Initial Estimates of the COVID-19 Revenue Shock for Local Governments in Virginia

Local governments in Virginia are losing at least $60 million a month as social distancing measures in response to the COVID-19 pandemic take hold in the Commonwealth. This is the estimate by Old Dominion University professors Ron Carlee and Robert McNab in a new working paper examining the impact of COVID-19 on local governments. Declines in local revenue will place pressure on local governments to reduce staff and services, further exacerbating the ongoing recession.

The researchers examined the local taxes that are most sensitive to diminished economic activity, especially in the hospitality, tourism and retail sectors. They identified five vulnerable taxes: sales and use, business and franchise license, hotel and motel, restaurant and food, and admissions.

"The near complete shutdown of the tourism and hospitality industries in Virginia is dramatically impacting the ability of hoteliers to fill their rooms. Many restaurants are finding that they cannot fill the gap in revenues created by social distancing measures." According to McNab, these declines in economic activity will translate to decreased revenue collections at the state and local government level.

The vulnerable taxes are a foundational element for cities and counties. These taxes generated $2.9 billion annually for local governments in Virginia in Fiscal Year 2018. In the Hampton Roads region vulnerable taxes generated over $637 million.

The revenue losses are estimated based on a 10% decline in sales taxes, a 20% decline in business taxes, a 50% decline in hotel taxes and meals taxes, and a 70% decline in admissions taxes. With the extension of stay-at-home orders, the researchers fear their estimates could be low.

Unlike the federal government, state and local governments must balance their budgets on a regular basis. Local revenues, once lost, typically cannot be recovered as cities and counties are constrained in the Commonwealth from levying new or higher taxes. These revenue reductions present an immediate challenge to local governments.

Local governments in Virginia operate on a July to June fiscal year. This means that severe revenue shortfalls will be seen in the current fiscal year that ends on June 30. With increased demands for services during this emergency response, local governments are at risk of being in deficit positions.

The loss in business taxes lags a year and will put in jeopardy next year's budget. Typically, local governments adopt budgets in May for the fiscal year that begins in July. As City Councils and County Boards enter the budget review season, they face great uncertainty in predicting revenues for the coming year.

Carlee, who is the former city manager of Charlotte, North Carolina and former County Manager of Arlington, Virginia, observes, "this crisis could not hit at a worse time in the annual budget process for cities and counties. There is not enough time to adjust for the immediate losses in the current fiscal year, and there is not enough information to plan for the next fiscal year. Local governments could be dipping into their reserves, or in extreme cases, following the private sector in having to lay off workers."

On March 30, the City of Norfolk, for example, announced that it had furloughed 550 part-time employees. This is a harbinger of what is to come.

Data for the ODU report indicates that the localities most dependent on vulnerable revenues are Williamsburg (38% of local revenues), Colonial Heights (24%), Fredericksburg (23%), and Norton, Harrisonburg, Emporia and Winchester (20% - 21% each). The vulnerable taxes generated $142 million annually for these seven communities. The localities that will lose the most revenue are (in descending order) Fairfax County, Virginia Beach, Arlington County, Henrico County, Loudoun County, Richmond, Norfolk and Chesapeake. These localities generated almost $1.4 billion from the vulnerable taxes in FY 2018.

The ripple effects of the COVID-19 economic shock will also emerge in the coming weeks. Almost 2.8 million workers in Virginia were employed in the private service sector in the third quarter of 2019, with an average of 420,000 working in the leisure and hospitality industry. While the education and health sectors are likely to be insulated from the economic shock, many workers in the leisure and hospitality industry will not.

At the local level, the impact of the COVID-19 pandemic will vary. In Williamsburg, almost 50% of jobs in 2019 were in arts, entertainment, recreation, accommodation and food services sectors. In Virginia Beach, the Commonwealth's largest city, more than 17% of jobs were in these sectors. "The record unemployment insurance claims in mid-March are a precursor for rapid increases in unemployment in Virginia," McNab said, noting that the retail sector is likely the next source of layoffs. Unemployment will increase significantly in March and April. As workers are laid off, their demands on state and local governments for unemployment insurance, rental or mortgage assistance, and other public services will increase.

Carlee said it is critical that the Commonwealth act quickly in getting stimulus money to the localities hardest hit with revenue losses. "Without immediate state and federal aid, local governments will face a revenue shock in the coming months that will lead to deficits in the current fiscal year and budget shortfalls for the new fiscal year that begins in July."