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Estimating Revenue Impacts of the Coronavirus Pandemic of 2020

Needless to say the COVID-19 Pandemic of 2020 is unprecedented in many ways. To assess its impact on municipal revenues, I suggest thinking about it in two parts: 1) the immediate effect of the pandemic including shelter-in-place and markets, and 2) the lasting effect of the pandemic after the immediate effects have passed. This post addresses the first part.

The Most COVID-19 Vulnerable Local Governments.

Cities, counties, and special districts are being affected differently the pandemic and this is largely based on the type of economic base in their community. Other cities with milder immediate revenue losses are facing severe risk because they are unprepared for even a modest drop in revenue.

The revenue impacts of the pandemic are being felt most severely in:

- Tourism based economies (tourist destinations, ski resorts, beach resorts, golf resorts, sports tournament. Primary impacted revenues: Hotel Occupancy Tax, Sales and Use Tax, Transactions and Use Tax, Business Operations Tax.
- Entertainment and sports, theater, music, movie and TV production. Primary impacted revenues: Sales and Use Tax, Transactions and Use Tax, Business Operations Tax.
- Casinos. Primary impacted revenues: Business Operations Tax, Sales and Use Tax, Transactions and Use Tax.
- Oil industry – refineries, etc. Primary impacted revenues: Business Operations Tax.
- Bars, restaurants. Primary impacted revenues: Sales and Use Tax, Transactions and Use Tax, Business Operations Tax.
- Traditional retail: apparel, autos, appliances. Primary impacted revenues: Sales and Use Tax, Transactions and Use Tax, Business Operations Tax.
- Transportation – service stations / fuel. Primary impacted revenues: Sales and Use Tax, Transactions and Use Tax, State fuel excise tax (state Local Streets and Roads allocations – HUTA and RMRA).
- Major airports – Primary impacted revenues: Sales and Use Tax, Transactions and Use Tax, State fuel excise tax (state Local Streets and Roads allocations – HUTA and RMRA).

Municipal Revenues Differ in Timing and Economic Linkage.

Some municipal revenue collections, by the nature of their design and collection practices, have a more direct and immediate relationship to the economy than others.

The Property Tax provides about $13 billion to cities in FY2019-20. Because of the way taxable property is assessed, due and paid, property tax revenues are slow to respond to changes in economic conditions. To the extent there is an effect of the immediate pandemic, associated changes in behavior, and economics on property values, we will not see this show up significantly in revenue allocations until 2021-22. Even then, the effects of this immediate although severe pandemic event may be mild when it comes to the taxable value of property, which for many properties, is already well below market value.

Sales and Use Tax including transactions and use taxes (add-on sales taxes) provide about $8 billion to cities in 2019-20On average, about 7 percent of total city revenues, about 20 percent of general revenues (varies). Counties get about $900 million for their general funds but depend on sales taxes for transportation, public safety and realigned health and social service programs to the tune of about $16.8 billion.

The effects of the pandemic and related economic conditions will have a fairly immediate effect on sales tax revenues. But the effect on your city or county will depend on the nature of your local economy. Especially impacted:

- Taxable sales of motor vehicle fuel and related products have fallen dramatically due to the shelter-in-place order. The service station category is about 8 percent of statewide sales.
- Auto sales likely to fall significantly. Auto is about 13 percent of statewide sales.
- Shift from dining to groceries will severely impact. (Take-out is taxed). Eating and drinking group is about 10 percent of statewide sales.
- Generally, drop in consumer confidence should impact negatively, but online sales may abate some of this. Refrigerator/freezer sales seeing a bump.
- Major impacts with corollary impacts on all related revenues.
- College Towns. With college life shut down at least through June, most of the students who by taxable goods have gone home to mooch off their families.

Hotel Tax (Transient Occupancy Tax) provides about $3 billion annually to cities statewide. Typically TOT comprises 5 to 10 percent of general revenues but for tourism oriented cities: 40 percent to 70 percent. TOT revenues are being hit hard by the pandemic event, although some tourism cities have already had their "high season" outside the March through June period.

Business Operations (License) Tax provides $2 billion statewide, from 2 to 8 percent of general revenues. Like sales tax, business tax revenue amounts and characteristics vary greatly among communities with different economies. Some cities get large revenues from some specific industries: casinos, refineries. Most business tax ordinances are structured as a base flat tax with a sliding scale based on gross business receipts reported in the prior year. Consequently, the effects of this mid-2020 event are not likely to show up in most city and county revenues until FY2021-22.

Parking Meter Revenues. Relatively small portion of general revenues in most cities, the effects on these revenues is immediate and severe due to tourism and workforce impacts.

Parking Tax. Just eighteen cities have parking taxes - cities near major airports or a tourist destination. The effects on these revenues is immediate and severe due to tourism and workforce impacts.

Admissions Tax. Just fifteen cities have an admissions tax due to their unique local economies. The effects on these revenues is immediate and severe due to tourism and workforce impacts.

Other local revenues: Utility User Taxes, Utility Fees, Parcel Taxes, Benefit Assessments, etc. are unlikely to be affected as significantly by this near term pandemic event.

City General Fund Revenues Do Not Depend on State Government Finances

Bad news: it's going to be a very difficult budget for the state legislature and governor this year. Good news: aside from tax payment deferral programs which are largely a question of cash flow, local revenues are well insulated from the state's budgetary problems. This is because:

- It will be difficult and painful, but the state is relatively well positioned to weather this storm with substantial reserves.
- Unlike in prior recessions, local governments have strong and encompassing constitutional protection from state actions that might affect revenues and mandates.
- Revenues to cities and special districts from the state are almost entirely special funds (i.e. streets and roads, grants from bond funds, etc.) - not general fund. In recent years there have been significant one time allocations for housing and homelessness programs, but these are largely competitive grant programs, are still at the top of the governor and legislature's priority list and the funding has already been set aside from prior budgets. There are no discretionary state funds in city general revenues.
- We can, however, expect substantial impacts in Local Streets and Roads (LSR) funds including from the Highway Users Tax Account (HUTA) and the SB1 Road Maintenance and Rehabilitation Account (RMRA). See my related post about that here: https://members.csmfo.org/communities/community-home/digestviewer/viewthread?GroupId=85&MessageKey=55c3e8df-853a-4cfe-916b-b243e4dbe8be

Except: New Deferred Payment Programs for Small Businesses

It appears at this time that the idea of promoting a statewide property tax payment deferral program has been set aside. But part of the argument against this idea of a statewide program is that county assessors already have the authority to grant payment deferrals for good cause. It's likely counties will see an increase in such appeals, but each appeal has implications for county revenue flows as well as other local agencies. Moreover, most counties, other than Los Angeles County, are on the Teeter Plan, such that such deferrals and delinquencies do not affect city or special district allocations.

The state has enacted a new Small Business Sales and Use Tax Payment Relief Plan, what amounts to a $50,000 loan for small businesses. To the extent businesses in your community participate, this will impact your sales and use tax cash flow. (See http://californiacityfinance.com/SUTdeferral200402.pdf)

On the bright side, if they work as intended, these business support programs will help businesses in our communities survive and our local economies will be better off, with long term benefits for our municipal finances and services.

This program is in addition to the Executive Order issued on March 30, 2020, granting taxpayers reporting $1 million or less in quarterly taxes an automatic three-month extension on the filing of 1st quarter 2020 tax returns. The extension applies to the reporting of taxes and fees due on or before July 31, 2020 and includes a waiver of interest and penalties. Qualifying taxpayers are not required to file a request for extension or request relief from penalty or interest.

So what to do? No doubt you've already been working at this.

1. Get information about the particular nature of the revenue base underlying your revenue sources that will be affected by this event:

    - Hotel Occupancy Tax
    - Sales and Use Tax
    - Transactions and Use Tax (add-on sales tax – behaves a bit differently)
    - Business Operations (License) Tax
    - Parking meter and parking tax revenues
    - Property Transfer Tax / Documentary Transfer Tax

    Consult with hoteliers, chamber of commerce, retailers, restaurants, realtors, etc. How are they being affected?

2. Keep your new copy of "The California Municipal Sources Handbook" Fifth Edition (https://www.cacities.org/publications) at hand to look up basic questions you have about local revenues and other matters of city finance.

3. Get advice from professionals that are ready and able to help. Talk with your auditors. Stay tuned with revenue consultants, especially your sales tax consultant: HdL (https://www.hdlcompanies.com/) or Avenu Insights (https://www.avenuinsights.com/) who can help you look in depth at the components of your tax base to estimate impacts. Reach out to consultants who can help you model the short term and long term financial impacts such as Russ Branson (http://russbransonconsulting.com) or Management Partners (https://www.managementpartners.com/) who can give you a (free) hypothetical city impact model tool.

4. Watch this site, GFOA (https://www.gfoa.org/) and my site (http://www.californiacityfinance.com/) for more info.

5. Reach out to your colleagues. It does us all good to help each other through this.

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