 10,472 were administratively resolved. Another 2,341 appeals were granted by local Boards of Equalization. Taxpayers filed 18 appeals in circuit courts of which seven were granted.

VML does not believe the assessment appeals process is flawed or in need of major policy changes and opposes statutory changes that would upend a process that protects taxpayers and the public.

SPECIFIC BUDGET ISSUES

In 1979, Virginia made sweeping changes in local governmental boundary change and transition issues, including a moratorium on city annexations that remains in place. In recognition of the lost revenue growth for cities, the General Assembly approved some changes in state funding commitments for selective programs and created a program of state assistance to local police departments (HB 599). Almost 70 percent of Virginians now live in communities served by police departments.

The state has increasingly de-emphasized its statutory commitment to the "HB 599" program but has never compromised on the annexation moratorium. VML calls on the state to honor its commitment to public safety by funding the program in amounts intended in the enabling legislation and restoring the “funding floor.”

The state must be a reliable funding partner in accordance with the Virginia Constitution and state statutes. The Standards of Quality should recognize the resources, including positions and capital needs, required for a high-quality public education system. The SOQ should reflect prevailing practices across the state, and the actual costs to educate Virginia’s children. This includes the cost to educate at-risk students, students in jeopardy of failing the state’s Standards of Learning tests, students with special needs, and school construction, renovation, and maintenance.

The state should fully recognize and fund the costs of rebenchmarking of the various educational programs, including the Standards of Quality, incentive, categorical, and school facilities programs as well as support services. Changing the process of rebenchmarking to artificially lower recognized costs like inflation does not change what it actually costs to provide education. Instead, it simply transfers additional costs to local governments and the real estate tax base.

The Commonwealth should~~:~~

- ~~Study the Standards of Accreditation and Standards of Learning to determine which standards impose costs on local governments that are not recognized in state funding formulas. In particular, changes adopted since 2009 to SOAs and SOLs should be examined, as state funding on a per-pupil basis and accounting for inflation and enrollment growth remains below 2009 appropriated levels.~~
- Re-examine those Standards of Quality that the Board of Education has recommended, but that the General Assembly has not funded. These standards reflect prevailing practices necessary to improve children’s academic performance. Student academic performance is required for schools to meet the accountability standards under the SOL and SOA. If funding is not available to pay for prevailing practices, the accountability standards should be adjusted so that local governments are not in the position of having to bear the entire burden of meeting these unfunded mandates.
- ~~Conduct a study that examines how other states fund education and whether the Commonwealth should use a funding strategy that establishes a more realistic base foundation amount per pupil – plus add-on funding to reflect higher costs for educating at-risk, disabled, ESL, and gifted students, etc. as well as funding for capital costs.~~

The state should provide sufficient funding for highway construction and maintenance, public transportation infrastructure and maintenance, ports, airports, and freight and passenger rail to promote economic development and public safety.

The state should continue to base its funding of retirement plans based on the contribution rates certified by the Virginia Retirement System.

VML supports increased state funding for the statewide network of planning district commissions/regional councils (PDCs). PDCs carry out efforts supported by state and local policy makers to advance and sustain regional coordination, cooperation, and technical assistance for the benefit of regions across the Commonwealth.

VML supports transparency in budgeting at both the state and local level. To that effect, the state should not disguise its budget reductions by using unidentified or non-specific reductions for aid to localities.

As a matter of fiscal reform, the state should develop financial priorities that account for both spending and revenue actions. The debate on such priorities should be public and should be transparent to the public in the Governor's Budget Bill and the General Assembly's Appropriation Act. For example, should education funding be afforded less priority than certain tax preferences?

GOVERNMENTAL ACCOUNTING STANDARDS BOARD (GASB)

The Governmental Accounting Standards Board (GASB) has put in place standards regarding the reporting of unfunded liabilities of cost-sharing plans. A cost-sharing plan is one in which participating government employers pool their assets and their obligations for a defined benefit pension, such as Virginia's teacher retirement plan. While the costs are shared, the state sets the rules regarding what benefits are required and what the state contribution will be.

GASB requires that the unfunded liability be apportioned among the participating employers that pay the retirement contributions to the pension plan. Teachers are employees of the school boards, which send retirement contributions to VRS. Because of this the unfunded liability falls solely on the school boards, even though the retirement contributions are funded, in part, by the state and the school board. This means that the liability will be shown on the city, county, or town financial statement.

The intent of GASB rules is to encourage transparency in pinpointing liabilities and the current method of assigning those teacher pension liabilities only to school divisions contravenes the goal of transparency.

Because there was not a process for apportioning the liabilities for these cost sharing plans, they previously had not been reported at the local level.

The unfunded liability should be shared by the state and localities based on the state's Standards of Quality and local composite index and reflected as such in reporting.

VML supports state policy changes that would provide for the Virginia Department of Education to pay the Commonwealth's share of retirement costs directly to the Virginia Retirement System to facilitate the sharing of these liabilities.

GOVERNMENT REFORM

VML supports a comprehensive review of the services provided by state and local governments. The purpose of the review is to ascertain which services are truly essential to support a productive economy and healthy society; determine the performance level of public services now in place; evaluate the policies and practices used by the state to assign responsibility and accountability between the state and local governments for providing public services; and determine the most effective, efficient, and equitable ways to fund essential public services. Such a review must start with a dialog including state and local officials, business interests, academia, and other interested parties.

TAX AND SPENDING REFORM

Any state initiative aimed at tax reform should first include a focus on state tax reform and the financing of state services including revenue sources. If the state paid an appropriate share of its obligations for locally administered state mandated or priority services, the reliance on local taxes would be reduced. Local officials should be included in any discussion that focuses on local taxing authority.

LOCAL FISCAL DISTRESS MONITORING

The Commonwealth has a process in place to identify, ~~and~~ notify, and assist local governments that may be in fiscal distress. Absent cause, this relatively new process should not be used as a tool to force local governments to enact specific changes at the direction of the Commonwealth without the consent of the local governing body. Local governments shall oppose any efforts to do so.