

**INTERIM REPORT OF THE**  
**JOINT LEGISLATIVE AUDIT AND REVIEW COMMISSION ON**  
**LOCAL MANDATES AND FINANCIAL RESOURCES**  
**TO**  
**THE GOVERNOR**  
**AND**  
**THE GENERAL ASSEMBLY OF VIRGINIA**



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## PREFACE

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Through House Joint Resolution 105, the 1982 session of the General Assembly directed the Joint Legislative Audit and Review Commission (JLARC) to study and report to the General Assembly on the:

- responsibilities of local governments for providing public services, and the differences in the responsibilities of counties, cities, and towns;
- sources of revenue that are or could be allocated to local governments and the adequacy of those sources; and
- the Commonwealth's responsibilities for providing public services and procedures for aiding local governments.

The resolution designated a 12-member legislative subcommittee to cooperate with JLARC during the study. Members were appointed from the House Committees on Finance and Counties, Cities, and Towns, and from the Senate Committees on Finance and Local Government.

The resolution requested that an interim report be presented to the 1983 session. This interim report provides background information on local governments in Virginia, focuses on the principal issues to be considered in the study, and highlights ongoing study activities.

A major portion of the interim report phase of the HJR 105 study has been devoted to obtaining input from local government officials and other interested organizations concerning issues and problems which warrant review. The HJR 105 Committee scheduled five regional workshops around the State to encourage local involvement. A sixth workshop was held specifically for town officials, and a statewide public hearing was held in Richmond. A total of 37 counties, 26 cities, and 39 towns sent representatives to one or more of these meetings. The issues which will be the focus of this study flow from these meetings.


One of the concerns voiced most frequently during the workshops and hearing dealt with the burdensome nature of State mandates. Mandates are constitutional, statutory, or administrative actions which place requirements on local governments. During the public meeting, several local government representatives acknowledged that most State mandates are desirable. Most speakers contended, however, that mandates limit local flexibility and often impose cumbersome requirements on local governments. This study will examine the mandates that the State has placed on its local governments. The final report will examine the extent to which State-mandated services dominate local

activities, and whether State mandates allow localities sufficient flexibility in their implementation. The report will also catalogue mandates seen by localities as particularly constraining.

A second concern voiced by local officials is the adequacy of State assistance to localities. Over time the Commonwealth has assumed a significant role in assisting localities with services. The State Comptroller estimated that in FY 1981 almost \$2.6 billion in State funds was spent to aid local governments. This study will examine whether the State adequately funds its service mandates. The study will also attempt to examine whether the methods of distributing State aid are based on fair or reasonable measures and whether the processes used in developing formulas have been reasonable.

The third central issue for the HJR 105 study is whether local governments have sufficient financial resources to fund the public services they must provide. In recent years, increasing service costs and stagnant revenue growth have led to fiscal stress for many localities. The HJR 105 study will examine local financial conditions and will attempt to compare the revenue-producing capacities and tax efforts of localities with similar features. Evidence of low revenue capacity or high tax effort may indicate that a locality is having difficulty maintaining existing services, and that additional taxing authority or State financial assistance may be warranted.

In adopting HJR 105, the General Assembly has begun a re-examination of some aspects of State-local relations. Findings and recommendations which result from study research will be included in the final study report, which will be completed prior to the 1984 session of the General Assembly.



Ray D. Pethtel  
Director

January 6, 1983

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## I. INTRODUCTION

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During the 1982 session, the Virginia General Assembly adopted House Joint Resolution 105, which directs the Joint Legislative Audit and Review Commission (JLARC) to study the responsibilities and financial resources of local governments. This interim report, which was requested by the study resolution, provides background information on local governments in Virginia, focuses on the principal issues to be considered in the study, and highlights ongoing study activities. Findings and recommendations which result from study research will be presented in the final HJR 105 report, which will be completed prior to the 1984 session of the General Assembly.

Virginia's 325 local governments are closely tied to the State. They are dependent on the State Constitution and general laws for the authority to organize, conduct their affairs, and raise and spend revenues. Many of their functions are carried out at least partially in response to responsibilities assigned by the State. Many other local government activities are defined, prescribed, or regulated by State statutes or administrative regulations. Finally, a major portion of local government funding flows from the State through a variety of aid programs and direct State services.

The General Assembly has focused much of its attention and effort on developing an appropriate relationship between the State and its local governments. In the past 12 years, 29 legislative studies have been conducted to explore ways of improving and coordinating State and local responsibilities. Many of these studies have resulted in significant statutory changes for local governments, including grants of additional local authority to operate in some areas, increased State financial assistance, and changes in the ways local governments deal with each other. House Joint Resolution 105 represents the most recent legislative examination of State and local interrelationships in Virginia.

### Study Resolution

House Joint Resolution 105 charges JLARC to study:

- responsibilities of local governments for providing public services, and the differences in the responsibilities of cities, counties, and towns;
- sources of revenue which are or could be allocated to local governments and the adequacy of those sources; and

- the Commonwealth's responsibilities for providing public services and procedures for aiding local governments.

One key focus of the study resolution is mandates placed on local governments by the State. The resolution directs that the study "identify to the extent feasible all local government mandates and related financial sources contained in each functional area of State government."

The resolution implies that the study be completed prior to the 1984 session of the General Assembly. A copy of House Joint Resolution 105 is included in the appendix of this report.

*Legislative Involvement.* To ensure coordination of the study between JLARC and standing committees of the legislature, HJR 105 designated a 12-member subcommittee to cooperate in study activities. Members were appointed from the House Committee on Counties, Cities, and Towns, from the House Finance Committee, and from the Senate Committee on Local Government, and the Senate Finance Committee.

The first joint meeting of the HJR 105 Committee was held in September, 1982. At that time, JLARC staff presented background information and a tentative workplan for the study. A subsequent meeting was held in November to solicit comments from local government officials and other interested parties.

## LOCAL CONCERNS

A major portion of the interim report phase of the HJR 105 study has been devoted to obtaining input from local government officials and other interested organizations concerning issues and problems which warrant review. To achieve this input, the HJR 105 Committee scheduled five regional workshops around the State. A sixth workshop was held exclusively for town officials, and a statewide public hearing was held in Richmond.

The regional workshops were designed as two-way forums, to present the study workplan to localities and to receive comments and suggestions from local officials. Workshops were held between late October and early December 1982 in Portsmouth, Prince William County, Wytheville, Lynchburg, and Harrisonburg. The workshop for town officials was held in Richmond. Several members of the HJR 105 Committee were able to attend one or more of these regional workshops.

The Statewide public hearing was held in Richmond on November 15, 1982. The hearing offered the opportunity for local officials and other interested parties to present their concerns directly to the 21 legislative members of the HJR 105 Committee.



The regional workshops and the public hearing were well-attended. A total of 37 counties, 26 cities, and 39 towns sent representatives to the meetings. In addition, a number of business and professional associations and other interested organizations were represented. At the public hearing, the HJR 105 Committee heard comments from 27 speakers. Eight additional individuals prepared and submitted statements for the hearing record. Figure 1 shows the geographic distribution of the local governments which attended either the workshops or the hearing.

The concerns expressed by local government officials most often centered on (1) the burdens imposed on local governments by State mandates; (2) the need for additional State financial assistance and the methods used to distribute it; and (3) the legal and practical limits that exist on local taxing powers. Exhibit A lists selected excerpts from statements prepared for the public hearing and regional workshops.

### State Mandates

State mandates impose service responsibilities and other requirements on local governments. In some cases, mandates require that local governments redirect their resources to meet Statewide rather than local priorities. State imposition of responsibilities and priorities on local governments is therefore a sensitive issue.

During the workshops and hearing, several local government representatives acknowledged that most State mandates are desirable. Some representatives acknowledged that most mandates involve activities or procedures that localities should perform and, in some cases, were performing prior to State mandates. Most speakers contended, however, that mandates limit local flexibility, often impose burdensome requirements on local governments, and are rarely accompanied by adequate State funding.

Much of the concern surrounding State mandates focused on lack of flexibility. Several representatives noted that mandates often involve the rigid application of requirements when more cost-effective alternatives were available. Other representatives asked that mandates only include requirements which are essential to the delivery of quality services. Suggestions for remedies included a statutory roll-back of State mandates, and grants of local authority to reduce mandated services whenever State funding for local programs is reduced. Several local representatives also urged the General Assembly to adopt a statute requiring reimbursement of costs for any new State mandates.

### State Financial Assistance

Many of the comments concerning State financial assistance were closely related to local concerns about State mandates. Local officials repeatedly expressed the view that State funds should support

Figure 1

**HJR 105 WORKSHOP AND HEARING ATTENDANCE**

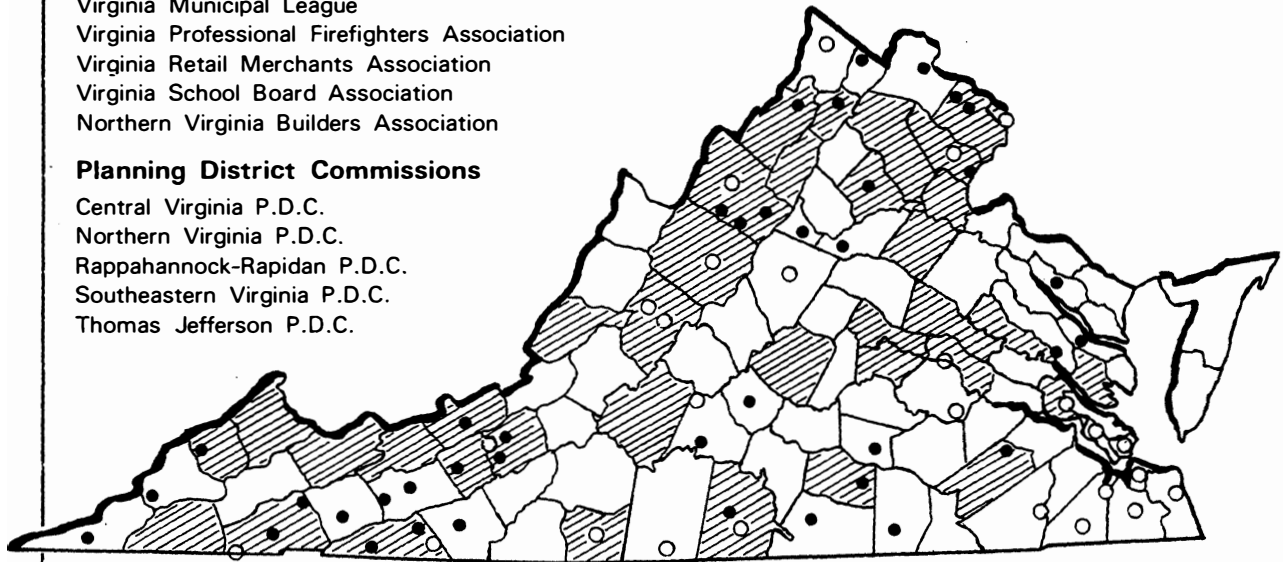
**ASSOCIATIONS AND OTHER GROUPS REPRESENTED**

**Professional Associations**

- Virginia Association of Community Service Boards
- Virginia Association of Counties
- Virginia Association of Housing & Community Development Officials
- Virginia Library Association
- Virginia Manufacturers Association
- Virginia Municipal League
- Virginia Professional Firefighters Association
- Virginia Retail Merchants Association
- Virginia School Board Association
- Northern Virginia Builders Association

**Planning District Commissions**

- Central Virginia P.D.C.
- Northern Virginia P.D.C.
- Rappahannock-Rapidan P.D.C.
- Southeastern Virginia P.D.C.
- Thomas Jefferson P.D.C.



**CITIES REPRESENTED**

- |                 |                  |              |                |
|-----------------|------------------|--------------|----------------|
| Alexandria      | Colonial Heights | Harrisonburg | Radford        |
| Bristol         | Danville         | Lexington    | Richmond       |
| Buena Vista     | Franklin         | Lynchburg    | South Boston   |
| Charlottesville | Galax            | Manassas     | Staunton       |
| Chesapeake      | Hampton          | Martinsville | Suffolk        |
|                 |                  | Newport News | Virginia Beach |
|                 |                  | Norfolk      | Winchester     |
|                 |                  | Portsmouth   | Williamsburg   |



**TOWNS REPRESENTED**

- |                |              |               |                |
|----------------|--------------|---------------|----------------|
| Abingdon       | Clintwood    | Herndon       | Rural Retreat  |
| Altavista      | Culpeper     | Hillsville    | Saltville      |
| Appomattox     | Dayton       | Independence  | Standardsville |
| Berryville     | Elkton       | Jonesville    | Urbanna        |
| Big Stone Gap  | Fries        | Kenbridge     | Vienna         |
| Blacksburg     | Front Royal  | Lawrenceville | Warsaw         |
| Blackstone     | Gordonsville | Leesburg      | Waverly        |
| Chase City     | Grottoes     | Marion        | West Point     |
| Christiansburg | Halifax      | Pearisburg    | Woodstock      |
|                |              | Pulaski       | Wytheville     |
|                |              | Quantico      |                |



**COUNTIES REPRESENTED**

- |            |                |
|------------|----------------|
| Alleghany  | James City     |
| Arlington  | King William   |
| Augusta    | Lunenburg      |
| Bedford    | Montgomery     |
| Bland      | Page           |
| Buchanan   | Powhatan       |
| Buckingham | Prince William |
| Culpeper   | Pulaski        |
| Dickenson  | Rockbridge     |
| Fairfax    | Rockingham     |
| Fauquier   | Scott          |
| Giles      | Shenandoah     |
| Gloucester | Spotsylvania   |
| Goochland  | Stafford       |
| Grayson    | Sussex         |
| Halifax    | Tazewell       |
| Hanover    | Warren         |
| Henrico    | Washington     |
| Henry      |                |

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Exhibit A

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EXCERPTS FROM HEARING AND WORKSHOP STATEMENTS

City of  
Chesapeake                    "...the majority of the mandates are desirable.  
Most of them are activities or procedures which the  
City of Chesapeake was doing prior to mandate  
enactment. When problems arise, they are usually  
related to administrative inflexibility created by  
the mandate."

Fauquier  
County                        "Allow the localities some freedom in the way  
mandated services are delivered. A strategy of  
this nature encourages efficiency, innovation and  
creativity."

Shenandoah  
County                        "Part of the frustration being experienced by local  
government in dealing with mandated services is the  
lack of flexibility to finance and administer  
them."

Newport News  
Citizens'  
Committee on  
State Mandates                "To give you an idea of the impact of State man-  
dates, we've estimated that in FY 1982, the Commit-  
tee significant State-mandated non-educational pro-  
grams alone cost our city over \$10.5 million.  
These are found in the public safety, individual  
and family services, transportation, general gov-  
ernment, and the justice areas. Educational man-  
dates last year cost us in excess of \$20 million."

Town of  
Saltville                     State mandates, both legislative and regulatory,  
place a substantial burden on local governments.  
Many of these mandated programs are essential to  
protect the public health, safety and welfare, and  
in these cases I do not feel that the State should  
be expected to provide all of the funding for such  
programs, since residents of a particular locality  
are often those benefitting most directly from a  
mandated program. It would be helpful, though, if  
all state agencies administering mandated programs  
could provide technical or financial assistance to  
localities to assist them in implementing mandated  
programs.

James City  
County                        "If a program is mandated, thereby using the local-  
ities to implement a State policy, the State should  
fully reimburse the localities on the basis of the  
cost of the mandated service. If the State is  
participating in a truly cooperative program, such  
as education, it may be desirable to supplement the  
cost basis by looking at need and equity."

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Exhibit A (Continued)

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Virginia School Boards Association	"Since its establishment in the early '70's, the school funding formula has never been fully funded. If the formula had been fully funded for the 1982-84 biennium, the State's share would have been approximately \$500 million more."
City of Richmond	"The greatest concerns as to equitable State aid are in the areas of education, street and highway maintenance and construction, and human services."
Fairfax County	"The Board [of Supervisors] believes that one of the major responsibilities of the State relative to aid is to fully fund its many mandates imposed on local governments."
King William County	"Local government has reached a maximum amount that can be extracted from the citizens through taxation in the limited areas allowed local governments for taxation, and in particular, the real estate taxes."
Gloucester County	"While...the General Assembly [has] enacted mandates, I must point out that the General Assembly has not provided the localities with any significant new revenue sources. Without such revenue sources the General Assembly has said in effect go back to your locality and raise the real estate tax rate or the personal property tax rate to meet the cost of these new programs which we have mandated you to provide."
City of Portsmouth	"We cannot look any longer to additional austerity measures to provide the answers to increasing financial demands. The belt has already been tightened; and at this point, the solution to the fiscal problems of the City of Portsmouth must be in the form of increasing revenues, not in curtailing expenditures."
City of South Boston	"The only [unrestricted] source of revenue substantial enough to make any difference is the local property tax....In our case the burden of the property tax as a percentage of local revenue has increased from 39.4% in 1979-80 to 47.4% in the current budget."
Prince William County	"The revenue sources available to cities and counties are not equal. The Commonwealth should treat us the same in terms of distribution of revenues and in the authority to generate revenues."

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Exhibit A (Continued)

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Virginia  
Municipal  
League

"The most common [problem of towns] is 'double taxation' where certain inequities result from town residents paying town taxes to receive certain services and paying county taxes for the same services which they cannot use."

Henry County

"It appears to us that the State will have to do one of two things: it will either have to defray more costs on the local level in some manner, or it will have to give local county governments, especially urban counties, more taxing powers."

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the costs of State mandates. Further, local officials argued that levels of financial support should reflect the level of State involvement in local activities.

Speakers most often pointed to public education as the area where State funding is most seriously deficient. To support their argument that the State's share of elementary and secondary education funding has declined over time, several speakers presented detailed comparisons of local costs for education and State funding. Dissatisfaction with the amount of school aid appropriated by the State was a theme which was repeated in all regional workshops and at the Statewide hearing.

The method used to distribute State aid for education was also the subject of considerable comment. A number of local representatives argued that the basic school aid formula is inequitable in its present form. They recommended that the formula be reconsidered and that changes be made to reflect levels of local tax effort. A number of other local representatives spoke in favor of the basic school aid formula, and asked that it not be reconsidered.

Other areas of State financial assistance were also singled out for comment. City and town representatives indicated that State support of city and town road maintenance should be fully funded by the State, inasmuch as county roads are all maintained by the State. The areas of human services and law enforcement were also cited as needing additional State funds.

### Local Financial Resources

Local taxing authority, as with all local government authority, depends on the actions of the General Assembly. Most workshop and hearing speakers commented on several actions the General Assembly has taken to limit local discretion and flexibility in generating tax revenue.

Many local government representatives testified that existing local revenue sources are inadequate to meet the increasing costs of services. Speakers noted that the State has capped or otherwise restricted tax rates for most local taxes, including business and professional licenses, the consumer utility tax, and the local sales and use tax. This, they observed, has led to an increasing share of local operations being supported by real and personal property taxes. Many of these speakers asked that localities be given greater authority and flexibility to levy taxes.

A number of speakers commented on the disparity in taxing powers between counties and cities. Counties argued that they should have the same taxing authority that cities have because their responsibilities for serving citizens, particularly in urbanized settings, are comparable to those of cities. At present, counties lack the authority granted to cities under the Uniform Charter Powers Act to

levy taxes in addition to those specified by State law. This authority has allowed cities to enact some taxes not generally granted to counties. Counties which want broader taxing authority asked that these distinctions be abolished.

Several town representatives discussed a special concern of town residents: "double taxation." Town officials observed that town residents pay taxes both to the town and to the county in which the town is located. These taxes support some services, such as trash collection, that are offered separately by the town and county. Although town residents only use the town-provided service, they are taxed to pay for both the town and county services. Several town representatives stated that this is a tax burden which should be lifted.

### RESEARCH ACTIVITIES

The concerns of local officials and the language of the study resolution point to three central issues to be addressed by the HJR 105 study:

1. To what extent do State mandates impose a burden on local governments?
2. Is the amount and type of State assistance to localities adequate?
3. Do local governments have sufficient financial resources to fund the public services they must provide?

The research activities for the study have been structured in an attempt to answer these central questions.

#### Special Research Efforts

Four special research efforts are planned for the HJR 105 study: 1) a survey of State agencies, 2) visits to selected localities, 3) a survey of local government officials, and 4) an assessment of the financial conditions in local governments. These four principal research efforts will continue through the remainder of the HJR 105 project.

*Survey of State Agencies.* A survey instrument has been mailed to all State agencies which administer mandates or provide funds to local governments. Agencies have been asked to identify State and federal mandates which they administer, and to list the types of State assistance they provide to local governments.

Follow-up interviews will be conducted with administrators in agencies which have significant contacts with local governments.

Interviews will be used to trace the evolution of State and local service responsibilities, understand the nature and origin of mandates, determine purposes of State aid and the methods of its distribution, and to assess the process for adopting new mandates and adapting existing mandates to different localities.

*Visits to Selected Localities.* A cross-section of counties, cities, and towns will be visited during the course of the study. Visits will be made in order to gather information on how mandates impact localities and on how State aid, federal grants, and local revenues are used to meet local needs. Another objective will be to explore the financial conditions and problems which exist in each locality. Visits will involve broad-ranging interviews with key elected and administrative officials in each locality.

*Survey of Local Government Officials.* The primary means of contacting local officials across the State is through a Statewide survey. Local officials will be surveyed in order to systematically assess their opinions and judgments about State mandates, State assistance to localities, and the adequacy of local financial resources. The survey will also be an attempt to obtain more specific information about difficult mandates, interactions with State agencies, local financial conditions, and other factors.

*Assessment of Local Financial Conditions.* One of the central issues for the HJR 105 study is the adequacy of local financial resources. An important part of this inquiry is to assess the degree to which localities are having difficulties maintaining existing services or adapting services to meet changing conditions. To answer this question, two research approaches have been adopted.

The first approach relies on the judgments and opinions of local officials about financial conditions and problems in their own localities. This information will be gathered from the survey of local officials and through visits to selected localities.

The second approach uses quantitative measures of local financial conditions to guide judgments about which localities are experiencing the greatest financial stress. Indicators which measure the capacity of local governments to produce revenues, the proportion of revenue capacity tapped to generate tax revenues, and the service activities of local governments will be used. These indicators will be examined for a five-year period to determine how financial conditions have changed over time. Another important aspect of this approach is that localities will be compared primarily to other localities which have similar economic, social, and size characteristics.



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## II. LOCAL GOVERNMENTS IN VIRGINIA

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Virginia's local governments constitute a vital element of public management in the Commonwealth. As the units of government closest to the Commonwealth's citizens, local governments are called upon to respond to and meet the many and varied service needs of their populations. They are also required to respond to additional priorities and responsibilities prescribed by the State and federal governments. In FY 1981, Virginia's 95 counties and 41 cities spent over \$4 billion in attempting to meet these obligations. In addition, cities and counties carried a total debt of almost \$2.7 billion. The expenditures and debts of Virginia's 189 towns would add significantly to these totals.

This chapter provides background information on the status of Virginia's local governments. It also focuses on the three areas of central concern for the HJR 105 study: State mandates, State assistance to localities, and local financial resources.

### ORGANIZATION, STRUCTURE, AND STATE MANDATES

Local governments in Virginia are creatures of the State. They may exercise only those powers that are expressly delegated to them through the State Constitution or legislative acts. This limit to the powers of local governments, which is informally known as Dillon's Rule, has been accepted as valid in Virginia for almost 100 years.

Virginia's 1971 Constitution grants the General Assembly very wide latitude to define the powers and responsibilities of local governments. This authority may be exercised either through general laws, which apply equally to all local governments, or through special acts, which apply only to specified localities. Article VIII of the Constitution states that:

- The General Assembly shall provide by general law for the organization, government, powers, change of boundaries, consolidation and dissolution of counties, cities, towns, and regional governments . . . .
- The General Assembly may also provide by special act for the organization, government, and powers of any county, city, town, or regional government . . . .

Few substantive checks exist on the General Assembly's authority to define the roles and functions of local governments.

## Virginia's Counties, Cities and Towns

By national standards, the organization and structure of Virginia's local governments is relatively simple. Virginia's total of 325 local governments places it 43rd nationally in the number of local governments in each state. And the number of basic forms of local government in Virginia--counties, cities, and towns--is far fewer than in most other states.

Counties, cities, and towns are the only constitutionally recognized forms of local government in Virginia. Their governmental powers and structures are specified in the *Code of Virginia*. Additional powers enjoyed by cities and towns are included in municipal charters, which are special acts of the General Assembly.

*Counties.* Virginia's 95 counties differ widely on almost any dimension of comparison. They range in population from almost 600,000 to slightly less than 3,000. They range in size from over 1,000 square miles to only about 24 square miles. And they vary widely in the types of services they provide and in the characteristics of their populations.

In practice, counties fill two principal roles. First, they fill a historical role as administrative "arms of the State." In this role, counties are required to carry out a number of State functions. Counties are required to administer elections, support local constitutional officers, collect State income taxes, and provide court facilities. They must also participate in other activities which are partly State functions, including operation of local welfare departments and public school systems.

Counties have a second role as units of local government. In this role, counties tax local businesses and citizens, appropriate and spend revenues, and provide a variety of other local services. These local services may include sewerage and water, solid waste collection and disposal, police and fire protection, recreation, and others.

As many counties have grown and become more urban, the number of distinctions between Virginia's counties and cities have lessened. Many counties have begun to provide services typical of cities and some towns. In recognition of these changes, the General Assembly has given counties almost all the powers granted to cities under general law. Counties, however, still do not possess the broad grants of authority given to municipalities under municipal charters. Counties must therefore continue to rely on general law or special acts for authority to carry out their activities and functions.

*Cities.* Virginia's cities are also diverse. They range in population from about 267,000 to less than 5,000. They range in area from over 400 square miles to under two square miles. And they also differ greatly in the characteristics of their residents and in the services they provide.

The Constitution of 1971 defines cities as "independent municipal corporations." Cities in Virginia are therefore politically and territorially independent of the counties which surround them. Although there are isolated examples of independent cities across the nation, Virginia is the only State whose cities all enjoy independent status.

Like counties, Virginia's 41 cities also serve dual functions as administrative "arms of the State" and as separate units of local government. Cities support local constitutional officers, collect State income taxes, and provide court, jail, welfare, and school facilities and services. As units of local government, they also tax, appropriate revenue, and provide a variety of local services required by their residents. Virginia's cities do, however, differ from counties in one key respect--the ability to govern through municipal charters.

Municipal charters are special acts of the General Assembly which set forth the governmental structure, functions, and powers of each municipality. Charters grant municipalities broad authority over the operations of their own local governments. Within limits specified by general law, charters are also tailored to allow substantial flexibility in meeting local needs. In some cases, charter provisions allow municipalities to carry out some functions and to levy some taxes not granted to counties under general law.

*Towns.* Virginia's 189 towns range in population from almost 31,000 to less than 100. Fourteen towns have populations greater than the smallest city. Most towns, however, have few residents. Only 26 of the State's towns have populations which exceed 3,500.

Like cities, towns are legally defined as municipal corporations. Towns therefore have the right to frame and request legislative enactment of municipal charters. Charter authority gives towns broad discretion in organizing and conducting their affairs.

Unlike cities, however, towns are not territorially independent of their surrounding counties. Towns therefore do not operate as administrative agents of the State. Town residents receive some services from adjacent counties and must pay some county taxes to support them. Most often, these services include public education and welfare services. Town residents also pay taxes to the town to support town activities.

Little data exists on the types of services provided by the State's 189 towns. The final HJR 105 report will attempt to describe town services and activities more fully.

*Other Political Subdivisions.* Although Virginia's Constitution only recognizes three forms of local government, general laws provide enabling legislation for a variety of special political subdivisions which serve local or regional interests. Special-purpose

subdivisions allow local governments additional flexibility in financing high-cost services, in targeting services to selected areas or populations, and in cooperating with other local governments. Examples of these subdivisions include community services boards, water and sewer authorities, industrial development authorities, sanitary districts, airport authorities, and redevelopment and housing authorities. A 1977 survey conducted by the Department of Housing and Community Development showed 219 special-purpose subdivisions then in existence in the State.

### State Mandates: Virginia in Relation to Other States

Many of the operations of local governments are required or defined by State mandates. State mandates affect the organization, staffing levels, services provided, administrative procedures, and budgets of all of Virginia's local governments. Many local government officials contend that State mandates limit local flexibility, strain local financial resources, and represent an undue local burden. A major thrust of the HJR 105 study will be to examine these issues.

Mandates are generally defined as constitutional, statutory, or administrative actions that place requirements on local governments. Individual mandates may be both constitutional and statutory, or statutory and administrative, at the same time. Mandates may also be compulsory requirements, conditions of financial assistance, or requirements for engaging in optional local activities.

In the past five years, state mandates on local governments have become issues in many states. At least ten states have commissioned independent assessments of the mandates placed on their local governments. Massachusetts, New York, Georgia, South Carolina, California, and Florida are among them. Some of these state studies have led to statutes requiring that the costs of any new mandates be reimbursed by the state. Others have led to less stringent requirements that proposed mandates include a fiscal impact statement. Virginia is one of 35 states in which legislative proposals affecting local governments must be appended with such a fiscal note.

The controversy surrounding state mandates most often concerns the localities' desire for local flexibility in the face of the state's desire for statewide uniformity. Local governments are generally apprehensive about the stated and hidden costs imposed by state mandates, which are rarely accompanied, they contend, by adequate state funding. Many local governments also question the desirability of preempting local objectives and priorities with state ones.

States most often cite one of four reasons as the rationale for placing mandates on local governments. First, the activity or service may be sufficiently important to require all local governments to comply. Second, the state may regard local uniformity as essential. Third, the state may feel that promotion of a statewide economic or social goal must override local priorities. And fourth, the state may

have decided that shifting a function from the state to local governments would reduce costs or improve service delivery.

*ACIR Study on State Mandates.* In an attempt to discover the extent of the practice of mandating in all 50 states, the U.S. Advisory Commission on Intergovernmental Relations (ACIR) undertook a state-by-state comparison in 1978 (Table 1). ACIR looked for 77 state mandates within five broad functions of local government: personnel, public safety, environmental protection, social services, and education. ACIR concluded that mandates posed significant problems in some states, but that substantial variations existed from state to state.

ACIR ranked Virginia eighth nationally in the number of mandates placed on local governments. Mandates were found in 46 of 77 categories--more than in other southern states. The areas found to be most affected by State mandates were personnel, environmental protection, education, and social services. Although the ACIR study did not examine all functional areas of local government, it did indicate that Virginia may place a larger number of mandates on its local governments compared to most other states..

In undertaking its comparative study of state mandates, ACIR recognized that counting mandates provides a limited view of their overall impact. ACIR therefore undertook a second study in 1981. This study focused on the amount of discretionary authority each state grants to its local governments.

*Local Discretionary Authority.* In its second study, ACIR examined four facets of local government operations: organizational structure, local functions, finance, and personnel. The study attempted to measure the relative autonomy that local governments possess in all 50 states. In its final report, ACIR concluded that Virginia grants its local governments considerable discretionary authority in local operations.

Virginia ranked eighth overall in the degree of latitude it grants its localities. The State ranked considerably above both the national average and most other southern states on each dimension which ACIR reviewed. As with all states, Virginia's cities and towns were judged to have more flexibility than its counties. This was attributed to the broad grants of authority contained in municipal charters.

The ACIR studies provide important perspectives and a preliminary indication of how Virginia stands relative to other states. The message of these studies appears to be that although Virginia imposes a relatively large number of mandates on its local governments, the Commonwealth also grants local governments comparatively broad authority to act.

*HJR 105 Study Issues.* The final HJR 105 report will examine more fully the mandates that the State imposes on its local governments. The report will specifically examine the service responsibilities placed on local governments, and the differences in the responsibilities of counties, cities, and towns. The report will also attempt

Table 1

## THE STATE MANDATING PRACTICE IN 77 SPECIFIC PROGRAM AREAS

	Total Reported Mandates	Local Employees Retirement and Working Conditions <sup>1</sup> (15 mandates)	Police (14 Mandates)	Fire (14 Mandates)	Environ- mental Protection (8 Mandates)	Social Services (6 Mandates)	Miscel- laneous (7 Mandates)	Education (13 Mandates)
<b>United States Average</b>	35	7	7	6	4	1	3	7
<b>New England Average</b>	35	8	7	7	3	1	3	8
Maine	39	11	6*	7*	3	1	3*	8
New Hampshire	40	10	7	9	5	1	4	4
Vermont	31	6	7	6	4	0	2	6
Massachusetts	46	8	10	10	3	0	5	10
Rhode Island	11	NR	NR	NR	NR	NR	NR	11
Connecticut	45	11	9	9	4	2	2	8
<b>Midwest Average</b>	37	6	7	6	4	1	2	10
New York	60	10	11	11	7	6	5	10
New Jersey	45	11	9	7	6	0	2	10
Pennsylvania	41	5	9	9	7	0	2	9
Delaware	21	2	4*	3	0	0	2	10
Maryland	20	2	1	1	2	1	2	11
District of Columbia	--	--	--	--	--	--	--	--
<b>Great Lakes Average</b>	37	5	5	7	3	2	4	7
Michigan	25	1*	3*	2*	5	1	4*	9
Ohio	49	13	10	10	1	2	4	9
Indiana	26	3	5*	8	6	1*	3	NR
Illinois	37	8	7	7	1	2	3	9
Wisconsin	50	11	10	10	3	2	4	10
<b>Plains Average</b>	38	8	8	6	3	2	3	7
Minnesota	41	12	7	5	8	6	4	9
Iowa	33	9	10	8	2	2	2	NR
Missouri	32	8	6	6	3	0	2	7
North Dakota	38	8	7	4	1	6	4	8
South Dakota	39	9	8	7*	3	0	3	9
Nebraska	36	5	8	6	5	1	4	7
Kansas	35	8	9	6	2	0	3	7
<b>Southeast Average</b>	27	5	5	4	3	1	2	6
Virginia	46	10	7	6	8	4	3	8
West Virginia	8	1	2	1	1	0	3	NR
Kentucky	28	5	9	9	1	0	2	2
Tennessee	23	8	9	0	4	0	2	NR
North Carolina	32	6	5	4	1	4	3	9
South Carolina	27	7	6	5	0	NR	3	6
Georgia	25	3	1	4*	7	0	2	8
Florida	43	5	9	7	8	1	3	10
Alabama	11	0*	1	0*	4	0	0*	6
Mississippi	29	6	3	5	2	0	4	9
Louisiana	20	3	8	4	1*	0	0	4*
Arkansas	33	7	5	6	4	0	4	7
<b>Southwest Average</b>	33	7	7	6	2	0	3	9
Oklahoma	25	3	8	6	1	0	0	7
Texas	33	9	6	6	1	0	4	7
New Mexico	36	7	7	5	4	0	4	9
Arizona	39	10	8	5	2	0	3	11
<b>Rocky Mountain Average</b>	36.8	9	7	6	5	3	2	5
Montana	48	13	10	9	5	2*	1	8*
Idaho	41	9	7	6	6	4	3	6
Wyoming	37	8	7	7	4	4	2	5
Colorado	23	6	4	4	4	4	1	NR
Utah	35	8	7	5	5	0	2	8
<b>Far West Average</b>	46	6	5	9	5	1	3	8
Washington	46	12	8	8	6	0	3	9
Oregon	45	12	9	10	3	0	4	7
Nevada	44	11	9	8*	3	2*	3	8
California	52	10	10	7	7	6	4	8
Alaska	39	8	9	8	3	0	2	9
Hawaii	49	13	10	10	6	0	1	9

\* = No response to two or more specific mandates within the category.

<sup>1</sup> Other than police, fire and education

Source: ACIR, *State Mandating of Local Expenditures*, 1978.

to examine the organizational, administrative, and budgetary impacts of mandates on local governments.

The final report will examine the extent to which State-mandated services dominate the activities of local governments, and whether State mandates allow localities sufficient flexibility in their implementation. The report will also catalogue mandates seen by localities as particularly constraining.

## LOCAL FINANCIAL RESOURCES

Local governments use the revenues they generate and receive in order to meet local service demands, as well as to comply with State and federal mandates. Although service requirements vary substantially among localities, they can and typically do include demands for water supply, sewer facilities, a road system, schools, law enforcement, fire protection, health and welfare services, parks and recreation facilities, and other services. While revenues to meet these responsibilities come partially from State and federal aid, most local financial resources must be generated by the localities themselves.

Although the 1970s was a period of real growth for local governments, recent conditions have caused many local governments to retrench. Increasing service costs, limited revenue growth brought about by a stagnant economy, and the partial withdrawal of federal aid have created financial stress for many localities.

A central question for the HJR 105 study is whether local governments have sufficient financial resources to fund the public services they must provide. The study resolution specifically directs an assessment of "sources of revenue that are or could be allocated to . . . local governments, and the adequacy of those sources." A major element of that question is whether the amount and type of State assistance to localities is adequate.

### Overview of Local Government Finances

Virginia's local governments have grown substantially over the past decade. Total local revenues grew 179 percent between FY 1971 and FY 1981. Local expenditures increased 139 percent over the same period, and the number of local government employees grew by two-thirds. Much of this growth can be attributed to increased local service demands, an increased flow of federal funds to local governments, and the recognition that more and better-trained staff were needed to administer increasingly complex federal and State programs.

Since the mid-1970's, however, local governments have been faced with revenues which have not kept pace with inflation. Reports from the Auditor of Public Accounts indicate that total local revenues grew 32 percent between FY 1976 and FY 1981, while the inflation rate

exceeded .57 percent. The result for many local governments has been re-examination of local priorities and management practices, increased local taxes, or reduced services.

*Local Government Revenues.* To fund their operations, local governments receive or produce revenues from a variety of local, State, and federal sources. In FY 1981, Virginia's cities and counties received a total of more than \$4 billion from these sources.

The majority of all revenues used by local governments are generated locally. Locally produced revenues come from local taxes, permits and licenses, court fines, service charges, investment interest, property rental and sale, and a number of other sources. Almost 60 percent of total local revenues are produced from these local sources (Figure 2). This percentage appears to have been stable over the past 10 years and does not appear to vary significantly among cities and counties.

State financial assistance is the second most important source of local government funds. State aid to localities comes in the form of revenue sharing grants, as aid for specific categorical programs, and through State service payments in lieu of local property taxes on State-owned property. As Figure 2 indicates, about 30 percent of total local revenues are provided by the State.

There appears to be little difference between cities and counties in the share of total revenue represented by State aid. Figure 2 does show, however, that State aid increased in importance between FY 1980 and FY 1981. This is due primarily to the General Assembly's 1980 funding of aid for localities with police departments, State assumption of some costs of local constitutional officers, and increases in State aid for maintenance of highways in cities and towns.

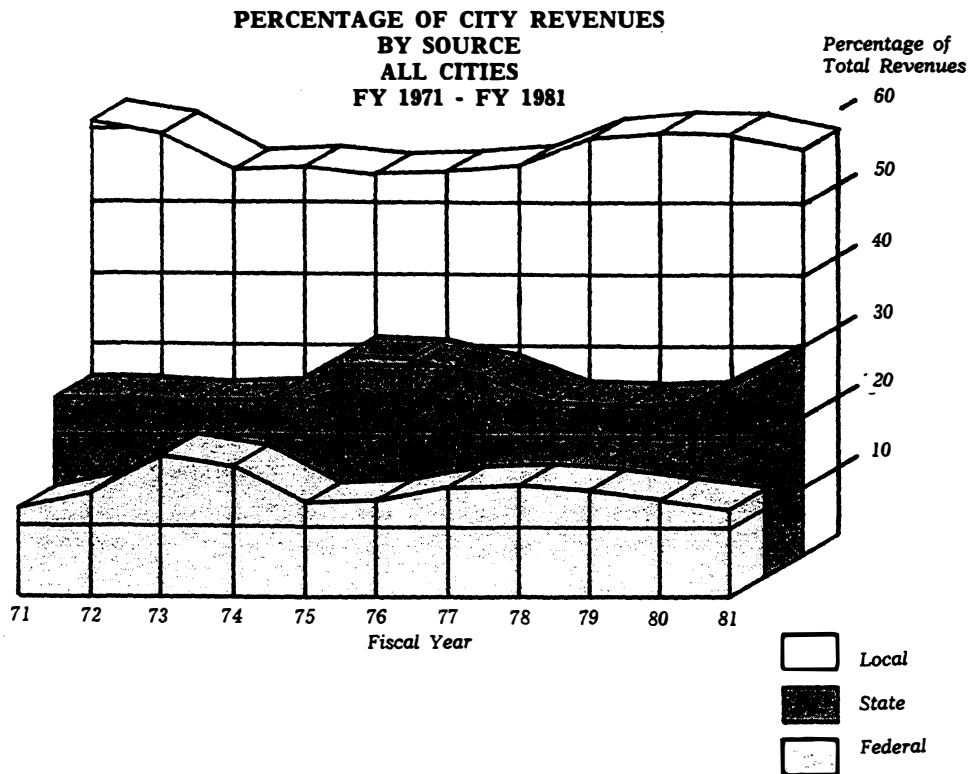
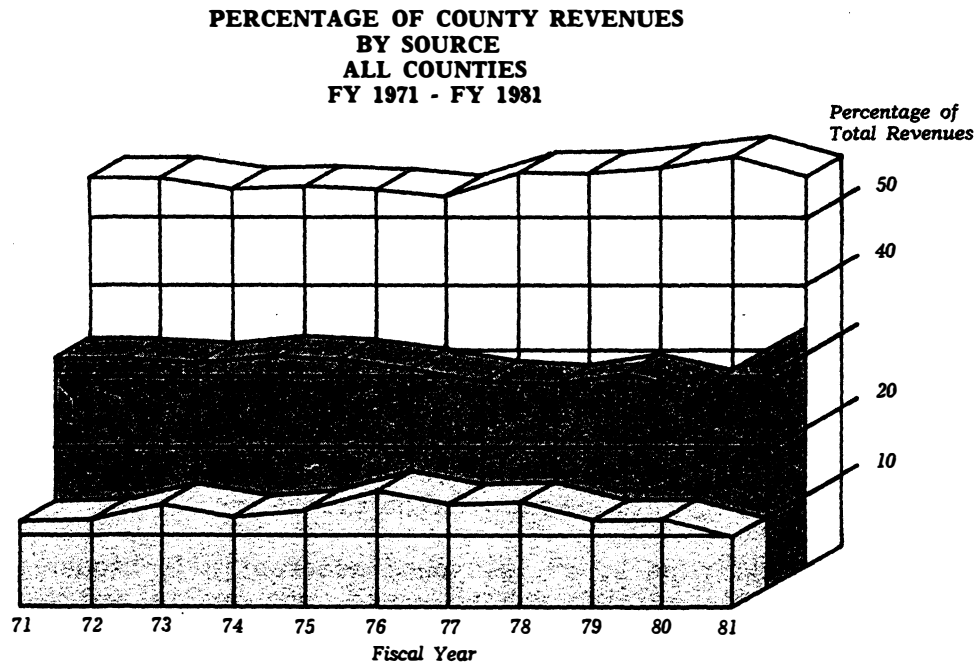
Federal aid is the third principal source of local revenue. Federal aid from general grants, categorical aid, and payments in lieu of taxes represents about 10 percent of local revenues. Local dependence on federal aid has declined to this level from its mid-1970s peak. Nevertheless, the dollar magnitude of federal aid remains significant. The Auditor of Public Accounts (APA) indicates that Virginia's cities and counties received \$443.8 million in federal aid in FY 1981.

Cuts in federal aid continue to occur as a result of the Reagan administration's attempts to reduce federal deficits and return more program responsibility to the states. The impact of such cuts on Virginia's local governments is difficult to gauge at this time, however. The APA's comparative cost reports do show that local governments received \$44.3 million less in federal aid in FY 1981 than they did in FY 1980. The magnitude and impact of federal budget cuts on local governments will be examined in more detail in the final HJR 105 report.



Figure 2

## SOURCES OF LOCAL REVENUES



Source: Comparative Cost Reports of the Auditor of Public Accounts.

*Local Government Expenditures.* Although most local governments provide a wide array of services and facilities, the budgets of cities and counties are dominated by five functions: education, public safety, public works, capital outlay and debt service, and health and welfare. These functions together accounted for 88 percent of city and county spending in FY 1981.

There are more similarities than differences in the spending patterns of Virginia's counties and cities (Figure 3). Education dwarfs all other local functions, and is followed in importance by public safety. Moreover, the proportions of total city and county expenditures represented by key local functions are generally close.

There are a few important differences in local spending patterns, however. Counties spend somewhat more per capita for education than cities do, and county budgets show a significantly higher proportion of total spending for education. This may be due to the fact that, for many counties, education is the principal public service demanded. Counties may therefore be able to more fully channel their efforts and spending into education than cities.

For their part, cities spend substantially higher per capita amounts for public safety, public works, and health and welfare services. City budgets reflect these higher expenditures by showing larger proportions of total spending in these categories. Much of these differences can be attributed to the service demands of urban populations. Demands for urban services include additional law enforcement protection, a more extensive road network, and sewer and water services. Some city officials also argue that the migration of middle- and upper-income families to suburban counties has also left cities with a more dependent population, requiring a higher level of city health and welfare services.

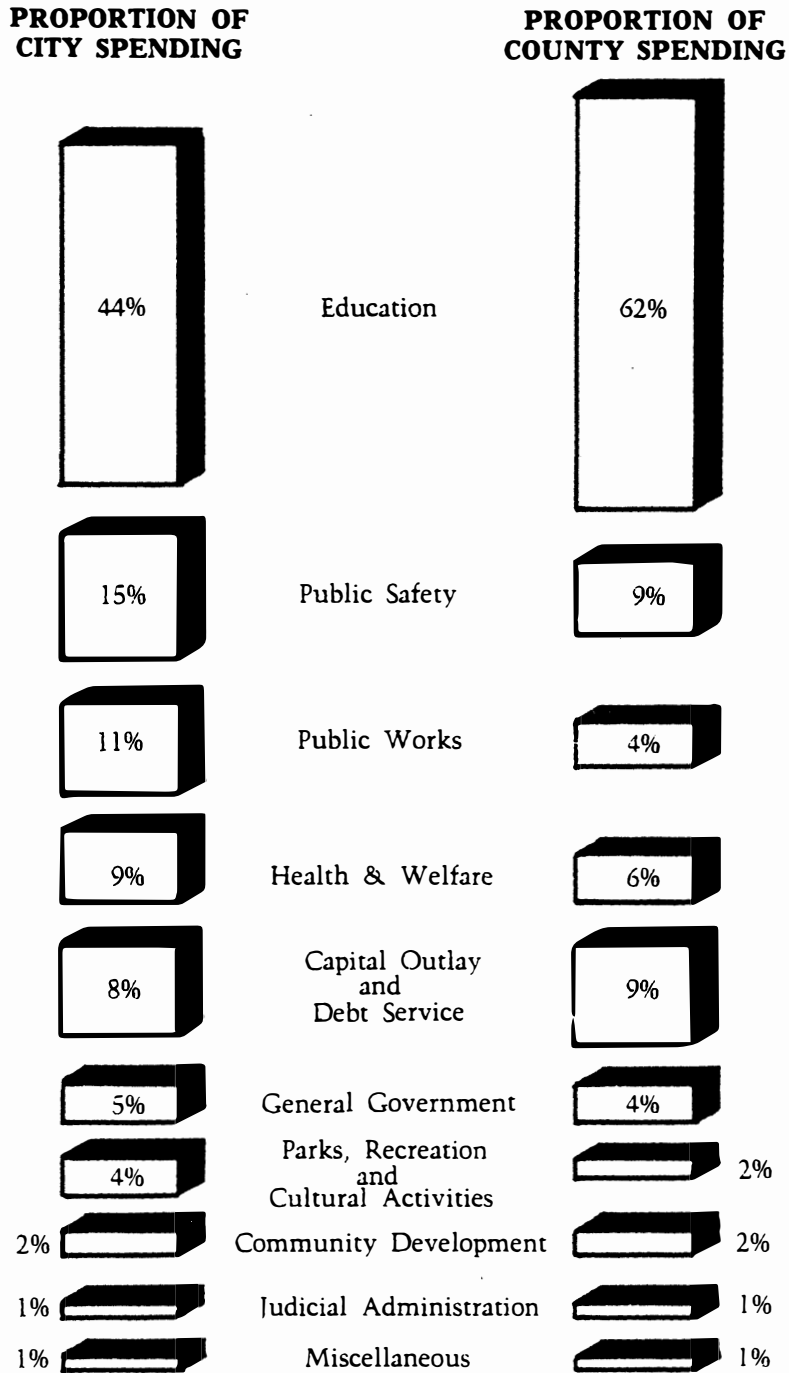
The extreme diversity which exists among Virginia's cities and counties makes it difficult to draw generalizations about local governments. For example, several legislative studies have concluded that urban counties bear greater resemblance to cities than to most other counties. The final HJR 105 report will attempt to probe more deeply into the differences between Virginia's localities. Part of the research effort will focus on identifying the key dimensions on which local governments differ, and on grouping together localities which face similar conditions.

#### State Assistance to Localities

Over time the Commonwealth has assumed a significant role in assisting local governments with services. Responsibility for providing assistance flows from constitutional provisions, statutory decisions, and historical tradition. In some cases, assistance is provided as recognition that local services provide benefits both for the localities and for the Commonwealth as a whole. In other cases, assistance is provided because service delivery is regarded as a shared State-local responsibility.

Figure 3

**CITY AND COUNTY EXPENDITURES, FY 1981**



Source: Comparative Cost Reports of the Auditor of Public Accounts.

A major portion of the Commonwealth's annual budget is spent to provide aid to localities. The Comptroller of the Commonwealth estimated that in FY 1981, \$2.6 billion in State funds was spent aiding localities. Almost all of this amount was spent either to provide direct State services to localities or to disburse financial assistance to local governments.

*Direct Services.* Direct services are services provided to local clients or local governments by State agencies. They are sometimes described as expenditures on behalf of local governments since they do not involve the transfer of funds to local treasuries. Direct services produce benefits for local governments by freeing up local financial resources which would otherwise be absorbed in these activities. Many of the functions for which direct services are provided are seen primarily as State responsibilities or as joint State-local functions.

The Auditor of Public Accounts reported that in FY 1981 direct services on behalf of local governments totalled \$843.3 million. Three agencies account for almost all listed expenditures: the Department of Highways and Transportation (DHT), the Department of Social Services (DSS), and the State Department of Health (SDH).

The Auditor identified \$633.1 million of DHT's expenditures for FY 1981 as spending on behalf of local governments. This amount includes virtually all DHT spending to construct and maintain the Commonwealth's roads, streets, and bridges. Although road construction and maintenance provides at least indirect benefits for localities, not all road spending should be considered a direct service to localities. Major portions of spending for interstate highways and some primary roads should probably be excluded, since such spending serves regional and national, as well as local, purposes. A more precise estimate of DHT's direct service spending will be prepared for the final report.

The Department of Social Services' principal direct service to localities is direct payment of financial assistance benefits to local recipients of Aid to Dependent Children (ADC). DSS spent \$177.7 million for ADC payments in FY 1981. This amount does not include any administrative overhead associated with preparing the checks and mailing them to local clients. DSS assumed this responsibility from local welfare agencies in 1978, in an attempt to increase efficiency and reduce total costs.

The State Department of Health (SDH) is the third key provider of direct services to localities. SDH provides the majority of total funding for and administers the operations of 134 local health departments Statewide. State spending to support local health departments totalled \$35.3 million in FY 1981. Although all local health departments are operated under contractual agreements between the State and the localities that contribute a share of total funding, all staff are employed by the State.

Although the APA reports provide the best available estimate of direct service spending, some expenditures are not included. For example, patrolling and accident investigation on county secondary roads by the State Police is a key direct service which is not listed. The final HJR 105 report will attempt to identify all major instances of direct service assistance to localities and estimate total direct service spending by the State.

*Financial Assistance.* As with direct services, State financial assistance represents a significant commitment to aid localities. Over the past ten years, State financial aid has been the most rapidly growing component of local government receipts. In FY 1981, 29 State agencies distributed State aid totalling almost \$1.3 billion to local governments or regional commissions and authorities. An additional \$280 million in federal funds was "passed through" State agencies to localities.

Most State aid can be described either as shared revenue or as categorical aid. Shared revenue includes all State funds disbursed to localities without requirements as to how localities use them. Categorical aid represents funds whose purpose and use is specified.

In FY 1981, about \$71.8 million in State revenue sharing funds were distributed to local governments. All but a fraction of this amount came from four sources--grants to localities with police departments, the local share of profits from Alcoholic Beverage Control taxes, the local share of wine and spirits taxes, and local distribution of the mobile home tax. Together these sources accounted for over 97 percent of revenue sharing funds (Table 2). Other sources of revenue sharing funds include the excess fees of court clerks, the rolling stock tax, and shared admissions taxes for boxing and wrestling events. One other source of revenue sharing funds--a tax on the rental of passenger cars--went into effect on July 1, 1981.

Most State financial assistance is earmarked for specific programs or purposes. This includes over \$1.2 billion in State funds and all federal funds distributed by 26 State agencies (Table 3). Assistance to categorical programs varies widely in size and scope, from very broad, complex and ongoing funding to narrow and limited individual grants.

The distribution of categorical aid is concentrated in five agencies--the Department of Education, the Department of Social Services, the State Compensation Board, the Department of Highways and Transportation, and the Department of Mental Health and Mental Retardation. These agencies together accounted for over 95 percent of the categorical aid disbursed to localities in FY 1981. Over 74 percent of the total, or \$1,107.6 million, was distributed by the Department of Education alone.

Table 2

## PRINCIPAL SOURCES OF STATE REVENUE SHARING

<u>Title</u>	<u>Description</u>	<u>FY 1981 Total</u>	<u>Method of Distribution</u>
Grants for localities with police department	General Fund appropriation	\$44.7 million	Multi-factor formula
ABC tax profits	Two-thirds of net profits over \$750,000	\$19.3 million	Population
Wine and spirits taxes	22 percent of taxes on wine	\$2.9 million	Population
Mobile home tax	3 percent of sales price	\$2.9 million	Distribution to home locality
Rental tax	2 percent of proceeds from passenger car rental	*	Distribution to locality of origin

\*Took effect in FY 1982.

Source: Commonwealth Accounting Reports System; *Code of Virginia*.

State financial aid for education is a complex amalgam of categorical programs and shared revenue. It is disbursed to meet the constitutional requirement that the costs of public education be apportioned between State and local governments by the General Assembly. Much of the aid is distributed to localities on the basis of several statutory formulas passed by the legislature. State aid for education can generally be grouped into three categories -- basic aid, special revenue sharing funds, and categorical programs.

Basic aid for education represents slightly less than half of total State aid for education. It amounted to \$445.6 million in FY 1981. Basic aid is intended to cover the State's share of the costs of meeting standards of educational quality promulgated by the General Assembly. Basic aid funds are distributed on the basis of each locality's school enrollment and relative ability to pay.

About one-fourth of State aid for education is in the form of special shared revenue. Special revenue sharing funds are the proceeds from one percent of the State's retail sales tax, which is earmarked

Table 3

SOURCES OF CATEGORICAL AID  
FY 1981  
(dollars in millions)

<u>Agency</u>	<u>State Funds</u>	<u>Federal Funds</u>	<u>Total</u>
Department of Education	\$ 945.4	\$162.2	\$1,107.6
Department of Social Services	44.3	83.2	127.5
State Compensation Board	83.7	--	83.7
Department of Highways and Transportation	65.3	--	65.3
Department of Mental Health and Mental Retardation	33.6	5.5	39.1
Department of Corrections	25.0	.2	25.2
Department of Aviation	1.0	11.4	12.4
Commission on Outdoor Recreation	.1	5.7	5.8
Virginia State Library	4.0	.8	4.8
Division of Criminal Justice and Crime Prevention	.2	4.1	4.3
Department of Housing and Community Development	1.4	.7	2.1
Office of Energy and Emergency Services	--	1.8	1.8
Department of Transportation Safety	.1	1.6	1.7
State Board of Elections	1.7	--	1.7
Virginia Commission on the Arts and Humanities	1.1	.4	1.5
Office on Aging	.1	1.4	1.5
10 Other Agencies	3.6	.7	4.3
TOTAL	<u>\$1,210.6</u>	<u>\$297.7</u>	<u>\$1,490.3</u>

Source: Commonwealth Accounting and Reporting System, 1981.

for public education. Distribution of funds is based on the size of each locality's school-age population. In FY 1981, special revenue sharing funds totalled \$243.3 million.

The remaining one-fourth of State education assistance provides a share of costs for several categorical programs, each of which has its own distribution formula or method. The remaining portion also funds the employer's share of retirement, social security, and group life insurance for public school employees.

The Department of Social Services disburses the second largest sum to localities. In FY 1981, DSS distributed \$127.5 million to the State's 124 local welfare agencies. This amount was used to cover the federal and State shares of most financial assistance programs, social service expenditures, and local agency administrative costs. Distribution of funds is generally on the basis of a percentage of approved costs, with different matching ratios for each financial assistance and service program.

State support of local constitutional officers--sheriffs, Commonwealth's attorneys, treasurers, and Commissioners of revenue--represents the third largest State aid program. Support of constitutional officers totalled \$83.7 million in FY 1981. State aid is distributed by the State Compensation Board, which approves administrative costs, as well as the number and salaries of all support personnel employed by each constitutional officer. State aid is distributed on a "proportion of approved cost" basis, with the specific State percentage set by statute. Salaries of constitutional officers are also set by law, based on the local population and the duties of the officer.

In FY 1981, the Department of Highways and Transportation provided \$65.3 million in financial assistance to localities. About \$48.2 million of this total represented assistance payments to cities and towns which maintain their own roads. Assistance is based on a per lane-mile payment for all streets approved by DHT. In FY 1981, DHT also provided \$7.7 million in aid for 15 mass transit systems, and \$9.4 million in aid to two counties which maintain their own highway networks.

The Department of Mental Health and Mental Retardation (DMHMR) is the fifth largest provider of categorical aid to localities. DMHMR funds up to 90 percent of the approved budgets of 37 Community Services Boards, which provide community mental health, mental retardation, and substance abuse services. In FY 1981, \$39.1 million was disbursed to these boards. The proportion of State funding is determined by a formula which attempts to measure the member localities' ability to support community services.

Although these five agencies provide the vast majority of all State financial aid, numerous other categorical programs exist. For example, the Commonwealth funds a share of the construction of local jails, and pays the costs of maintaining State prisoners there. The



Virginia State Library provides funds for the operation of local libraries and for the purchase of books. The State also pays a major portion of the costs of electoral boards. Other programs include grants for the arts and humanities, construction and operation of airports, and development of litter control programs. In all its forms, State financial assistance allows local governments more flexibility in the use of their own resources, while at the same time providing funds to support a Statewide objective.

*HJR 105 Study Issues.* The central issue concerning State aid is whether the type and amount of assistance to localities is adequate. Because current data are limited, the final report will catalogue more completely the types of direct services and financial assistance provided to localities. The final report will also examine whether the State adequately funds its service mandates.

A second key issue related to State financial assistance concerns methods of distributing State aid. The final report will attempt to examine whether the methods of distributing State aid are based on equitable measures and whether the processes used in developing formulas have been reasonable. An effort will also be made to compile all current distribution formulas and methods in one volume.

### Local Taxing Authority

Although the Commonwealth limits the powers of local governments and imposes significant service responsibilities on them, it also grants localities the power to tax. Most of the 60 percent of total local revenues which localities raise themselves comes from local taxes. Locally produced revenues have been the second most rapidly growing component of total local revenues over the past ten years--behind State financial assistance.

Local taxing authority is derived from the General Assembly in two ways: (1) through general laws which apply equally to all localities and (2) through special authority granted to individual localities by special legislative acts.

Cities and towns possess broader taxing powers than are granted to counties. For example, the Uniform Charter Powers Act grants cities and towns the power to "raise annually by taxes and assessments on property . . . and other subjects of taxation" the funds needed to finance the government. Cities and towns may therefore levy taxes not prohibited by general law, if the levy is consistent with their own charters. Because counties lack charters, they must rely on special acts of the General Assembly to levy taxes not granted under general law.

Towns possess one other unusual power: the power to preempt certain county taxes. Several general laws provide that if a town levies certain taxes, the county may not levy the same taxes within the

town. Most of these laws are intended to allow towns a stable and predictable source of revenue, without permitting excessive double taxation of residents and businesses. The right of preemption exists for several key taxes, although it does not exist for real and personal property taxes, the two most significant sources of local tax revenue.

Over the past ten years, several legislative studies have examined individual local taxes. A consistent theme of these studies has been the need to ensure that rates for individual taxes do not become excessive. Most of these studies resulted in the placement of caps on the maximum tax rates which can be charged by localities. Statutory maximum rates are now in place for most major local taxes. Real and personal property taxes are the key exceptions. Many local government officials contend that these caps on tax rates have unduly limited their ability to raise revenue.

Although there is substantial variation from locality to locality, both cities and counties rely on the same major taxes (Table 4). (Data currently available does not permit a similar analysis for towns.) Cities and counties derive the bulk of local tax revenues from real property taxes, personal property taxes, local sales and use taxes, consumer utility taxes, and business and occupational license taxes. These five taxes accounted for 92 percent of city tax revenues and 94 percent of county tax revenues for FY 1981. All five are granted under general law. The key features of the principal local taxes are summarized in Table 5.

*Real Property Tax.* All of Virginia's local governments are highly dependent on the real property tax, which is the most complex and controversial of all local taxes. In FY 1981, real property taxes produced 47 percent of all locally raised city revenue and 61 percent of all locally raised county revenue.

In levying a real property tax, local governments tax the assessed value of privately owned property. There is no upper limit on the tax rate that may be imposed by a local government. In 1980, effective real property tax rates ranged from 13 cents per \$100 of assessed value in Cumberland County to \$2.07 per \$100 of assessed value in Manassas Park.

Several types of special purpose or special assessment districts are also empowered to levy real property taxes. Sanitation districts, fire service districts, and mosquito control districts are examples. Levies for these entities are generally collected by the local government and appropriated for use by the special district.

Assessment procedures of local governments are a sensitive area of real property tax levies. Inconsistencies in local practices led the 1975 General Assembly to enact laws requiring assessment at 100 percent of fair market value. In 1976, additional laws were enacted requiring general reassessments at least every two years for cities and every four years for counties. These provisions have since been modi-

Table 4

PRINCIPAL LOCAL TAXES

<u>Tax</u>	<u>Number of Cities and Counties Levying</u>	<u>Proportion of Local City Revenue</u>	<u>Proportion of Local County Revenue</u>
Real Property Tax	136	47%	61%
Tangible Personal Property Tax*	136	13	16
Local Sales and Use Tax	136	12	10
Consumer Utility Tax	76	11	4
Business, Professional, and Occupational License Taxes (BPOL)	62	9	3
Merchants' Capital Tax	65	0	1
Motor Vehicle Licenses	124	2	2
Other Taxes	--	<u>6</u>	<u>3</u>
TOTAL		100%	100%

\*Includes Machinery and Tools tax.

Source: *Code of Virginia*; Auditor of Public Accounts Comparative Reports on Local Governments, FY 1981; Virginia Municipal League Survey of Tax Rates, 1981.

fied to allow more time between reassessments for cities under 30,000 and counties under 40,000. Nevertheless, over the past eight years the intent of the General Assembly appears to have been to make assessment procedures more uniform among localities.

Although statutes require assessment of property at 100 percent of fair market value, the Virginia Constitution does allow some exceptions. Special assessment procedures are allowed for agricultural, horticultural, forest, and open-space lands. Where special assessment procedures are adopted, assessments are based on the value of land used for similar purposes. In practice, special assessment procedures have resulted in lower effective tax rates in many localities.

## PRIMARY LOCAL TAXES LEVIED UNDER GENERAL AUTHORITY

<u>Revenue Source</u>	<u>Description</u>	<u>Statutory Limits</u>
1. Real Property Tax	<p>Tax applied against value of taxable property</p> <p>Rates set annually by locality</p> <p>Assessment required at 100% of fair market value</p> <p>Special assessments for agriculture, forest, and open space uses</p>	<p>No limitations in rate, but must be uniform within district</p> <p>Complete or partial exemptions for government-owned property, churches, and charitable groups</p> <p>Local option exemptions allowed for elderly and disabled</p>
2. Personal Property Tax	<p>Tax applied against value of tangible personal property</p> <p>Rates set annually by locality</p> <p>Different rates may apply to each class of property, as defined in <u>Code</u></p> <p>Different valuation methods may apply to different property categories, as defined in <u>Code</u></p>	<p>No limitations on rates</p> <p>Complete or partial exemptions for State property, churches, and charitable groups</p>
3. Sales and Use Tax	<p>Tax applied against same items as State sales tax</p> <p>Local option add-on to State tax</p> <p>Collected by State Tax Department</p>	<p>Rate allowed is 1%</p>
4. Consumer Utility Tax	<p>Sales tax applied against utility services</p>	<p>Rates cannot exceed 20% of each utility bill</p>

	Includes water, natural gas, telephone and electricity	Tax applies only to first \$15 of each bill
	Excludes propane, firewood, coal, and residential fuel oil	Localities with higher rates as of July 1, 1972 may continue higher rates
		Town tax preempts county tax under certain conditions
5. Motor Vehicle License Tax	License tax applied on all motor vehicles owned by residents or businesses in a locality	Rate cannot exceed State charge for vehicle licenses
		Town license tax preempts county tax
		Rental passenger vehicles are excluded
6. Business, Professional, and Occupational License Tax (BPOL)	License tax applied against proportion of gross receipts, as flat fee, or both	Effective tax rates limited by statute
	Taxes the privilege of engaging in a trade or business	Localities previously above maximum rate must begin reducing rate by January 1, 1983
		Cannot be used by locality levying merchants' capital tax
		Town BPOL tax preempts County BPOL tax
7. Merchants' Capitol Tax	Tax applied against value of merchants' capital on tax day	Rate cannot exceed that in effect on January 1, 1978
	Capital defined as value of inventory, accounts receivable minus payable, and tangible in-fact property	Cannot be used by any locality imposing BPOL tax

Property owned by public service corporations represents a unique class of real property for tax purposes. Property in this class includes land owned by railways, public utilities, and pipeline companies. Assessment for these companies is conducted by the State Corporation Commission. Although not all public service property is assessed at 100 percent of fair market value, laws do provide for incremental increases in assessment rates until the 100 percent level is reached.

Exemption of certain property from real property taxes has been a continuing problem for some localities. At present, a variety of exemptions exist, including all government-owned property, church facilities, and educational institutions. In some localities, these exemptions apply to over half of all real property. Local officials in these localities argue that exemptions concentrate the tax burden on non-exempt property and limit local tax flexibility.

In addition to these required exemptions, local governments may provide optional exemptions or tax relief for a number of other types of property. These types of property include privately owned public-use airports, rehabilitated housing, and property owned by the elderly and handicapped.

*Personal Property Taxes.* All of Virginia's cities and counties levy taxes on tangible personal property. Levies on personal property are the second most important source of local tax revenue. As with real property taxes, taxes are applied against the value of taxable property, and there is no maximum rate that may be charged. Personal property taxes may also be levied by special assessment districts.

The *Code* allows localities to set different tax rates for different classes of personal property. For example, farm animals and machinery, boats, mobile homes, aircraft, antique automobiles, heavy construction machinery, and specified other classes of personal property may each be taxed at a different rate. The principal limitation is that property defined within each class must be taxed at the same rate. These special rates also may not exceed the general rate applied to most forms of personal property.

Assessment procedures for personal property vary substantially from locality to locality, and the *Code* offers local governments only general guidance on this subject. The *Code* defines categories of personal property for valuation purposes, requires valuation methods to be consistent within categories of property, and requires that a reasonable determination of fair market value be made.

*Local Sales and Use Tax.* The only other tax levied by all of the State's cities and counties is the sales and use tax, a one percent add-on to the State's sales tax. In FY 1981, the local option sales tax accounted for about 10 percent of the tax revenue raised by cities and counties.

Because the local sales tax is piggy-backed on the State tax, it is basically applied to the same items and transactions. The tax is collected for local governments by the State Department of Taxation and is returned to the locality where the tax was paid.

An unusual feature of the local sales tax is that counties must share sales tax revenue with their incorporated towns. Towns which do not operate schools are eligible for up to one-half of sales tax revenue, based on their proportion of the school-age population within the entire county. Towns which do operate schools are eligible for a percentage of total local sales tax receipts that equals their proportion of the county's school-age population.

*Consumer Utility Tax.* Most cities and about half of all counties levy a consumer utility tax, which is often described as a sales tax on utility services. Sales of electricity, natural gas, telephone services, and water are taxed and taxes are levied as a percentage of each bill. In FY 1981, consumer utility taxes produced 11 percent of city-raised revenues and about 4 percent of county-raised revenues.

The General Assembly's concern about the impact of utility taxes on residential consumers led to placement of a cap on rates in 1971. Rates were limited to 20 percent of the first \$15 of each residential utility bill. Localities which were charging higher rates on July 1, 1972 were permitted to continue charging existing rates, but were not permitted to increase them. In 1978, 16 localities charged rates above the statutory maximum. No limit was placed on tax rates for commercial and industrial consumers.

Under certain conditions, towns which levy a consumer utility tax may preempt consumer utility taxes levied by the county. If a town provides police or fire protection and water or sewer services, the town tax supersedes the county tax. If a town operates its own schools, it may also preempt the county's consumer utility tax.

*Business, Professional, and Occupational License Taxes (BPOL).* Among the most involved of local taxes are business, professional, and occupational license taxes, which apply to businesses, trades, occupations, professions, and to the firms conducting them. BPOL levies tax the privilege of engaging in a trade or business. They are generally levied as a proportion of gross receipts, although they may also be levied as a flat fee, or as both a flat fee and a percentage of receipts. Substantial variations in rates, classification of occupations and businesses, and manner of levying the taxes exist from locality to locality.

As with the consumer utility tax, the General Assembly's concern about excessive taxes led to placement of a cap on BPOL taxes in 1978. Localities which charge a rate above the maximum must begin rolling back tax rates by January 1, 1983.

There are two other unusual features of BPOL tax provisions. First, no county may levy a BPOL tax within a town which levies a similar tax, without the approval of the town's governing body. Second, localities which levy BPOL taxes on merchants may not levy a merchant's capital tax.

*Merchants' Capital Tax.* Many counties which are prevented from levying BPOL taxes within towns have adopted taxes on merchants' capital. Sixty-five counties currently levy a merchants' capital tax, although it produces only about one percent of the total tax revenue raised by counties.

Merchants' capital taxes are applied against the value of capital on a specified tax day. The Code defines capital as the value of inventory, accounts receivable minus accounts payable, and the value of certain other intangible property. In practice, however, most counties levy the tax only on a merchant's inventory.

As with most taxes, a maximum rate is specified by law. Rates for merchant's capital taxes cannot exceed those in effect on January 1, 1978. In addition, localities imposing a BPOL tax on merchants may not levy a merchants' capital tax.

*Other Taxes Levied Under General Authority.* Localities may levy a variety of other taxes under general authority. Although these taxes produce small amounts of revenue Statewide, they do produce significant tax revenue in some localities.

Motor vehicle license taxes are imposed in 124 localities. These annual licenses account for 2 percent of city and county tax revenues, and are levied on each motor vehicle registered in a locality. Rates may not exceed license fees charged by the State.

All cities and counties may also levy a severance tax on the value of coal or natural gas extracted from the earth. At present, only five counties levy this tax, which is imposed on one percent of gross receipts. In these localities, however, the tax produces a major proportion of total tax revenue.

A variety of other taxes exist under general authority, including the utility license tax, alcoholic beverage license tax, capitation tax, recordation tax, bank franchise tax, and the tax on wills and grants of administration. Most account for very small proportions of local tax revenue.

*Taxes Levied Under Charter Authority or Special Act.* Cities and a few counties are authorized by charter or special legislative acts to levy additional taxes. Most of these taxes have been studied over the past five years by special legislative subcommittees.

Taxes granted under charter or special authority remain a subject of controversy, and are often cited in the debate over the taxing authority granted to local governments. Many county officials



contend that all localities should be granted authority to levy these taxes, while many city officials oppose any proposal to limit the rates they may charge for these taxes.

There are four principal taxes levied under charter or special authority: a transient occupancy tax, a restaurant meals tax, a cigarette tax, and an admissions tax. Although most of these taxes do not produce large amounts of tax revenue, they are very significant sources of tax revenue for a few localities.

The transient occupancy tax is a percentage tax on the room charges and camping fees in hotels, motels, boarding houses, and campsites. Transient occupancy taxes are currently levied in 23 cities and 5 counties. They produce the most significant revenue in localities where tourism is important. Twenty-three cities also levy a percentage tax on the sale of prepared food in restaurants. At present, no county has been granted this authority. The meals tax also produces significant revenue in resort areas.

Cities and a few counties have the authority to levy a tax on cigarettes. The cigarette tax is levied as a cents-per-pack addition to the sales price of cigarettes within a locality. Nineteen cities and two counties currently levy a tax on cigarettes.

Eleven cities also levy an admissions tax on amusements and other theatrical events. Admissions taxes are generally levied as a percentage of the admissions price, and are most often included in the ticket price. Although four counties have been granted authority to charge an admissions tax, none currently imposes one.

*HJR 105 Study Issues.* The principal issue concerning local financial resources is whether local resources are sufficient to fund public services. Because local taxes produce the bulk of local revenues, a parallel issue must be whether local taxing authority is adequate.

The final report will examine more completely the taxing authority which is granted to local governments. The report will also examine the extent to which local governments have used their taxing authority and whether that use has increased over time. Attempts will be made to compare the revenue-producing capacity and tax effort of localities with similar features. Evidence of low revenue capacity or high tax effort may indicate that localities are having difficulty maintaining existing services, and that additional taxing authority or State financial assistance may be warranted.

## CONCLUSION

Virginia's local governments will be faced with significant challenges in the 1980's. Increasing service costs and slowed revenue growth will place localities under pressure to improve their efficiency

and effectiveness. Local governments will also look to the State for relief from mandates which are seen as burdensome, for increased State financial assistance, and for expanded local taxing authority.

In adopting House Joint Resolution 105, Virginia's General Assembly has begun a re-examination of some aspects of State-local relations. In its activities to date, the HJR 105 Committee has sought substantive input from local governments. The Committee has also directed JLARC staff to conduct research to assess the nature of State mandates placed on local governments, the adequacy of State assistance to localities, and the adequacy of local financial resources. The final HJR 105 report will present findings and recommendations which result from continuing staff research.

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**APPENDIX: House Joint Resolution 105**

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HOUSE JOINT RESOLUTION NO. 105

*Specifying a program for review under provisions of the Legislative Program Review and Evaluation Act of 1978, relating to systematic review of state government by the Joint Legislative Audit and Review Commission in the area of general government.*

WHEREAS, the Legislative Program Review and Evaluation Act of 1978 (§§ 30-64 et seq. of the Code of Virginia), provides for the Joint Legislative Audit and Review Commission to conduct a systematic evaluation of state government according to schedules and areas designated for study by the General Assembly; and

WHEREAS, in accordance with Senate Joint Resolution 50 passed by the 1980 General Assembly, the Joint Legislative Review and Audit Commission is now scheduled to review and evaluate the functional area of general government; now, therefore, be it

RESOLVED by the House of Delegates, the Senate concurring, That the Commission shall make an interim report to the Governor and the General Assembly on the functional area of government, focusing on the responsibilities of local governments for providing public services, the differences in the responsibilities of counties, cities and towns, the sources of revenue that are or could be allocated to the various types of local governments, the adequacy of those sources, the Commonwealth's responsibilities for providing public services and procedures for aiding local governments and such other matters as the Commission may direct prior to the 1983 Session of the General Assembly. As part of the interim report the Commission shall identify to the extent feasible all local government mandates and related financial sources contained in each functional area of state government. For purposes of the interim report, the Commission shall coordinate its review effort with a joint committee consisting of three members appointed by the chairman of the House Counties, Cities and Towns Committee, three members appointed by the chairman of the Senate Local Government Committee, three members appointed by the chairman of the House Finance Committee and three members appointed by the chairman of the Senate Finance Committee; and, be it

RESOLVED FINALLY, That the reports, findings and recommendations prepared by the Joint Legislative Audit and Review Commission for the studies to be performed under this resolution shall be transmitted to the appropriate standing committees of the House of Delegates and the Senate, all members of the General Assembly and the Governor.

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