

**REPORT OF THE
JOINT LEGISLATIVE
AUDIT AND REVIEW COMMISSION ON**

**Intergovernmental Mandates
and Financial Aid to
Local Governments**

**TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA**



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Preface

Senate Joint Resolution 45 and House Joint Resolution 156 of the 1990 General Assembly Session directed the Joint Legislative Audit and Review Commission (JLARC) to conduct a follow-up study to the 1983 JLARC report, *State Mandates on Local Governments and Local Financial Resources*. In Senate Joint Resolution 235 (1991 Session), the Commission was directed to further examine State-local relations through an examination of State and local service responsibilities. The issues raised in these resolutions are being examined in two phases. Phase One, addressed in this report, focuses on mandates and local financial resources. Phase Two, which will be reported prior to the 1993 General Assembly Session, examines the service responsibilities of State and local governments.

During the course of this study, local government officials expressed concern that mandates are becoming increasingly burdensome. Their concerns center on two primary issues: an increase in the absolute number and complexity of mandates, and a perceived lack of funding. These concerns appear to have been exacerbated by declines in federal funding during the 1980s and by the current economic downturn.

In some cases these local concerns are warranted. However, the State has played a stable role in providing funding to local governments during the 1980s. Despite stable funding by the State, local financial conditions are cause for concern. Recent economic indicators suggest that, like the State, many local governments are faced with declining revenues. And even during the relatively prosperous 1980s, not all local governments enjoyed high growth in revenue capacity.

This report presents several short- and long-term policy options available to the State to help alleviate the strain mandates can impose on local governments and to ease the current fiscal stresses that local governments face. These options fall under three broad categories: increasing local taxing authority, increasing State financial aid, and improving the mandating process. A companion report, titled *Catalog of State and Federal Mandates on Local Governments* (House Document No. 53), identifies the specific mandates currently imposed on local governments, as well as some local concerns with those mandates.

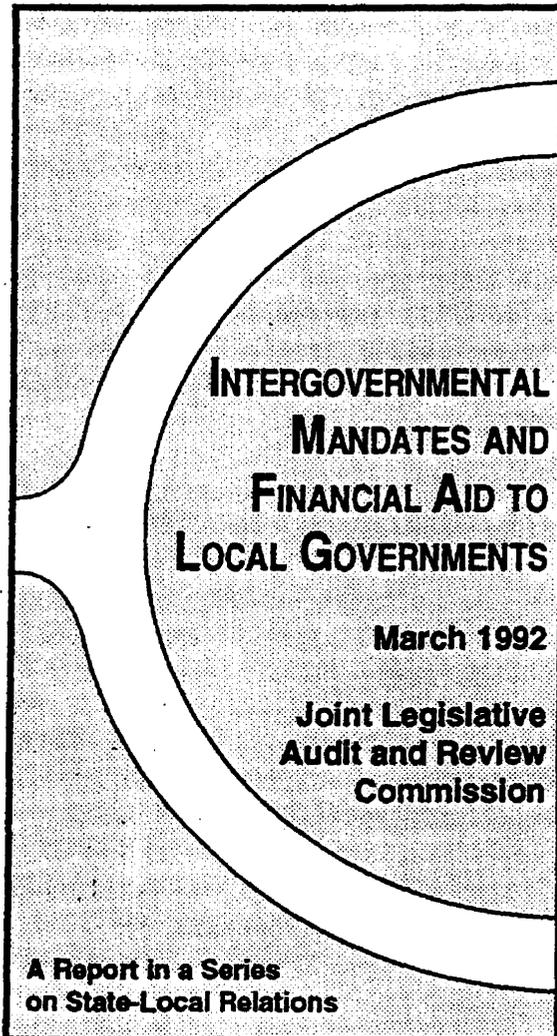
On behalf of the JLARC staff, I would like to thank the State agencies and local governments from which we collected information for their cooperation and assistance during this study.



Philip A. Leone
Director

March 9, 1992

JLARC Report Summary



Local government operations are significantly affected by State and federal involvement through intergovernmental mandates and financial aid. Localities are dependent upon financial assistance to provide mandated services. While mandates are generally considered to be a legitimate means for implementing essential policies and maintaining standard levels of services, local officials are often critical of the manner in which mandates are implemented. In addition, local officials emphasize the burdensomeness of mandate enforcement without, as they per-

ceive, sufficient monetary resources for compliance.

In 1983, the General Assembly directed the Joint Legislative Audit and Review Commission (JLARC) to study State mandates on local governments and local financial conditions. The study found that although there was little consensus on the unreasonableness of specific mandates, localities repeatedly cited funding as a key problem with mandates. In addition, the study noted that many local governments had experienced fiscal stress, and some were facing eroding financial conditions.

The General Assembly, through resolutions adopted in 1990 and 1991, requested that JLARC staff reexamine mandates and financial aid to local governments, and the division of service responsibilities between the State and local governments. The study is being conducted in two phases. Phase One, which is presented in this report, examines issues related to mandates and local financial resources. Phase Two, which will be presented prior to the 1993 General Assembly Session, addresses issues related to State and local service responsibilities.

Many of the local concerns raised during the current study are similar to those expressed during the 1983 study. Those concerns include:

- lack of flexibility in the implementation of mandates,
- inadequate funding for mandates,
- unequal taxing authority for cities and counties, and
- lack of adequate taxing authority for all localities.

Local concerns are exacerbated by the current economic downturn, as they were by the recession of the early 1980s.

Despite the problems identified by local officials, overall the State has played a stable role in providing revenues to local governments. Conversely, the last decade has witnessed a dramatic decline in the federal role. Although significant new federal mandates have been imposed on localities in recent years, federal financial aid has decreased.

This report summary briefly addresses the major findings and recommendations of Phase One of the study. More detailed analysis is included within the text of the report. A companion report, titled *Catalog of State and Federal Mandates on Local Governments*, identifies the State and federal mandates currently imposed on local governments as well as some local concerns with those mandates.

Recent Economic Indicators Suggest Deteriorating Local Fiscal Conditions

During the second half of the 1980s, local governments experienced substantial growth in revenues due to strong national and regional growth. The median increase in revenue capacity per capita from FY 1985 to FY 1989 was 30 percent, while growth in the government goods and services inflation index was only 18 percent. Only ten localities' revenue capacity growth did not match the increase in the inflation rate for government goods and services.

Despite the growth in revenue capacity, the second half of the decade witnessed a steady increase in revenue effort for both cities and counties. Only 30 local governments did not increase local revenue effort from FY 1985 to FY 1989.

Since that time, local revenue conditions appear to have deteriorated. The

1990-1991 national recession has resulted in decreasing home sales, prices, employment, and retail sales. These conditions have begun to affect local revenues. In addition, State reductions in aid to localities have further impeded local governments' ability to provide mandated services within existing revenues. These pressures are reflected by the recent budget actions localities have taken to control expenditures. The number of local budget actions taken has more than tripled since FY 1988. The ability of many local governments to continue to provide existing levels of mandated services within available revenues is of concern.

Local Concerns about Mandates

Local officials reported several broad-based concerns with mandates, including the cumulative impact of mandates, lack of local input into the development of mandates, inflexibility of mandates, overlapping mandates, and inadequate funding to meet mandates. Local concerns were especially evident in areas where State and federal involvement has historically been significant or is becoming increasingly significant — education and environmental protection, for example.

JLARC staff found that in some cases these concerns are warranted:

- Mandates are extensive, covering most areas of local government activity.
- The number of mandates imposed on local governments increases yearly.
- In some cases, mandates do not allow local governments sufficient flexibility in implementation.

- Some mandates issued by State agencies overlap with each other.

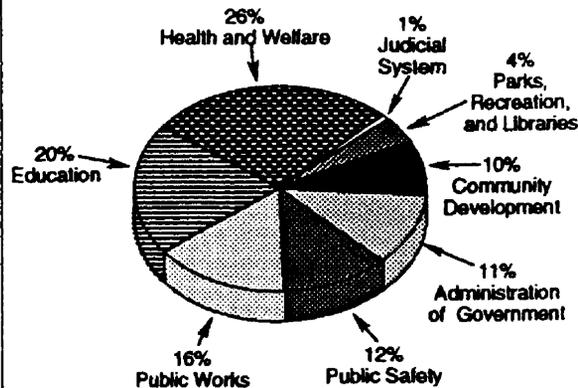
JLARC staff identified 338 State and federal mandates on local governments. Most mandates affect the areas of education, health and welfare, and public works.

In recent years most areas of government have been affected to varying degrees by new mandates. JLARC staff identified 81 mandates imposed since the 1983 mandates study. Virginia's interest over the past few years in improving and preserving the environment has manifested itself in several new environmental protection mandates imposed on local governments. There has also been a substantial increase in education mandates. This increase can primarily be attributed to the 1988 revision of the educational Standards of Quality.

The State has taken a number of actions to mitigate the impact of mandates on localities. For example, the State has demonstrated its interest in improving communication and cooperation between State and local government through an ongoing study of administrative requirements imposed on local governments. Through this effort the Administration intends to eliminate any unnecessary reporting and other administrative requirements on local governments. Some State agencies grant waivers from mandates for individual localities. Others form advisory groups, or convene workshops or meetings of interested parties, including local government officials, when developing regulations. Also, as part of Project Streamline several State agencies have instituted studies and other actions to provide more coordinated oversight and direction to local governments.

Despite the State's actions, mandates are still a problem for local governments. Some of the more problematic mandates originated at the federal level, and therefore, few immediate changes can be made to streamline and reduce the impact they have

Proportion of State and Federal Mandates on Localities by Functional Area, 1991



on local governments. However, there are some options available to the State, addressed later in the summary, to ensure that local governments are better able to adequately meet mandate requirements.

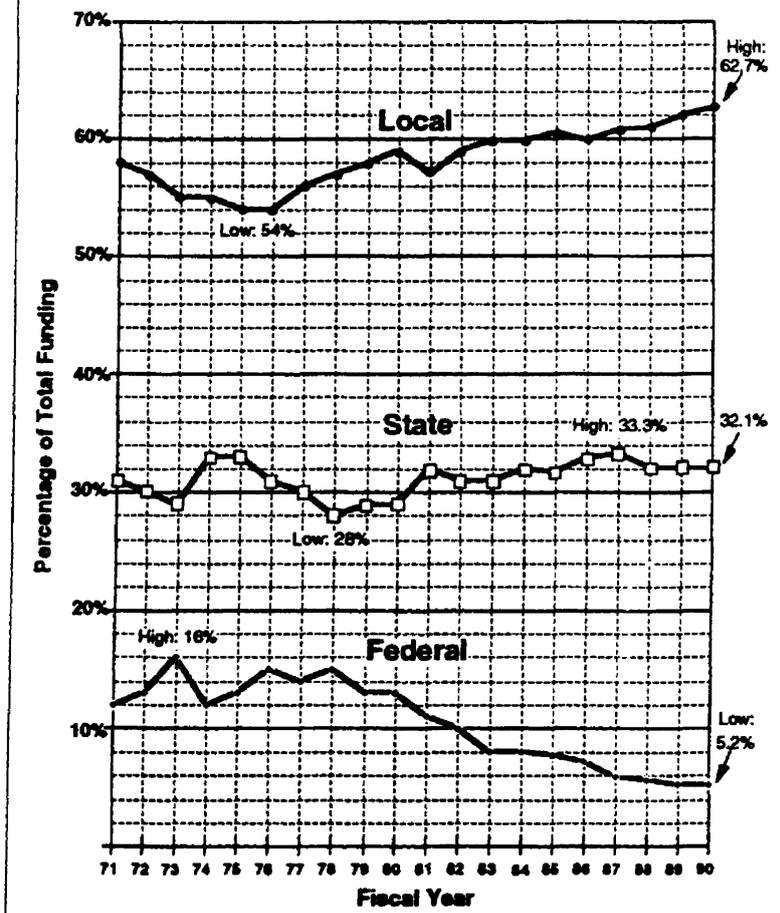
State Aid to Local Governments Has Been Stable, But Federal Aid Has Declined

The State has assumed a significant role in assisting local governments with provision of services. Responsibility for providing assistance flows from constitutional provisions, statutory references, and historical tradition. Local governments receive three types of assistance from the State: financial, direct, and technical. Virginia devotes a major portion of its annual budget to providing this assistance to localities.

The majority of State aid to localities is in the form of financial assistance. In FY 1990, Virginia provided more than \$3.4 billion in financial assistance to local governments — a 110 percent increase since FY 1982. Further, the State has provided local governments with a stable source of funding. A 1985 JLARC report on local fiscal stress and State aid found that the State's

Funding Sources for Cities and Counties FY 1971 - FY 1990

Shown as Percentage of Total Funds



share of total local revenues had increased to 32 percent, allowing the local share to remain stable despite continuing reductions in federal funding. By FY 1990, the State continued to maintain its share of local funding at 32 percent. However, local governments have increased locally-raised revenues from 60.6 percent to 62.7 percent, in part to compensate for the declining share of federal revenue. During the same time period, federal revenues declined from 7.7 percent to 5.2 percent of total local revenues.

Reflective of its commitment to financial assistance, the State attempted to limit reductions in aid to localities in addressing the State's revenue shortfall. As such, re-

ductions in State aid accounted for only 13.6 percent of the total budget reductions taken by the State to close the State's shortfall for the 1990-1992 bienium.

Much of the State's financial assistance is distributed using methods that attempt to account for local need or ability to pay. In other words, localities with a lower ability to pay, as measured by revenue capacity and adjusted gross income, receive more State financial assistance per capita. Thus, localities in the Southwest and Southside regions of the State generally receive higher levels of State aid per capita than other areas of the State.

In addition to financial assistance, the State provides direct services to local clients and local governments. These services are essentially expenditures made on behalf of local gov-

ernments. For example, the State directly provides and pays for the construction and maintenance of non-interstate roads in most counties. Direct services free local financial resources which otherwise might have to be expended in providing these services. In FY 1990, the State provided more than \$1.2 billion in direct assistance to local governments.

Technical assistance, advice, or training provided to local governments is another form of State aid. Localities often request technical assistance to help them comply with mandated requirements. Through the JLARC staff's survey of local governments, localities generally reported satisfaction with the State's provision of technical assistance.

However, some agencies which primarily play a regulatory role were rated less favorably.

Policy Options

To address the current economic downturn and local officials' concerns about mandates, a number of policy options have been identified. The resolutions directing Phase One of this study direct JLARC to examine additional revenue sources that could be used to provide services. The General Assembly has two broad options to increase local resources: increase local taxing authority and increase State financial aid to local governments. The advantages of both are that local governments would have additional funds to support mandated services, and thus would be better able to accomplish policy goals. However, these approaches may be dependent on the willingness of citizens to accept additional tax burdens. Options to improve the mandating process itself have also been developed.

Equalize City/County Taxing Authority

Differences between city and county taxing authority exist due to historical distinctions in the levels of services provided. However, increased urbanization and suburbanization of Virginia's localities have blurred these distinctions. Many counties are now required to provide levels of services similar to cities. Consequently, taxing authority between cities and counties should be equalized. The following recommendation is made:

- The General Assembly may wish to allow counties taxing authority equal to that of cities.

Provide Additional Taxing Authority

During the 1980s, localities substantially increased their use of taxes. Many localities are currently using most of the

taxes granted them. In addition, where taxing authority exists, local governments have been more likely to increase, rather than decrease, tax rates in recent years. Pressure to increase local taxes may mount as fiscal conditions continue to decline, and if local funding responsibilities are increased. Under such circumstances, additional taxing authority — either allowing new taxes or increasing the caps on current local taxes — would likely be needed. The following recommendation is made:

- If funding responsibilities of local governments are increased, the General Assembly may wish to provide cities and counties with additional taxing authority to help fund the additional responsibilities. Taxes that the General Assembly should consider include an addition to the local option sales tax, the meals tax without referendum, and the cigarette tax. In addition, the General Assembly may wish to consider raising the maximum rates allowed on certain local taxes, such as the transient occupancy tax for counties, utility license tax, and mineral taxes.

Increase State Financial Assistance

State financial assistance to local governments has been an ongoing, priority commitment of the State, and has been a relatively stable component of local government budgets. However, recent fiscal conditions have resulted in decreased State financial aid. The State revenue shortfall caused by the 1990-1991 recession required a reduction in aid to localities of more than \$297.6 million. This has negatively impacted long-standing local programs such as elementary and secondary education. Therefore, the following recommendation is made:

- When the State's fiscal climate and revenue projections improve, the

General Assembly may wish to establish as a priority the restoration of funding for aid to locality programs which were reduced during the 1990-1992 biennium.

As in the 1983 JLARC mandates study, program areas have been identified in which State financial aid is not consistent with State involvement or historical funding efforts. In particular, State financial assistance for environmental protection has not been consistent with the State's involvement in this area. While there has been an increase of 14 environmental mandates in the past few years, federal and State assistance has not been consistent with this expansion of responsibilities. Further, where financial data are available it appears these new mandates are or will have a substantial fiscal impact on local governments. State-wide funding goals need to be established to provide an equitable and stable source of financial assistance for specific programs such as environmental protection. Therefore, the following recommendation is made:

- In order to promote stable and equitable funding for State-local programs, the General Assembly may wish to require a review of mandates in specific program areas to establish the full cost of implementing the mandates on local governments and to develop an appropriate basis for determining State-local funding responsibilities. The General Assembly may then wish to develop clear objectives for funding a share of program costs.

Require State Payment for State Mandates

House Bill 751 (State Payment for State Mandates Act) of the 1990 General Assembly Session proposed fully funding the cost of State mandates imposed on local governments. If passed, this legislation would have suspended most new laws and regulations

requiring local provision of additional services without sufficient funding.

A number of other states have generally similar policies. Their experiences suggest that such policies are not effective. While these requirements may result in the limitation or modification of mandates to make them less costly or obtrusive to local governments, the policies have generally not resulted in extensive funding of mandates. In addition, such policies have led to greater judicial intervention. Given the mixed results in other states, it appears the desired results may better be achieved in a more affirmative manner, as discussed in the next section.

Improve Current State and Local Mandate Environment

Due to the current financial conditions in Virginia, the short-term outlook for substantial amounts of additional State financial aid is not good. Therefore, five methods for addressing the effects of mandates on local governments are presented. These include: maintaining a catalog of all mandates on local governments, conducting a one-time review of all current mandates to identify areas where mandates could be relaxed or eliminated, implementing new mandates on an experimental or pilot basis, suspending temporarily selected mandates, and enhancing the fiscal note process.

Catalog of Mandates. In order to recognize the impact mandates have on local governments, legislators and agency heads need to be aware of the number and extent of State and federal requirements. Several recent studies have recognized the importance of having comprehensive, up-to-date information about mandates. To this end, a catalog such as the companion document prepared for this study should be developed and updated annually. Over time, the catalog may point to areas where mandates are becoming excessive or duplicative. The following recommendation is made:

- The Commission on Local Government (COLG) should maintain and periodically update a catalog of State and federal mandates imposed on local governments. On an annual basis, COLG should add to the catalog all new mandates imposed on local governments and delete those mandates which have been eliminated. In addition, a summary of the fiscal impact of the new mandates should be compiled into the document.

One-Time Review of Existing Mandates.

By performing a one-time review of the mandates they administer, State agencies could potentially identify areas where the burdensomeness of mandates could be relieved. Ideally such a review would point to opportunities for relaxation or elimination of problematic mandates. Mandates would be prioritized according to their necessity, thus allowing agencies to determine requirements not essential to local service delivery. The following recommendation is made:

- The General Assembly may wish to require all State agencies imposing mandates on local governments to conduct an in-depth assessment of the mandates they are responsible for administering. Specific attention should be given to streamlining, reducing, or eliminating mandates where possible.

Pilot-Testing or Temporarily Implementing New Mandates.

It is often difficult to predict the actual outcomes of implementing specific mandates. Whether or not mandates will produce their intended results is not always identifiable prior to implementation. In order to gauge the effectiveness of mandates, they should, where possible, be pilot-tested in a representative sample of localities. This procedure will allow agen-

cies to refine the mandates to achieve stated objectives as well as more completely understand the fiscal impact on local governments prior to statewide implementation. The following recommendation is made:

- The General Assembly may wish to require State agencies, where appropriate, to implement mandates on a trial basis through local pilot programs prior to requiring all localities to implement the mandate. Where possible, a representative cross section of localities should be used for any pilot project.

Temporary Suspension of Selected Mandates.

State and federal mandates limit local governments' options to cut lower priority programs from their budgets in times of economic downturn. Therefore, if financial conditions worsen and State aid is cut significantly, suspension of some State mandates could help ease the fiscal stress local governments face. However, the short-term advantages of temporary suspension must be weighed against the possible long-term disadvantages before a final policy decision is made.

The *Code of Virginia* currently authorizes the Governor to temporarily suspend certain mandates on a local government based upon application by that local government. Similar provisions could be made to allow the Governor to suspend an administrative mandate statewide based on the Governor's judgment that the mandate imposed an unreasonable financial burden on localities. The following recommendation is made:

- The General Assembly may wish to amend §2.1-51.5:1 of the *Code of Virginia* to allow the Governor to temporarily suspend selected administrative mandates identified as imposing extreme financial burdens on lo-

calities. Mandates to be suspended should be based in part on the results of the one-time review of existing mandates previously recommended. Amendments to this section of the *Code of Virginia* and resultant suspension should expire two years after enactment.

Enhance the Fiscal Note Process. It is important that legislators are aware of the fiscal impact of proposed legislation on local governments prior to the appropriate full committee voting on the legislation. The Commission on Local Governments is responsible for preparing fiscal notes for legislation potentially affecting local governments. Although the cost estimating process is generally sound, the current process is constrained by Virginia's short Session length. Further, the process:

- does not provide cost estimates to the legislature in as timely a manner as desirable, and
- does not identify all bills with a potential fiscal impact on local governments due to statutory constraints.

The lack of time available to complete a fiscal note is a limitation inherent to the existing legislative system. The COLG is often unaware of pending legislation with a local fiscal impact prior to its formal introduction. These problems might be reduced by transferring the fiscal note function to the

legislative branch. Evaluation of the fiscal impact on local governments could then theoretically start at the bill drafting stage.

To enhance the fiscal note process, the following recommendations are made:

- The Commission on Local Government should adopt as a primary goal the completion of cost estimates for proposed legislation before the legislation is first reviewed by the full committee. In addition, the Commission on Local Government and the Division of Legislative Services should jointly review and revise the procedures in place for notifying the Commission of bills requiring a cost estimate.
- The General Assembly may wish to amend §30-19.03 of the *Code of Virginia* to require that legislation negatively affecting the revenue-raising ability of local governments, except those providing property tax exemptions in accordance with §58.1-3610 through §58.1-3621 of the *Code of Virginia*, be submitted to the Commission on Local Government for a fiscal impact analysis.
- The General Assembly may wish to direct the Joint Subcommittee studying the legislative process to evaluate the consequences of moving the fiscal note process to the legislative branch.

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Chapter I: Introduction

In Virginia, localities may exercise only those powers delegated by the State through either general law or charter. Along with the delegated powers, the State participates in partnerships with localities. It has also assigned local governments extensive responsibilities for providing services. The State has defined, prescribed, or regulated many of these services to maintain consistency and ensure desired policy outcomes. The State has also provided funding for some of these services to assist in meeting the costs of the services. In addition, the State determines the specific taxes that localities may levy and for most taxes prescribes their legal maximum rates. The combined impact on localities of mandated programs and restrictions on revenue raising instruments has caused much concern among local officials. These concerns have been exacerbated by the current State revenue shortfall, which is resulting in both cuts in State programs and some reduction of State aid to localities.

In 1983, at the direction of the General Assembly, JLARC conducted a study of State mandates on local governments and local financial conditions. The study found that although there was little local consensus on the unreasonableness of specific mandates, localities repeatedly cited funding as a key problem with mandates. Further, the study noted that many local governments had experienced fiscal stress, and some were facing eroding financial conditions.

To address the continuing concerns of State and local officials, the General Assembly in 1990 directed JLARC to conduct a follow-up to the 1983 study. In 1991, the General Assembly expanded the study to include an examination of State and local responsibilities for service delivery. To fully meet the legislative directives, the study is being conducted in two phases. Phase One addresses issues related to mandates and local financial resources. Phase Two addresses issues related to State and local service responsibilities. This report presents the findings and recommendations from Phase One — a follow-up of the 1983 study on mandates and local financial conditions.

Since 1983, mandates imposed on local governments appear to have become more extensive and are perceived as being increasingly burdensome. The number of mandates has increased, and in many cases the mandates have become more complex. Though some of the new mandates affecting localities originate with the federal government, federal financial aid to meet those mandates has not been forthcoming. Indeed, federal intergovernmental aid has declined to almost negligible amounts for Virginia's more prosperous localities. As a result, State and in particular local governments have assumed costs in areas where federal funds have declined. Based on these findings, several proposals have been presented for the General Assembly's consideration.

PREVIOUS JLARC STUDIES OF MANDATES AFFECTING LOCAL GOVERNMENTS AND LOCAL FINANCIAL RESOURCES

The General Assembly has focused considerable attention and effort over the years on exploring ways to improve State-local relations. This interest is evidenced in part by a series of JLARC studies focusing on various aspects of the State's relationships with local governments. The original 1983 report, *State Mandates on Local Governments and Local Financial Resources*, received substantial attention from both legislators and local officials. As a result, two follow-up reports were prepared: *Local Fiscal Stress and State Aid* (1985), and *Towns in Virginia* (1985).

The three JLARC reports presented recommendations and policy options for the legislature to consider. Implementation of some of these recommendations has resulted in increased funding for certain programs, more equitable distribution formulas, and continued analysis of fiscal stress indicators. Not all recommendations were implemented, and some current local concerns are similar to those expressed during the original series of studies.

State Mandates on Local Governments and Local Financial Resources

The 1983 mandates study addressed three primary objectives: (1) to identify State mandates and the extent to which they impose a burden on local governments; (2) to examine the adequacy of the amount and type of State financial assistance to localities; and (3) to determine whether local governments have sufficient local financial resources to fund the public services they are required to provide.

The study found that, in general, local officials did not disagree with the substance of State mandates, but were more concerned with the levels of State funding to meet those mandates. JLARC found that State funding of mandates was substantial and that it kept pace with historical State commitments in all areas except the educational Standards of Quality, categorical aid for special education, and auxiliary grants. In these areas, State aid was found to be inconsistent with levels of State control.

The study also found that localities had experienced various financial stresses in the late 1970s and early 1980s, including two economic recessions, reduced federal financial aid, and increased interest rates which made local borrowing more difficult. These stresses did not affect localities uniformly. Rather, cities as a group showed a higher level of fiscal stress.

Local Fiscal Stress and State Aid

In September 1985, JLARC issued a follow-up report to the 1983 mandates study. In its update of local fiscal conditions, JLARC found that per-capita local revenue capacity had grown between FY 1981 and FY 1983 by approximately eight percent, while

the cost of government services had increased by 15 percent. Despite this discrepancy, local tax effort had decreased slightly. Overall, there was very little change in the relative rankings of localities based on the stress index.

Between FY 1981 and FY 1983, State aid to local governments had increased. State aid did decrease, however, for special education and local health departments. Despite the overall increase in State aid, some localities remained severely fiscally stressed.

Towns in Virginia

JLARC issued a second follow-up report in 1985, focusing on the fiscal condition of towns, their ability to provide services, and relations between towns and counties. Because of a lack of data, fiscal condition indicators for towns could not be prepared. Based on a qualitative review, the study found that towns, especially when compared to cities, did not appear subject to as high a level of fiscal stress. This lower level of stress was attributed to the fact that towns were generally not involved in the provision of high-cost public programs. However, the study did conclude that declines in federal assistance could promote fiscal stress in towns.

As part of the 1985 study, JLARC conducted case studies of 15 towns throughout the State. Although town-county relations were unique for each of the towns studied, JLARC identified three primary findings from the case studies. First, consideration of city status by towns had a decidedly disruptive effect on town-county relations because counties stood to lose some of their real estate and personal property tax revenue. Second, the establishment of town-county liaison committees in several areas of the State served to facilitate town-county communication and cooperation. Third, towns and counties were not taking full advantage of increased economies of scale which could be realized from more extensive use of intergovernmental agreements and contracts.

Actions Taken Since the JLARC Reports

Follow-up of the 1983 and 1985 recommendations and policy options revealed that the State has taken a number of actions to alleviate problems at the local level (Exhibit 1). Some of these actions were in direct response to Commission recommendations. Other actions have been based on complementary, independent work of other committees or commissions.

The recommendation that the General Assembly should direct an assessment and validation of the basis for sharing major program costs was implemented by JLARC's series of studies on the Standards of Quality (SOQ). The cost methodology proposed in these reports was adopted for use in determining the State budget for SOQ programs. Basing portions of the costs on each locality's ability to pay, the State fully funded its share of the SOQ costs.

Exhibit 1

**Selected Recommendations and Policy Options
Implemented From Previous JLARC
State-Local Relations Studies**

Recommendation	Action Taken
The General Assembly should direct an assessment and validation of the basis for sharing major program costs.	Assessments were completed for the Educational Standards of Quality in 1986 and 1988.
Funds should be provided to fund the State's historical share of 82 percent of the estimated State share of the costs of meeting the Educational Standards of Quality.	As a result of increased State funding and changes in methodology, the State's funding of its share of costs increased to 100 percent from FY 1987 to FY 1990.
Funds should be provided to fund 80 percent of the Auxiliary Grants Program.	The State's share of funding for the Auxiliary Grants Program was increased to 80 percent in FY 1987.
The General Assembly should consider distributing additional aid to localities on the basis of a stress index or formula.	Fiscal stress and/or revenue capacity are now used in distributing funds for selected programs. For example, the Chesapeake Bay Local Assistance Department uses the fiscal stress index as one of four criteria for allocating Chesapeake Bay Preservation Act grants.
The General Assembly should prepare recommendations for highway funding which would both narrow the benefit gap between cities and counties and aid in reducing the fiscal stresses facing cities.	Distribution formulas were revised in 1985. The Virginia Department of Transportation is currently involved in a study in which this issue will be further examined.
Priority State funding should be provided to localities to fund several programs at levels more consistent with State control and the State's historical commitment.	The State has increased funding to localities in the areas of education and health.
The State should develop a new formula for funding local health departments.	A new formula was developed in 1987.
The Commission on Local Government should prepare an analysis of fiscal capacity, tax effort, and fiscal stress on a continuous basis.	Reports have been generated in 1989, 1990, and 1991.

Source: JLARC staff analysis.

JLARC also conducted an assessment and validation of the basis for sharing major program costs for cooperative health departments. That study resulted in the revision of the local cooperative health department program formula, which now uses local revenue capacity and income data as factors. And, in accordance with a recommendation by JLARC and others, 80 percent of the auxiliary grant program was funded by the State beginning in FY 1987.

In 1985, the General Assembly reconfigured highway aid on a more equitable basis by revising statutory distribution formulas. This provided for increased funding for urban street payments, increased funding of secondary road construction in Arlington and Henrico, and direction of additional funds to localities with the greatest need.

In response to another JLARC recommendation, the Commission on Local Government assumed the responsibility to generate and report analyses on revenue capacity and fiscal stress indicators. Fiscal stress and/or revenue capacity now play a role in the distribution of funding for the State and local hospitalization program, community health departments, housing and community development, and Chesapeake Bay preservation.

Not all study recommendations have been implemented. Explicit commitments to program funding have not been established in statute. In addition, taxing authority between counties and cities has not been equalized. Several of the recommendations concerning towns have also not been implemented. However, several recommendations are currently being examined through the ongoing efforts of other commissions and committees.

CURRENT JLARC STUDY EFFORT

The current JLARC study of State-local relations is being conducted based on four major directives (Appendix A):

- Senate Joint Resolution (SJR) 45 and House Joint Resolution (HJR) 156 from the 1990 General Assembly Session request that JLARC conduct a follow-up study of the 1983 JLARC report, *State Mandates on Local Governments and Local Financial Resources*.
- SJR 235 from the 1991 General Assembly Session directs JLARC to examine State and local government service responsibilities.
- An amendment to the 1990-92 Appropriation Act further directs JLARC to examine procedures for estimating the full cost of State mandates on local governments.

As previously noted, the study is being conducted in two phases. Phase One addresses issues related to mandates and local financial resources (SJR 45, HJR 156, and

the 1990-92 Appropriation Act amendment). Phase Two addresses issues related to State and local service responsibilities (SJR 235).

Four major issues addressing State and local service responsibilities have been identified for Phase Two of the study:

1. What public services are currently provided by the State and local governments?
2. How should responsibility for providing these services be assigned between the State and local governments?
3. Are the functional assignments of services between the State and local governments appropriate?
4. What funding structures could be used to provide adequate resources for service delivery structures recommended for change?

Findings and recommendations from Phase Two of the study will be presented prior to the 1993 General Assembly Session. This report contains the results from Phase One of the study.

Phase One Study Issues

Seven issues were developed to address the study requirements of Phase One:

1. What State and federal mandates are placed on local government activities?
2. To what extent are State and federal mandates problematic to local governments?
3. How effective is the process used to produce fiscal impact estimates of State mandates on local governments?
4. What is the overall fiscal condition of Virginia's localities?
5. Do local governments have adequate ability to generate local revenues to fund mandated services?
6. Does the State provide adequate financial assistance to local governments to enable them to meet service requirements?
7. Does the State provide adequate technical assistance to local governments to enable them to meet service requirements?

Though this study phase is largely a follow-up to the 1983 study, it does move beyond the original report in an important way. This study identifies federal as well as State mandates which affect local governments.

Mandate Defined

In analyzing the effect of State and federal requirements on local governments, the following definition of "mandate" was used:

a constitutional, statutory, or administrative action that places a requirement on local governments.

This definition of mandate is the same as that used in the 1983 JLARC mandates study.

The definition includes three types of mandates: compulsory orders, conditions of financial aid, and regulation of optional activities. *Compulsory orders* are requirements with which localities must comply regardless of aid, such as the Chesapeake Bay Preservation Act. *Conditions of financial aid* are requirements that arise as a condition of receiving financial aid from either the State or federal governments. For example, to qualify for urban street assistance payments, cities and towns (with populations greater than 3,500) which maintain their own roads must meet Virginia Department of Transportation standards for road maintenance.

State regulation of optional activities includes activities which are not required but are subject to regulations if performed. For example, if a locality elects to provide public water and sewer services, the locality must follow certain Department of Health regulations in constructing the water and wastewater facilities. They must also follow State Water Control Board regulations for the ongoing operation of the facilities. Though these activities are technically optional, localities may have little choice whether to provide them. For example, the decision to provide water and sewer services is more likely driven by population density than by choice.

Research Activities

Cross-cutting research activities were conducted to collect and analyze information about mandates affecting local governments and local financial conditions. These research activities included: a mail survey of cities and counties, a mail survey of State agencies, follow-up interviews with 14 State agencies, periodic meetings and interviews with local government officials, and document reviews.

Mail Survey of Cities and Counties. A 28-page survey was sent to all cities and counties. This survey requested the opinions of local government officials about mandates, local financial conditions, and State financial and technical assistance. It also requested information on specific actions localities have taken in response to difficult

financial conditions. Responses were received from 108 of the 136 cities and counties. A map identifying responding localities is included as Appendix B.

Mail Survey of State Agencies. A survey was also sent to all State agencies. Information was requested on State and federal mandates administered by each agency, and technical and financial assistance programs provided to local governments. Survey responses indicated that 46 State agencies interact with local governments either through mandates or assistance programs or both.

Follow-up Interviews with Selected State Agencies. Additional information on State-local interaction was collected through follow-up interviews with 14 State agencies. Agencies within the functional areas most involved in mandates were selected for interviews. These areas include education, health and welfare, corrections, transportation, and environmental protection. Topics addressed during the interviews included: procedures used in developing regulations, development of fiscal impact analyses of agency regulations, methods of providing technical assistance, and the evolution of selected mandates and financial aid programs. In addition, agency personnel were requested to respond to specific local concerns about selected mandates and financial aid programs.

Meetings and Interviews with Local Government Officials. Meetings and interviews with local government officials were conducted to obtain input into the study's research design and to discuss in more detail concerns raised by respondents to the local government survey. These group meetings and one-on-one interviews were conducted at various points during the study. Topics discussed included: the level of local input in the development of mandates, adequacy of State financial and technical assistance, and ways to improve implementation of mandates. JLARC staff also contacted many local government officials by telephone to follow up on survey responses.

Meetings and Interviews with the Center For Public Service. Because the Center has a great deal of expertise in State and local issues, especially in the areas of finance and taxes, JLARC staff met with staff of the Center to discuss in more detail the issue of mandates on local governments. Based on these meetings, JLARC requested that the Center for Public Service staff conduct an analysis of issues surrounding local government taxes and taxing authority. The results of this analysis were issued in a Center for Public Service report titled *Special Analysis of City and County Taxes*, November 1991. This report will serve as a foundation for assessing availability of revenues and funding structures in Phase Two. In addition, JLARC staff and staff from the Center have met to identify and discuss issues related to Phase Two of the study.

Review of Documents. Numerous documents and reports were reviewed during the course of the study. Foremost among these was a review of the *Code of Virginia* to identify State mandates affecting local governments. In addition, Commission on Local Government documents were used in evaluating local fiscal conditions during the middle to late 1980s. Reports from ongoing and previous studies of mandates conducted both within and outside of Virginia were also examined to identify actions that have been taken to address concerns about mandates and financial aid to localities.

Use of the Geographic Information System. Much of the analysis of local fiscal conditions was completed using the geographic information system (GIS). This system was used extensively for the 1991 legislative redistricting process. With the assistance of Division of Legislative Automated Systems' staff, JLARC staff were able to analyze local government fiscal data at both the statewide and individual local government levels. In addition, the capability to display the results of the analysis in color allowed for easier identification of trends and areas of the State which warranted additional analysis.

REPORT ORGANIZATION

Chapter I has presented an overview of the previous JLARC studies on mandates and local financial conditions, and has presented the framework for the current study. Chapter II discusses current local financial conditions and how conditions have changed over the last several years. Chapter III addresses the effects of mandates on localities and the process by which the fiscal impact of mandates is determined. The level of State aid provided to local governments and the adequacy of that aid are discussed in Chapter IV. Finally, Chapter V presents policy options and recommendations for the General Assembly's consideration in addressing mandates and local financial conditions.

A companion JLARC report, *Catalog of State and Federal Mandates on Local Governments*, provides a listing of the mandates currently imposed on local governments. In addition, it identifies local concerns with specific mandates. In some cases the relevant State agency's response to certain local concerns is also provided.

Chapter II: Local Fiscal Conditions

In the 1983 mandates report, JLARC reported that local governments experienced increasing fiscal stress between 1977 and 1981. In the 1985 *Local Fiscal Stress and State Aid* report, JLARC found that the fiscal stress of local governments had not increased during the 1982 to 1983 period. However, increases in local revenue capacity per capita had not matched the historical increases in the cost of providing government goods and services. Local revenue effort during the same period had moderated.

Since that time, local government fiscal conditions have changed. Due in part to strong national and regional economic growth during the second half of the 1980s, many local governments enjoyed substantial growth in local revenues. Through FY 1989 (the most recent period for which complete data are available), local revenue capacity on a statewide basis showed a substantial increase. All but ten localities had increases greater than the inflation rate for government goods and services. Since that period, conditions appear to have changed. While data are not available for a complete analysis of local revenue conditions for FY 1990 and FY 1991, indications are that local fiscal conditions have recently deteriorated.

Even in FY 1989, areas of concern were evident. Many less affluent localities did not enjoy substantial growth in revenue capacity. While many of the localities that exhibited strong growth in revenue capacity experienced slow growth or even declining revenue effort, revenue effort increased among the majority of local governments. Further, the overall fiscal stress of cities, as measured by the composite stress index, continues to be of concern.

More recently, new fiscal pressures have been exerted on many local governments. Virginia's economy has suffered from the 1990-1991 national recession. In fact, regions of Virginia that had experienced substantial growth in the 1980s, particularly Northern Virginia, have been severely impacted by the economic downturn. This has resulted in declining home sales, prices, employment, and retail sales — all of which affect local revenues. State reductions in aid to localities have further affected local governments' ability to provide services within existing revenues.

The impacts of all of these actions are reflected by the recent budget actions localities have taken to control expenditures. Since FY 1989, the number of such budget actions taken by localities has more than tripled. Clearly, the ability of many local governments to continue to provide existing levels of services within available revenues is in doubt. Therefore, any State policies that require local governments to provide additional services should also consider their local fiscal conditions. The fiscal condition of localities is assessed in subsequent sections of this report on revenue capacity, revenue effort, resident income, and fiscal stress. An assessment of more recent, recession-based factors is also included.

LOCAL REVENUE CAPACITY

An important dimension of a local government's fiscal position is its revenue capacity. Revenue capacity is a measure of the revenue which may be obtained by a local government through the use of statewide average tax rates and non-tax revenue effort. The fiscal position of a local government is particularly affected by the growth in its revenue base over time. If the revenue base does not grow at a rate that is consistent with the demand for services, then the local government could be faced with increasing taxes, increasing user charges, or reducing services. However, if a local government's revenue capacity exhibits strong growth, the locality is in a better position to continue to provide existing services without increasing taxes or other revenue-raising mechanisms.

Calculating Revenue Capacity

Revenue capacity is a measure of each locality's potential ability to raise the revenues used to provide services. Revenue capacity is the amount of revenue that a locality could generate if that locality used statewide average rates of return from taxes, service charges, and other revenue-raising instruments.

The revenue capacity measure is based on the representative revenue system approach of the U.S. Advisory Commission on Intergovernmental Relations. It was refined for use in Virginia by the Tayloe Murphy Institute and the Institute of Government at the University of Virginia. During the 1980s, JLARC further revised and updated the revenue capacity measure. Currently, the Commission on Local Government (COLG) is responsible for calculating revenue capacity for each local government on an annual basis.

Revenue capacity measures five components of a locality's revenue-generating potential based on the following indicators: (1) real estate and public service corporation property tax revenues, (2) tangible personal property tax revenues, (3) motor vehicle license tax revenues, (4) sales tax revenues, and (5) adjusted gross income as a proxy for all other locally-generated revenues. Exhibit 2 illustrates the revenue capacity calculation.

Local Revenue Capacity in the 1980s

Unlike the FY 1977 through FY 1983 period, growth in local revenue capacity for FY 1985 through FY 1989 was strong. Overall, the increase in local revenue capacity during this period was slightly more than one and one-half times the inflation rate for government goods and services.

FY 1989 Local Revenue Capacity. In FY 1989, the average local revenue capacity per capita was \$754. That is, the average local government had the capacity to generate average revenues of \$754 per person to support local services. As a group,

Exhibit 2

Computing Revenue Capacity

Per-Capita Revenue Capacity

$$\begin{aligned} &= [\text{Estimated True Value of Real Estate Property}] \times \\ &\quad [\text{Statewide Average Tax Rate}] \\ &+ [\text{Estimated True Value of Public Service Corporation} \\ &\quad \text{Property}] \times [\text{Statewide Average Tax Rate}] \\ &+ [\text{Number of Motor Vehicles}] \times \\ &\quad [\text{Statewide Average Personal Property Tax Per Vehicle}] \\ &+ [\text{Adjusted Number of Motor Vehicles}] \times [\text{Average License Fee}] \\ &+ [\text{Sales Tax Revenue}] \\ &+ \frac{[\text{Adjusted Gross Income}] \times [\text{Statewide Average Yield Rate}]}{\text{Locality Population}} \end{aligned}$$

Example: Brunswick County (1989)

Per-Capita Revenue Capacity

$$\begin{aligned} &= [\$438,793,000] \times [.00826] \\ &+ [\$29,744,000] \times [.00759] \\ &+ [11,897] \times [\$150.28] \\ &+ [10,474] \times [\$16.51] \\ &+ [\$434,961] \\ &+ \frac{[\$105,281,047] \times [.02023]}{16,000} \end{aligned}$$

Per-Capita Revenue Capacity

$$= \frac{\$8,375,791}{16,000} = \$523.49 \text{ per-capita}$$

Source: JLARC staff exhibit of Commission on Local Government data.

counties had somewhat higher revenue capacity than cities — \$760 for counties compared to \$739 for cities. On a locality-by-locality basis, there was wide variation in the amount of revenue capacity per capita. Lee County had the State's lowest revenue capacity per capita at \$392. Bath County's revenue capacity, \$3,351, was the State's highest. Bath County's high revenue capacity is largely attributable to the Virginia Power generating station operating in the county. A full listing of revenue capacity per capita for each locality is provided in Appendix C.

The statewide distribution of local revenue capacity for FY 1989 showed distinct patterns. The majority of local governments in the Northern Virginia and Piedmont regions had a per-capita revenue capacity higher than the statewide median of \$673. A

majority of the localities in the Southwest region of the State, on the other hand, fell within the lowest 25 percent of all localities in terms of local revenue capacity per capita. However, it should be noted that revenue from mineral taxes — usually imposed in southwestern Virginia localities — are not directly accounted for in the revenue capacity measure. It is likely that if revenue from these taxes were directly counted, the revenue capacity per capita for several coal-producing counties in Southwest Virginia would be higher.

Growth In Revenue Capacity, FY 1985-FY 1989. The overall increase in median revenue capacity per capita for the FY 1985 to FY 1989 period was approximately 30 percent. For the same period, growth in the government goods and services inflation index was about 18.2 percent. This indicates that the revenue base of most Virginia localities grew at a much higher rate than the cost of providing government goods and services. Only ten localities' revenue capacity growth failed to match the increase in the inflation rate for government goods and services.

Much of the growth in revenue capacity was due to the substantial increase in the true value of real estate. From 1985 through 1989, growth in the true value of real estate increased more than 75 percent. This increase in the true value of real estate was primarily responsible for the approximately 60 percent increase in real property tax revenue. By contrast, between 1985 and 1989, the average effective true real property tax rate for all localities decreased from \$.87 to \$.82.

Table 1 displays the average revenue capacity for cities and counties for most years since FY 1977. In FY 1977, counties and cities had approximately the same revenue capacity. Through FY 1982, the tax bases of cities had grown at a higher rate than counties. However, since FY 1982, the rate of growth in revenue capacity per capita was slightly greater for counties than for cities.

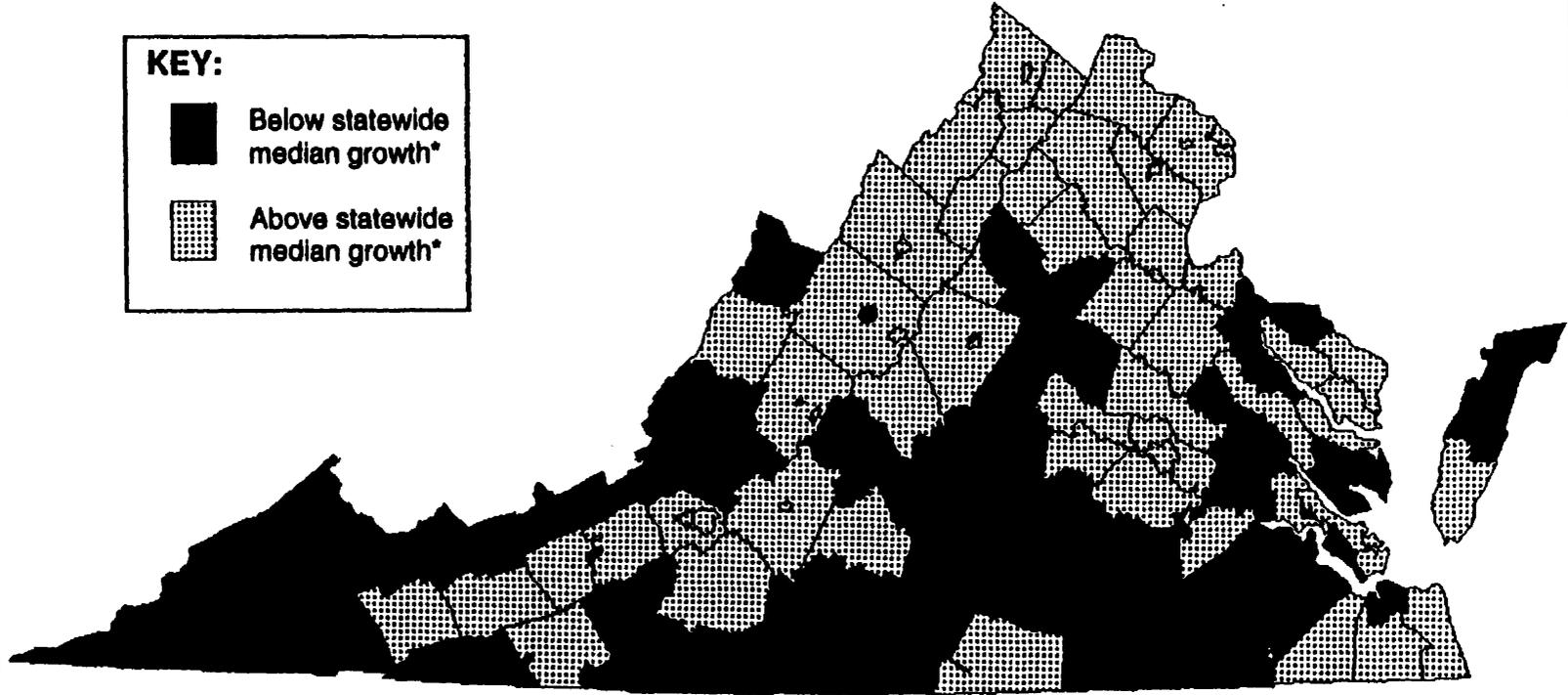
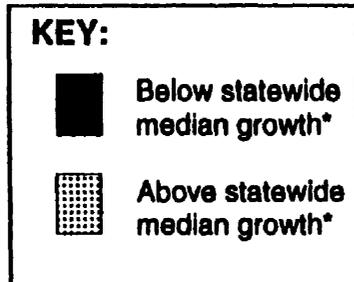
On a statewide basis, growth in local revenue capacity for the FY 1985 through FY 1989 period was substantial. Still, the uneven distribution of growth across the State is apparent (Figure 1). Using the median growth rate in revenue capacity (29.8 percent) as the point of comparison, clear patterns are evident. The majority of localities in the Southwest and Southside regions of the State had an increase in revenue capacity below the statewide median. In fact, seven of the ten localities exhibiting the slowest rate of growth in revenue capacity were located in Southwest or Southside Virginia. Yet all localities in the Northern Virginia region experienced growth in revenue capacity greater than the median growth rate. More specifically, seven of the ten localities that exhibited the highest rate of growth in revenue capacity were located in the Northern Virginia region.

LOCAL REVENUE EFFORT

One option available to local governments to increase local revenues is to increase local revenue effort. Revenue effort refers to the degree to which a local

Figure 1

Growth in Revenue Capacity, FY 1985 - FY 1989



*Note: Statewide median growth = 29.8%

Source: Commission on Local Government, September 1991.

Table 1

**Local Revenue Capacity Per Capita
FY 1977 - FY 1989**

<u>Year</u>	<u>State</u>	<u>Cities</u>	<u>Counties</u>
1977	\$339	\$337	\$340
1981	484	486	483
1982	504	485	483
1983	524	513	529
1985	558	557	558
1986	591	589	592
1987	637	624	643
1988	676	669	679
1989	754	739	760

Source: Commission on Local Government and *Local Fiscal Stress and State Aid*, JLARC, 1985.

government taps its available revenue capacity. A very high revenue effort indicates that a local government is utilizing a high degree of available revenue capacity to provide local services. A locality with a high revenue effort has less flexibility in utilizing additional tax bases as demands for services increase.

Calculating Local Revenue Effort

Local revenue effort is a measure that indicates to what degree localities are utilizing their available revenue capacity. The revenue effort measure was also developed by the U.S. Advisory Commission on Intergovernmental Relations. JLARC staff updated the revenue effort measure during the 1980s. The Commission on Local Government continues to calculate and refine the revenue effort for each local government on an annual basis.

A local government's revenue effort is equal to its actual local tax revenues and other locality-specific revenue-raising instruments divided by its revenue capacity. As with revenue capacity, this measure of revenue effort provides a sound basis for examining each locality's tax levels, assessing how tax levels have changed over time, and comparing localities to each other. An example of how revenue effort is computed is shown in Exhibit 3.

Exhibit 3

Computing Local Revenue Effort

Revenue Effort
= [Real Property Tax Revenue]
+ [Public Service Corporation Property Tax Revenue]
+ [Tangible Personal Property Tax Revenue]
+ [Motor Vehicle License Tax Revenue]
+ [Local Option Sales Tax Revenue]
+ [Other Local Revenue]
Revenue Capacity

Example: Brunswick County (1989)

Revenue Effort
= [\$1,631,312]
+ [\$125,296]
+ [\$1,190,645]
+ [\$183,115]
+ [\$434,961]
+ [\$1,384,502]
\$8,375,791

Revenue Effort
= $\frac{\$4,949,831}{\$8,375,791} = .5910$

Source: JLARC staff exhibit of Commission on Local Government data.

Local Revenue Effort in the 1980s

As in both the 1983 and 1985 JLARC reports, there was a striking difference between the revenue effort of cities and counties in FY 1989. As a group, cities had a higher revenue effort than counties. In addition, the level of revenue effort also varied across the State, with the Southwest region showing relatively low effort and the Northern Virginia region registering relatively high effort. Between FY 1985 and FY 1989, more than 77 percent of the localities in the State increased their revenue effort.

FY 1989 Local Revenue Effort. In FY 1989, the average local revenue effort was .80. In other words, the average locality collected 80 percent of its revenue capacity. As a group, cities had a substantially higher revenue effort than counties — 1.13 for cities

and .65 for counties. As with local revenue capacity, there was substantial variation in local revenue effort on a locality-by-locality basis. The lowest revenue effort was in Rappahannock County at .39. The highest was in the City of Richmond at 1.64. Table 2 displays the average local revenue effort of cities and counties since FY 1977.

Local revenue effort across regions of the State varied dramatically. Many localities in the Southwest region of the State had relatively low revenue efforts. Carroll County, for example, had a local revenue effort of .46 in FY 1989. Conversely, much more affluent localities in the Northern Virginia region had relatively high revenue efforts. Prince William County, for example, had a local revenue effort of 1.19 for the same period. Localities in the Tidewater area also had relatively high revenue efforts. A complete listing of revenue effort for each locality is provided in Appendix D.

Growth in Revenue Effort, FY 1985 - FY 1989. Though revenue effort remained fairly stable in the early 1980s, the second half of the decade witnessed a steady increase in revenue effort for both cities and counties. Only 30 local governments did not increase local revenue effort from FY 1985 to FY 1989. This overall growth in revenue effort indicates that local governments were tapping their revenue bases at higher levels than in the past to provide local services. This trend of increasing local revenue effort was not the expected outcome, given the robust growth in local revenue capacity over the same time period.

In a period where local revenue capacity is not growing at a fairly strong rate or is not increasing greater than the rate of inflation, it is reasonable to assume that local

Table 2

**Local Revenue Effort
FY 1977 - FY 1989**

<u>Year</u>	<u>State</u>	<u>Cities</u>	<u>Counties</u>
1977	.68	1.00	.55
1979	.71	1.04	.57
1981	.76	1.12	.60
1982	.75	1.11	.60
1983	.75	1.11	.60
1985	.75	1.11	.60
1986	.76	1.11	.61
1987	.78	1.13	.62
1988	.79	1.15	.64
1989	.80	1.13	.65

Source: Commission on Local Government and *Local Fiscal Stress and State Aid*, JLARC, 1985.

governments would have to tap into more of their available revenues to continue providing the same level of local services. However, overall growth in local revenue capacity in the FY 1985 through FY 1989 period exceeded the rate of inflation — both inflation measured by the consumer price index and the cost of government goods and services index.

There are a number of potential reasons local government revenue effort increased despite the strong growth in revenue capacity. First, local governments provided services, either mandated or local option, that could not be funded simply through the increase in local revenue capacity. The growth in local government expenditures offers some evidence of this.

Local government expenditures, on a per-capita basis, increased at a fairly high rate for the period FY 1985 through FY 1990. For example, on a statewide basis, local expenditures increased about 50 percent. For cities the increase was slightly more than 46 percent, and for counties it was 53 percent. These increases were greater than the statewide growth in local revenue capacity. Therefore, in order to provide desired levels of services, localities may have been required to increase taxes to provide sufficient local revenues.

Second, localities with relatively low growth in revenue capacity were being required to increase their revenue effort at a higher rate to counter the low revenue capacity growth. In general, the Southside and Southwest regions of the State, which experienced relatively low growth in revenue capacity, exhibited high growth in revenue effort. Conversely, some of the localities with low growth in revenue effort, such as localities in Northern Virginia, had relatively high growth in revenue capacity.

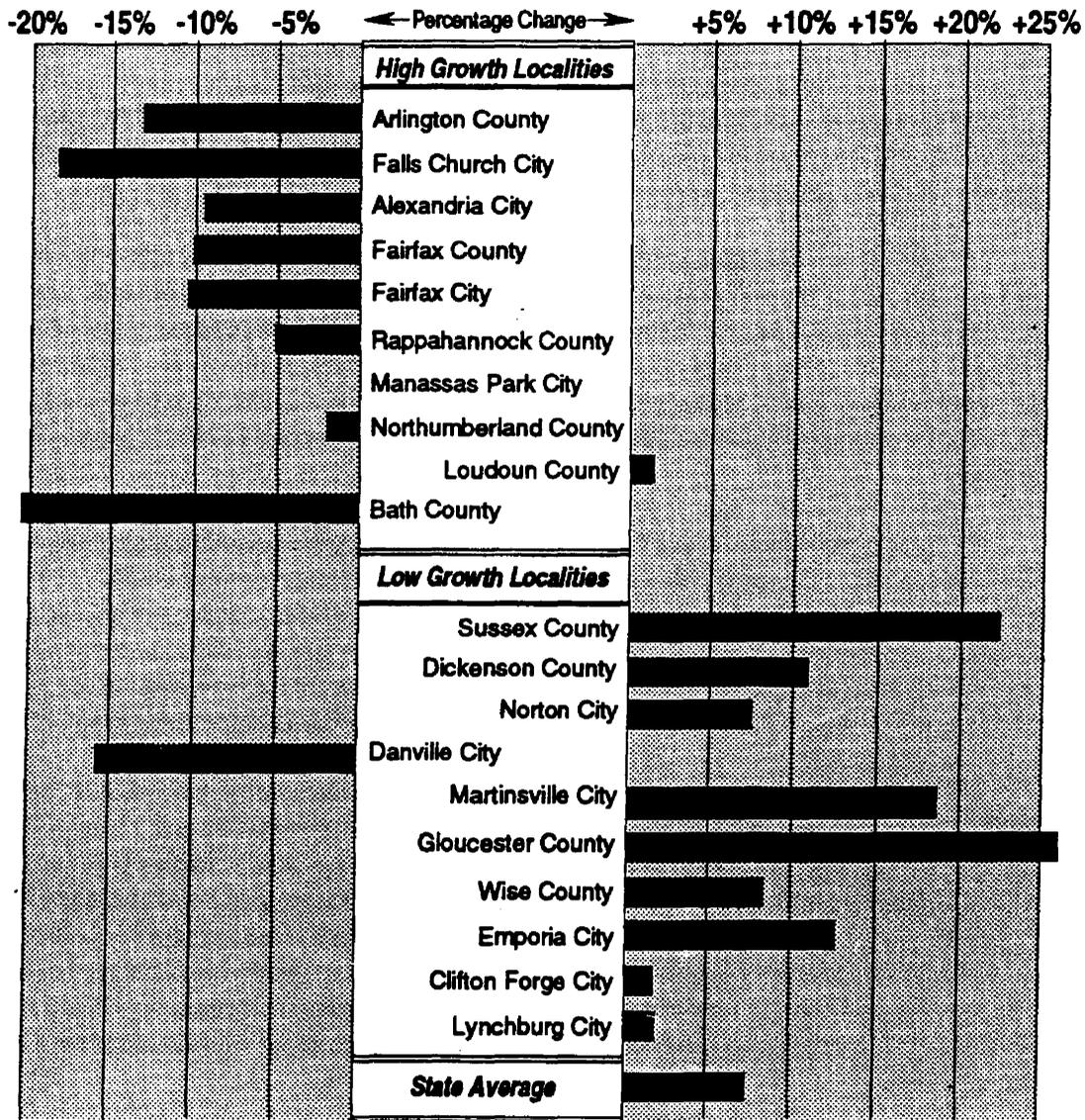
As indicated in Figure 2, seven of the ten localities with the lowest growth in revenue capacity exhibited above-average increases in revenue effort. In these cases, increases in revenue capacity alone were apparently not sufficient to provide local services absent an increase in local revenue effort. However, in some cases, localities with high revenue capacity growth registered declines in revenue effort. For example, nine of the ten localities with the highest growth in local revenue capacity had decreases in local revenue effort. The strong growth in local revenue capacity possibly enabled these local governments to collect sufficient revenues to meet service demands with lower revenue efforts.

Use of Taxing Authority

To obtain a more distinct understanding of how revenue effort increased, JLARC staff examined local governments' taxing authority. Information on which much of the analysis is based was prepared on an accelerated basis by the Center for Public Service for use in this JLARC report. The Center's report, *Special Analysis of City and County Taxes*, is available through the University of Virginia Center for Public Service and JLARC.

Figure 2

Change in Revenue Effort FY 1985 - FY 1989



Source: JLARC staff analysis of Commission on Local Government data.

Examination of local governments' use of individual taxes revealed that localities have both adopted new taxes and increased effective rates on existing taxes. In addition, localities have increased their use of non-tax revenue sources such as user fees and fines.

Changes in Taxing Authority Granted. Since 1983, the General Assembly has granted localities some additional taxing authority. Counties have been given authority to impose meals/prepared foods and transient occupancy taxes. Previously, only selected counties were allowed to use these taxes. Unlike cities, however, restrictions on the use of these taxes exists for counties. Most counties must get voter approval to impose the meals tax, and it is also capped at four percent for counties. For the transient occupancy tax, the amount of the tax is capped at two percent. Even with these constraints, counties are increasingly using these taxes.

In addition, all localities were given authority to impose an oil severance tax in 1985. However, this authority expires in July 1992. Only six counties, primarily in Southwest Virginia, levy this tax.

Finally, in 1989 seven cities and four counties in the Northern Virginia and Tidewater areas were given authority to impose a local option income tax under certain conditions. This tax must first be approved through voter referendum, which authorizes the tax for five years. Further, the revenues generated from the income tax can only be used for transportation-related activities. None of the eligible localities have imposed this tax.

Imposition of New Taxes. Table 3 identifies the major local taxes and the number of local governments imposing each tax. As the table indicates, over the last several years localities are increasingly using the taxes available to them. For example, since 1983, a utility license tax has been added by 45 local governments — 42 counties and three cities. Currently, 82 percent of all cities and counties impose this tax. In addition, 34 counties have imposed the transient occupancy tax since it was authorized for all counties in 1985. Only one locality eliminated a tax from use. Rappahannock County no longer imposes a machinery and tools tax.

These results clearly suggest that localities are using most of the major taxes currently authorized. The meals tax is the only major tax authorized for all cities and counties which is not used by a majority of them. A possible reason for the relatively low use of the meals tax among counties is the condition that counties obtain voter approval before imposing the tax. Of the four meals tax referenda voted on in November 1991, only one was passed. In addition, counties may not levy the meals tax within the limits of an incorporated town unless the town grants the county such authority. Appendices E and F provide full listings of local taxing authority and the taxes imposed by each locality.

Changes in Effective Tax Rates. Another important component of taxing authority is the extent to which localities have increased their tax rates. Table 4 shows the number of cities and counties which have increased or decreased their tax rates for eight principal taxes.

The first important finding is that for each of the taxes examined, more localities showed increases than decreases in tax rates. In some cases, the difference is quite large. For example, from FY 1983 to FY 1989, 69 localities increased their effective tangible personal property tax rate, while only 25 decreased the tax rate. The vehicle license tax

Table 3

**Comparison of Local Taxes Levied
FYs 1977, 1983, and 1992**

Tax	Cities			Counties		
	FY 1977	FY 1983	FY 1992	FY 1977	FY 1983	FY 1992
Real Property	41	41	41	95	95	95
Tangible Personal Property	41	41	41	95	95	95
Retail Sales	41	41	41	95	95	95
Machinery and Tools	41	41	41	94	95	94
Motor Vehicle License	41	41	41	80	87	93
Consumer Utility	36	38	40	33	50	76
Utility License	37	37	40	9	29	71
Meals/Prepared Food	11	18	40	NA	NA	12
Transient Occupancy	16	21	35	5	5	39
Cigarette*	15	16	18	2	2	2

*Only two counties are authorized to impose a cigarette tax.

NA: Not authorized for use by counties in FY 1977 and 1983.

Source: *State Mandates on Local Governments and Local Financial Resources*, JLARC, 1983; and the Center for Public Service, University of Virginia.

Table 4

**Changes in Local Effective Tax Rates for Selected Taxes
FY 1983 - FY 1989**

	Tax Increase			Tax Decrease		
	City	County	Total	City	County	Total
Real Property	16	62	78	28	24	52
Tangible Personal Property	15	54	69	8	17	25
Consumer Utility	8	10	18	6	5	11
Motor Vehicle License	19	55	74	1	3	4
Meals/Prepared Food	7	0	7	1	0	1
Transient Occupancy	10	0	10	0	0	0
Cigarette	10	0	10	0	0	0

Source: JLARC staff analysis of data published by the Center for Public Service, University of Virginia.

is another tax with a striking difference between the number of localities increasing and decreasing the effective rate in the period examined. Between FY 1983 and FY 1989, 74 localities increased the effective tax rate, while only four localities decreased the effective rate.

The trend observed for the real property tax is particularly noteworthy. The 1983 JLARC report showed that 84 localities had decreased their effective real property tax rates from FY 1977 through FY 1983, while 50 had increased the rates. However, between FY 1983 and FY 1989, 78 localities increased the effective real property tax rates and 52 decreased rates. For the same period, the assessed value of real property increased more than 96 percent. This increase was far greater than inflation as measured by the consumer price index (24 percent). This increase in effective real property tax rates by a majority of localities could indicate that many local governments, despite a robust economy, needed increasing revenues from local property taxes to continue to provide needed or desired levels of local government services.

Non-Tax Sources of Local Revenue. In addition to taxes, localities use other sources, such as fines and user fees, to increase local revenues. Non-tax revenues accounted for only 13 percent of locally-generated revenues in FY 1990. They are important, however, because they can help local governments support specific operations and services. For example, a county may charge residents for trash pick-up. Those charges are then used to maintain the collection service.

The proportion of total local revenues from tax and non-tax sources remained fairly constant between FY 1983 and FY 1989. Since the number of tax sources and rates imposed by local governments during that period increased, it would be expected that non-tax revenue mechanisms would also have had to increase in order for the proportions to remain constant. This increase in non-tax mechanisms is supported by local officials' survey responses. Fifty-four localities reported that they increased and/or levied new fines or user fees in FY 1988 through FY 1989.

Effects of Revenue Capacity and Revenue Effort

The apparent trend of low revenue capacity growth and an increasing revenue effort has a source of concern. A locality with slow growth in revenue capacity has limited ability to continue supporting local services. And a locality with a growing revenue effort is reducing its ability to tap available local resources in the future as the need for revenues continues to increase.

Forty-one localities experienced growth greater than the median growth rate for revenue effort and below the median growth rate in revenue capacity (Figure 3). In this situation, a locality has a limited source of revenues, and is tapping this revenue at a growing rate. These local governments may be in a relatively weak position to rely on raising taxes in order to continue providing local services in the future — both mandated and local option services.

LOCALITY ADJUSTED GROSS INCOME

Adjusted gross income (AGI) is the income reported by Virginia taxpayers each year on Virginia's income tax reporting forms. AGI is also an important dimension of a local government's overall fiscal health, because some of a locality's ability to raise revenues to provide both mandated and local option services will likely depend in part on its residents' incomes. AGI is used in some State funding formulas that distribute significant amounts of aid to local governments — for example, the composite index for distributing basic aid for education. AGI is also used as one dimension in calculating both local revenue capacity per capita and local fiscal stress.

Calculating Adjusted Gross Income

AGI in Virginia is based on federal adjusted gross income with several adjustments. These adjustments include both the addition and subtraction of certain items to the federal adjusted gross income. According to the report titled *1989 Virginia AGI: Distribution of Virginia Adjusted Gross Income by Income Class and Locality*, issued by the Center for Public Service at the University of Virginia, the following items are added to the federal adjusted gross income in calculating Virginia AGI:

- interest from debt instruments of other states,
- the ordinary income portion of a lump sum distribution from a qualified retirement plan, and
- interest and dividend income which U.S. law exempts from federal income tax but not state income tax.

Items subtracted from federal adjusted gross income include:

- all or a portion of qualified retirement benefits if retirement income was less than \$40,001;
- interest from federal obligations exempt from state income tax but not federal income tax;
- certain benefits received under the Social Security Act, Railroad Retirement Act, and the Workman's Compensation Act; and
- foreign source income received as a Virginia resident.

Unlike personal income, Virginia AGI also excludes transfer payments, certain fringe benefits, income of persons not required to file a tax return, and income of non-resident military personnel. While overall these exclusions may be slight, they can substantially affect calculations for individual localities. For example, the exclusion of

non-resident military income from AGI can have a significant impact on the apparent wealth of the Hampton Roads area due to the relatively large military population.

Median Adjusted Gross Income, 1985-1989

There are a number of different measures of AGI available for analysis. These include the AGI per exemption and the median AGI of all returns, married couple returns, and individual returns. The composite fiscal stress index calculated by the Commission on Local Government (COLG) uses the median AGI of all returns. Therefore, this measure was selected for further analysis.

Median AGI for All Returns, 1989. In 1989, the statewide median AGI was \$20,945. For counties the median AGI was \$23,037, as compared to \$18,365 for cities. On a locality-by-locality basis, there was wide variation in the level of AGI. Northampton County had the lowest AGI at \$12,801. Fairfax County's AGI — \$33,240 — was the State's highest. A complete listing of median AGI for all returns is provided in Appendix G. Table 5 displays the median AGI for cities and counties since 1985.

Growth in Median AGI for All Returns, 1985-1989. The median growth rate in AGI between 1985 and 1989 was approximately 18 percent. For the same period, growth in the consumer price index was about 15 percent. This indicates that the AGI of most Virginia localities grew at a higher rate than inflation. Forty-eight localities, however, did not experience growth in median AGI greater than inflation as measured by the consumer price index (Figure 4).

Although local revenue capacity, revenue effort, and median AGI individually are measures of local fiscal conditions, the composite fiscal stress index provides a broader measure of local financial stress by combining these three measures. The composite fiscal stress index was designed to illustrate the cumulative conditions of these fiscal indicators.

Table 5

Median Locality Adjusted Gross Income

<u>Year</u>	<u>State</u>	<u>Cities</u>	<u>Counties</u>
1985	\$17,700	\$16,037	\$18,944
1986	18,627	16,746	19,950
1987	19,335	17,261	21,267
1988	20,661	18,408	22,552
1989	29,945	18,365	23,037

Source: *Virginia AGI: Distribution of Virginia Adjusted Gross Income by Income Class and Locality*; 1985, 1986, 1987, 1988, and 1989; Center for Public Service, University of Virginia.

COMPOSITE FISCAL STRESS INDEX

In 1983, JLARC developed a composite fiscal stress index. This index identified those local governments with relatively poor fiscal conditions across a number of indicators. The index is a relative measure in that it identifies those local governments experiencing high fiscal stress compared to other local governments. In FY 1989, there was significant variation in the levels of stress faced by local governments in Virginia. As in years past, cities showed a higher level of fiscal stress than counties.

Calculating Local Fiscal Stress

Measures of revenue capacity, revenue effort, and resident income provide reliable indicators of a local government's fiscal position. However, none of these measures alone is an adequate indicator of local fiscal condition. Rather, a local government that shows a pattern of stress across all of the indicators may more reliably be considered to have a poor fiscal condition.

The original composite stress index developed by JLARC measured stress across five indicators of local fiscal health — revenue capacity, change in revenue capacity, revenue effort, change in revenue effort, and resident income (proxied by the poverty rate, median family income, and change in income). The Commission on Local Government is currently responsible for reviewing the methodology and annually updating the fiscal stress measure.

In that role, the COLG revised the original methodology developed by JLARC for the fiscal stress measure beginning with the FY 1989 composite fiscal stress index. For FY 1989, the COLG calculated the composite fiscal stress across three measures — revenue capacity, revenue effort, and median adjusted gross income (all State tax returns). A detailed discussion of the calculation of the fiscal stress index and the revision to the fiscal stress methodology is available in the COLG's 1991 *Report on the Comparative Revenue Capacity, Revenue Effort, and Fiscal Stress of Virginia's Counties and Cities 1988/89*.

In order to combine a locality's relative standing in terms of the three measures into a single composite fiscal stress index, the raw scores for each measure were standardized. This standardization was achieved in two steps. First, each raw score was converted into a corresponding z-score. (The z-score is a commonly used statistical transformation, which represents how many standard deviations a raw score value is from its mean value.) The second step was to convert each z-score into a number, called a relative stress score, which is positive in all cases. After the standardization was completed, a composite fiscal stress index was calculated for each locality by summing the relative stress scores across the three measures. Exhibit 4 illustrates the calculation.

Staff of the COLG indicated that the new methodology yields an "increased degree of statistical precision" using the most up-to-date indicators available. For

Exhibit 4

Computing the Local Fiscal Stress Index

Fiscal Stress = Revenue Capacity Per-Capita Relative Stress Score
+ Revenue Effort Relative Stress Score
+ Median Adjusted Gross Income Relative Stress Score

Example: Brunswick County (1989)

		<u>Relative Stress Score</u>
Fiscal Stress	= Revenue Capacity Per-Capita	58.20
	+ Revenue Effort	51.37
	+ Median Adjusted Gross Income	60.98
		<hr/>
	Composite Fiscal Stress	= 170.55

Source: JLARC staff exhibit of Commission on Local Government data.

example, relying exclusively on median adjusted gross income obviates using a poverty indicator which at the time of the FY 1989 fiscal stress calculations was approximately ten years old.

Local Fiscal Stress In Virginia

It is important to emphasize that the composite stress index is a relative measure. It serves to identify those local governments which are experiencing a high level of fiscal stress compared to other local governments across the State. This means that whether overall local fiscal conditions are good or bad, roughly one-half of all localities will have an above-average fiscal position and approximately one-half will have a below-average fiscal position.

FY 1989 Local Fiscal Stress. Fiscal year 1989 statewide fiscal stress rankings were developed based on a locality's fiscal stress score relative to the statewide average and the distance from the average as measured by the standard deviation. In FY 1989, the average fiscal stress score was 165. The standard deviation was 9.53. Therefore, any locality with a composite fiscal stress score equal to or greater than 165 but less than 174.53 (one standard deviation above the average score) was characterized as experiencing "above average fiscal stress." Those with a fiscal stress score greater than one

standard deviation above the average (174.53) were characterized as experiencing "high fiscal stress."

On the other hand, localities with a fiscal stress score below the statewide average score of 165 were in a relatively good fiscal position compared to other localities. Those localities with a fiscal stress score less than 155.47 (one standard deviation below the average score) were characterized as experiencing "low fiscal stress." A listing of the fiscal stress score for each city and county is included in Appendix H to this report.

There is wide variation in the FY 1989 fiscal stress scores. Stress scores ranged from a low of 126.18 in Bath County to a high of 183.73 in the City of Norfolk. Clearly Bath County, which generates much of its revenue from a Virginia Power generating station, had relatively low levels of stress. The City of Norfolk, on the other hand, had high levels of stress across all of the indicators.

Figure 5 illustrates the statewide distribution of local fiscal stress scores. The majority of localities in the Southwest, Southside, and Tidewater regions of the State experienced high or above-average stress. Localities in the Shenandoah Valley region were generally experiencing below average stress. Finally, many of the localities in Northern Virginia and Piedmont appeared to have low stress.

City/County Differences. Cities were more likely to experience higher levels of fiscal stress relative to counties. For FY 1989, cities had an average stress index score of 171.7 compared to the county average of 162.1. Further, of the 21 localities classified as high stress, 18 were cities and only three were counties. In fact, 88 percent of all cities were considered to have above-average or high fiscal stress. Of the five cities with below-average or low fiscal stress, four were located in the Northern Virginia region.

While only 12 percent of cities enjoyed below-average or low fiscal stress, 59 percent of Virginia's counties fell into this category. In fact, 13 counties were considered to have low fiscal stress, while only four cities — Falls Church, Fairfax, Manassas, and Alexandria — were in this category.

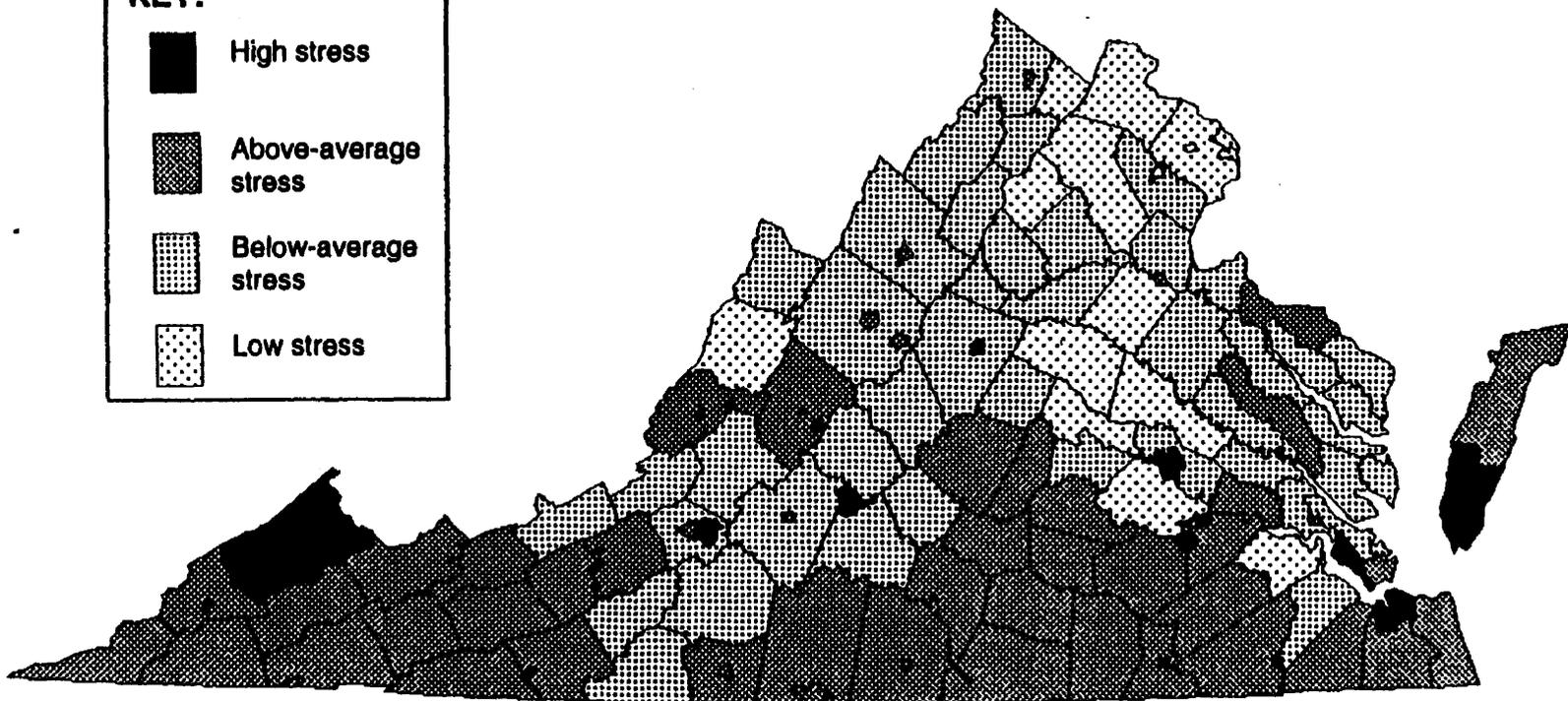
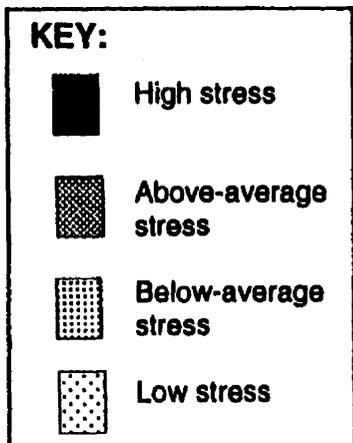
As in the two previous JLARC reports, high revenue effort was the greatest stress facing cities. More than 92 percent of all cities had an above-average revenue effort. Overall, the average revenue effort in cities was substantially higher than that of counties. For FY 1989, the revenue effort for cities was 74 percent greater than that displayed by counties.

MORE RECENT ECONOMIC INDICATORS SUGGEST DETERIORATING LOCAL FISCAL CONDITIONS

For most of the decade of the 1980s, the economies of both the United States and Virginia experienced strong growth. As evidenced by the number of localities with revenue capacity growth greater than common measures of inflation, many local

Figure 5

Local Fiscal Stress - FY 1989



Source: Commission on Local Government, September 1991.

governments shared in this growth. Yet the increasing revenue effort of many local governments suggests that, despite substantial growth, local governments increased taxes to provide required or desired levels of services. Because the fiscal stress, revenue effort, and revenue capacity measures illustrate local conditions only through FY 1989, it was necessary to review other indicators to illustrate the potential fiscal conditions local governments have faced since FY 1989.

Many selected indicators suggest that local fiscal conditions have worsened since FY 1989. While local revenue growth has typically mirrored that of the State, the State's revenue slowdown as well as the performance of many economic indicators suggest that local revenue growth is not continuing at a robust rate. The State's reductions in aid to localities for the 1990-1992 biennium have also added to the fiscal strain of local governments. Finally, the magnitude of recent budget actions taken by local governments provides further evidence of the worsening fiscal conditions faced by many local governments.

Future Local Revenue Growth Will Likely Moderate

Like the State, local governments enjoyed tremendous revenue growth during the economic expansion of the 1980s. However, common economic indicators suggest that economic growth in Virginia, and therefore Virginia's local governments, has subsided since 1989. For the FY 1985 through FY 1990 period, local revenues increased more than 80 percent. Growth in local revenues was similar to growth in the State's general fund revenues. Yet the State's revenue growth slowed substantially beginning in 1989.

Planned reductions in the United States' defense budget also have the potential to negatively affect local governments. Finally, in selected localities for which FY 1991 and projected FY 1992 and FY 1993 data were obtained, local revenue growth in selected revenue sources has not matched historical increases. In fact, for some local governments, declines in certain revenue sources have occurred.

Recent Economic Recession Has Negatively Affected Local Governments. The most recent recession has not left Virginia or its local governments untouched. The poor fiscal conditions faced by many local governments in Virginia may be evident in several economic statistics.

Since the beginning of the recession, employment in specific job classifications showed dramatic decreases. For example, construction-related employment in the Northern Virginia and Hampton Roads areas decreased by 35 and 21 percent, respectively. Other areas of the State were also affected by the decline in relatively high paying construction-related employment in the Northern Virginia region. As noted by the Virginia Employment Commission (VEC):

Northern Virginia real estate has been devastated, and this has produced high unemployment among construction workers in the rural areas thirty to eighty miles south and west of Washington, D.C.

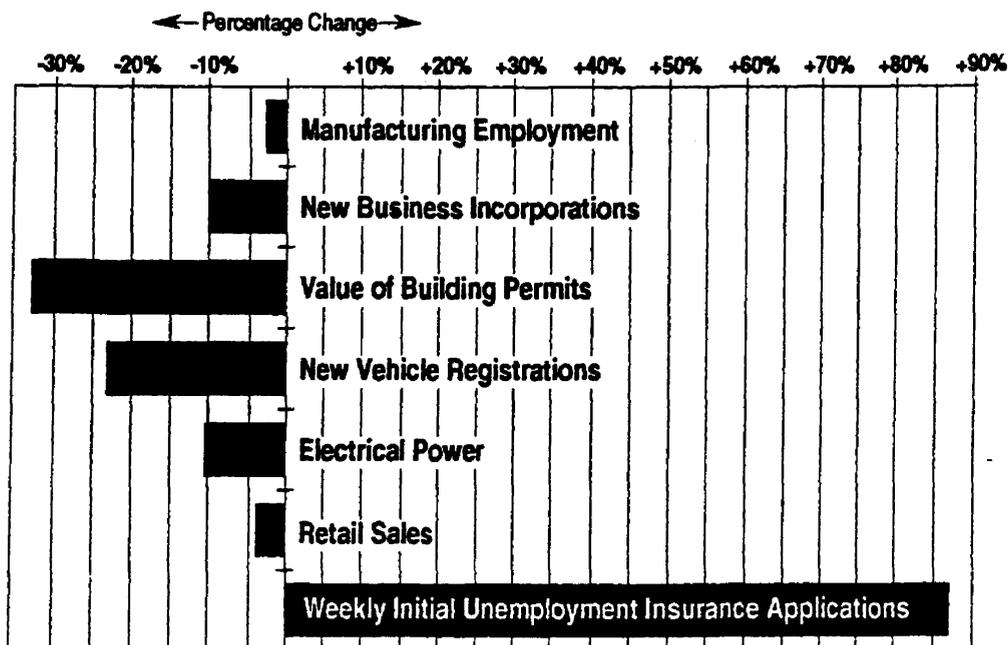
The impact of the national recession was also felt in other economic areas commonly used as measures of Virginia's overall economic health. Thirteen of 15 economic indicators used by the VEC showed unfavorable changes for the January 1990 to January 1991 period. Many of these indicators registered substantial declines (Figure 6). For example, new vehicle registrations and valuation of building permits registered declines of greater than 20 percent. Other economic indicators registered somewhat less substantial declines.

Decreases in employment and earnings can directly affect home sales and prices. In Alexandria City and Arlington and Fairfax Counties, housing sales between 1989 and 1990 decreased 23 percent. In addition, sale prices of homes declined by almost five percent.

Commercial real estate has also been affected. Fairfax County reported that the value of building permits declined by \$389 million for the first nine months of 1990. The county also noted:

Figure 6

Change in Virginia Economic Indicators January 1990 - January 1991



Source: JLARC staff analysis of data published by the Virginia Employment Commission.

[One] component of real estate tax is normal growth in residential and commercial sectors. This rate is estimated at two percent for 1992, the lowest level of growth the County has experienced in twenty years.

The effect of the most recent recession on the commercial real estate sector has the potential to affect the local economy for years. In a recent United States Conference of Mayors study, one Virginia city commented that:

The very significant difference in the cause of this recession compared to the last one creates uncertainty about the long term impact and the nature of the eventual recovery from the current recession.... Due to the fact that the city is largely dependent upon property taxes, the effects of the current recession will restrict budgetary options for the next three to five years as demand "catches up" to the oversupply of vacant commercial office and retail space in the region.

These trends are particularly noteworthy since they could be reflective of an overall trend in the value of real estate which, through real property taxes, can lead to little or no growth in local revenues.

Declining State Revenues Suggest Declines in Local Revenues. Like the State, local governments also enjoyed substantial growth in locally-raised revenues from FY 1980 through FY 1990. In fact, as compared to the growth in State general fund revenues, growth in locally-raised revenues from FY 1985 through FY 1990 closely matched the State's growth (Figure 7). This growth is likely attributable to increases in population, local revenue capacity, and local revenue effort.

However, in FY 1990, the beginning of a national recession began to affect Virginia. As a result, substantial reductions in State general fund revenue collections occurred. Because growth in locally generated revenues appears to be related to that of the State, it is likely that annual growth in local revenues also will moderate or decline in the near future.

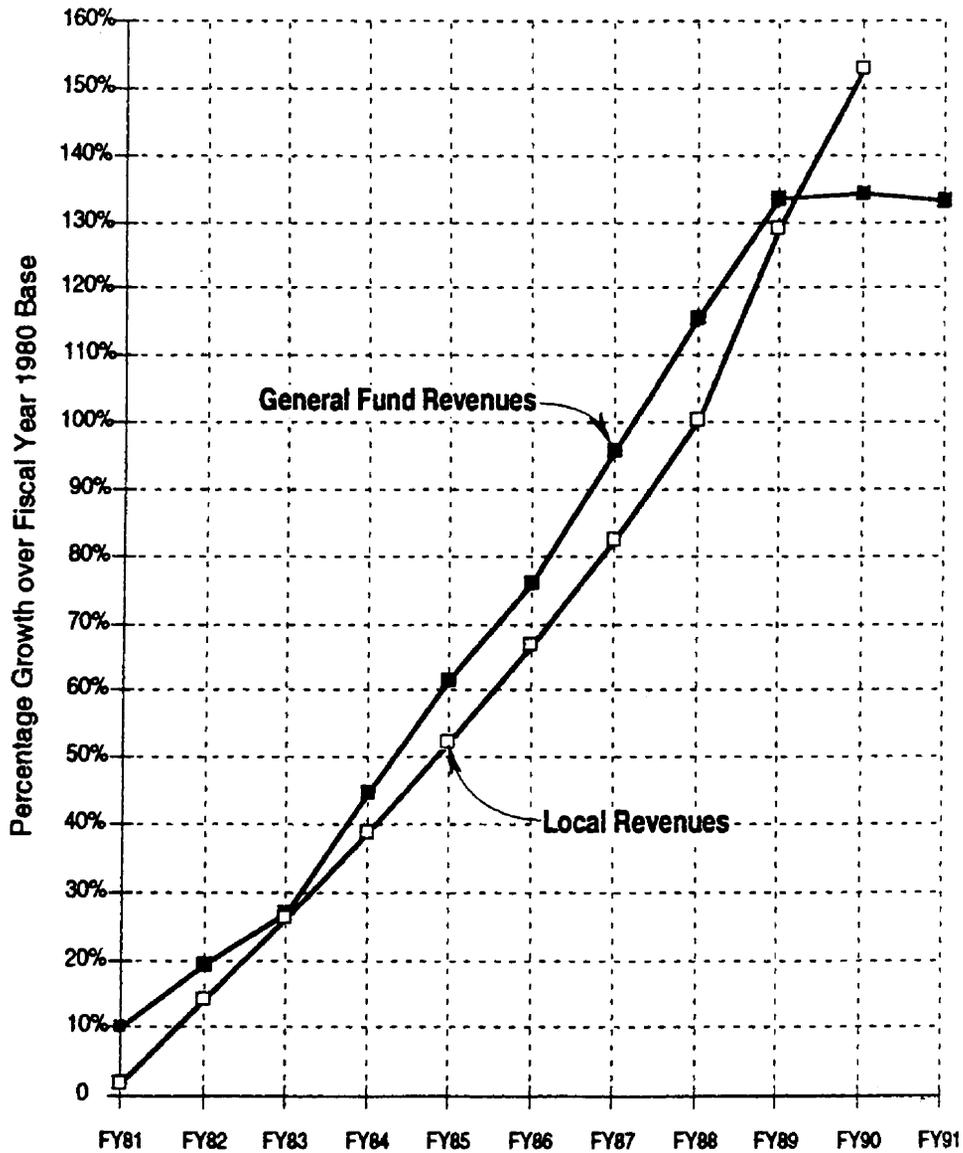
It appears that the impact of the national recession may affect local government revenues later than it has the State's general fund revenues. For example, local government revenue growth exceeded the State's in FY 1990. However, analysis of selected localities' revenue collections for FY 1991 and projections for FY 1992 and FY 1993 indicates that the moderation of local revenue growth began in FY 1991.

Analysis of Selected Localities Indicates Some Local Revenue Sources Will Likely Decline. Comprehensive local financial data is largely unavailable after FY 1990. As a result, JLARC staff collected more recent local financial data for selected localities in order to determine the extent to which local revenue growth has been affected since FY 1990.

For example, Fairfax County experienced annual growth in real property revenue from FY 1985 to FY 1990 averaging more than 15 percent. Yet for the FY 1990

Figure 7

Growth in Local Revenues Compared to Growth in State General Fund Revenues Since Fiscal Year 1980

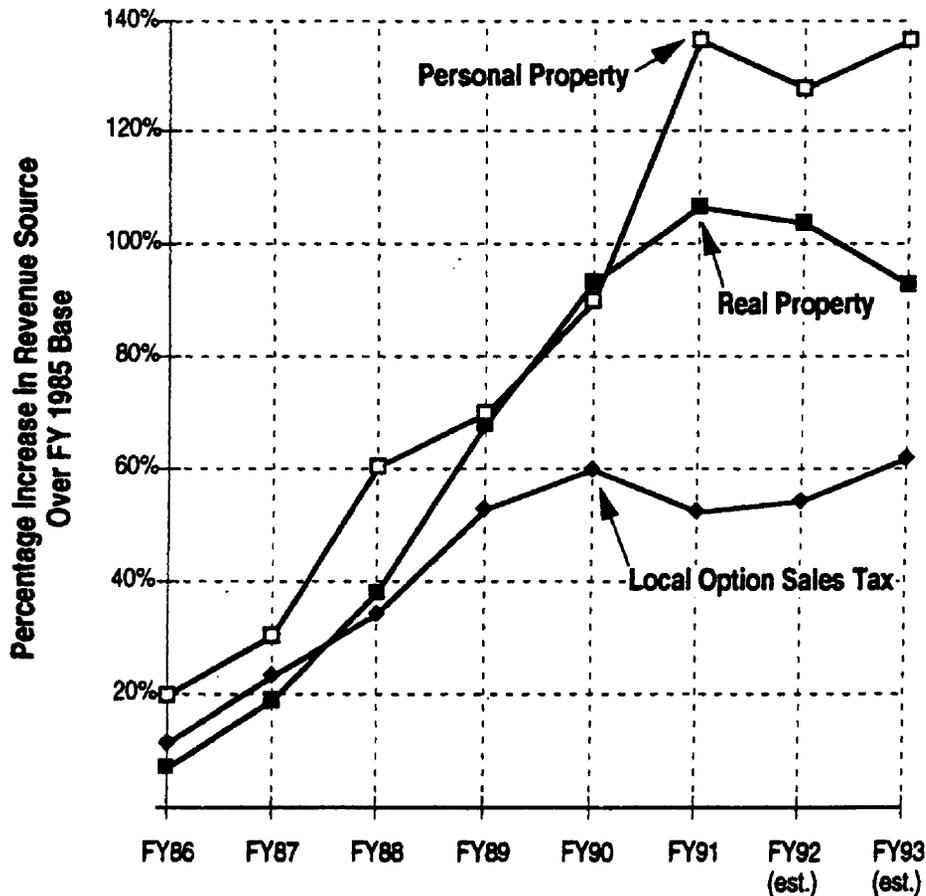


Source: Auditor of Public Accounts data; and Secretary of Finance presentation to Senate Finance, House Appropriations, and House Finance Committees on August 23, 1991.

to FY 1991 period, growth in this revenue source was about seven percent. Average increases in real property revenue for FY 1992 and FY 1993 as compared to FY 1991 is projected to decline by about three percent. Other sources of local revenue have similar trends (Figure 8).

Figure 8

Projected Growth in Selected Local Revenue Sources for Fairfax County FY 1986 - FY 1993



Source: Fairfax County Office of Management and Budget.

Many other localities exhibited similar patterns, although not quite as dramatic. For example, the City of Danville experienced annual growth in local real property tax revenue averaging more than 13 percent for the FY 1985 through FY 1991 period. For FY 1992, growth in projected real property revenues is expected to be only 1.5 percent. Giles County experienced annual growth in real property tax revenues averaging about 10 percent for the FY 1985 through FY 1990 period. For FY 1991, this revenue source declined by about 2.6 percent.

Not all localities for which JLARC had FY 1991 revenue data exhibited decreases in real property tax revenues. But where increases did occur, they were often

at a lower rate than exhibited in previous years. And other revenue sources in these localities may have registered declines. For example, according to data obtained from the Auditor of Public Accounts, York County experienced annual growth in real property tax revenues averaging 19 percent for the FY 1985 through FY 1990 period. In FY 1991, growth in real property taxes was about 16 percent. Yet the amount of revenue York County collected from both the personal property tax and the local option sales tax for FY 1991 was less than the previous year.

Reductions in U.S. Department of Defense Expenditures May Affect Local Governments. In FY 1990, the U.S. Department of Defense (DOD) expended more than \$15.7 billion in Virginia for personnel salaries and procurement contracts. The defense industry has a substantial impact in certain regions of the State — especially Northern and Southeastern Virginia — where it is basically a primary industry. For example, one of the State's largest private sector employers, the Newport News Shipbuilding Company, is very dependent upon DOD shipbuilding contracts. In fact, two planning district commissions, Northern Virginia (PDC 8) and Hampton Roads (PDC 23), accounted for more than 90 percent of the total statewide DoD expenditures for salaries and procurement contracts.

In 1989, future reductions totalling 25 percent were planned for the DoD budget. As noted in the November 1991 issue of the *U.S. Economic Outlook: 1991-94*, the WEFA Group stated that "defense spending will continue to be cut sharply," projecting declines of "7.0%, 6.5% and 5.8% in 1992, 1993, and 1994, respectively." The magnitude of the defense presence in Virginia leads logically to the assumption that these proposed cutbacks have the potential to negatively affect both the State and those local governments with a large military presence. For example, a recent study by the Federal Reserve Bank of Atlanta noted that:

The five states most likely to suffer severely because of defense outlay cuts are Connecticut, Massachusetts, Virginia, Missouri, and Colorado. For the times measured, these states typically have had a larger-than-average share of employees tied to defense

The recent decline in military tensions between the United States and Soviet Union has the potential to further increase cutbacks beyond the 25 percent originally planned for the DoD budget. The consequences of further cutbacks on defense-dependent Virginia localities could be profound.

Reductions in State Aid to Local Governments

In order to address a more than \$2 billion revenue shortfall in the State's 1990-1992 budget, reductions in State aid to local governments were initiated. A total of \$297.6 million in State aid to localities was eliminated for the biennium. This amount represents approximately 13.6 percent of the total budget reductions taken by the State to address the revenue shortfall.

The amount of reductions in State aid to local governments varied by program. Four programs — the educational Standards of Quality, recordation tax, Compensation Board, and aid for law enforcement (“599” funds) — accounted for more than 82 percent of the total reductions (Table 6).

Reductions in aid to local governments add to the difficulties local governments face in their attempts to meet the day-to-day demands for services. Many primary services, such as education, health and welfare, and to some extent public safety and public works, are need-driven. Children must be educated and clients eligible for particular social services must be served. Because many local services are need- or entitlement-driven, local governments have little discretionary control over whether these services are to be provided. They do, however, have somewhat more control over how and how many services are to be provided.

At the present time, anticipated State aid to local governments for FY 1992 is expected to decrease even further from FY 1991 levels. The reductions in aid to localities were minimized to the extent possible for FY 1991 — requiring even greater reductions for FY 1992. Reductions were minimized in the first year of the biennium because at the time the reductions became necessary, local governments had finalized their FY 1991 budgets and were almost two months into the fiscal year operating under that budget.

Despite the reductions in aid to local governments, there is estimated to be a net increase in State aid to local governments from FY 1990 to FY 1991. However, for FY

Table 6

**Reductions in Aid to Local Governments
FY 1990 - 1992 Biennium**

<u>Program</u>	<u>Biennium Reductions</u>	<u>Percentage of Total Reductions</u>
Educational Standards of Quality	\$131.9*	44.3%
Recordation Tax	60.0	20.1
Compensation Board	34.5	11.6
Aid for Law Enforcement (“599” funds)	18.3	6.2
All Other Reductions	<u>52.9</u>	<u>17.8</u>
Total	297.6	100.0

Reductions in the Educational Standards of Quality reflect the restoration of \$15 million in aid in November 1991.

Note: Biennium reductions are in millions of dollars.

Sources: Department of Education, Department of Criminal Justice Services, and the Department of Planning and Budget.

1992, there is estimated to be a slight decline in the amount of State aid provided to local governments compared to the previous fiscal year (Figure 9). This will only increase the fiscal adversity facing local governments for the remainder of FY 1992.

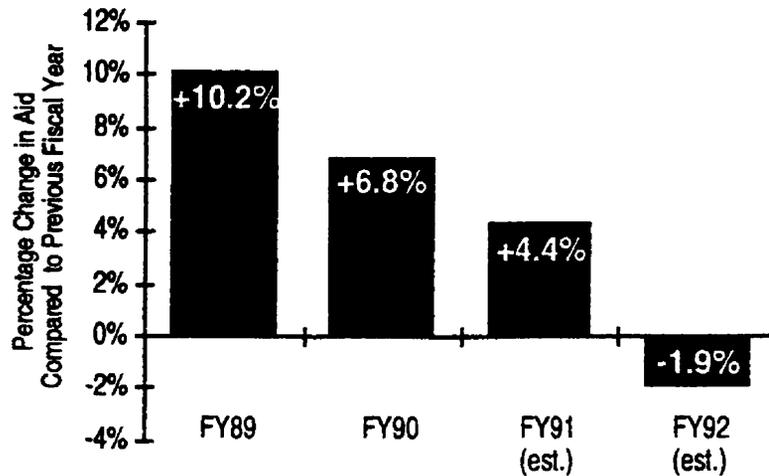
Local Budget Actions To Control Expenditures

If local governments are struggling with inadequate local revenues or weak revenue growth, then actions to control expenditure growth are often taken. When faced with inadequate or slowing revenue growth, local governments may decide to reduce fringe benefits, salaries, or even the number of staff they employ. They may eliminate positions through attrition or by freezing job vacancies. Other budget controls frequently used by local governments include deferral of spending on capital projects and deferral of maintenance on existing equipment and facilities.

Local governments have taken budget actions to control expenditures every year since FY 1985. However, if local government fiscal conditions have worsened since the FY 1989 revenue capacity, revenue effort, and fiscal stress index measures were computed, increases in local government budget actions since that time period should be evident.

Figure 9

State Financial Aid to Local Governments: Increase or Decrease Compared to Previous Fiscal Year, 1988-1992



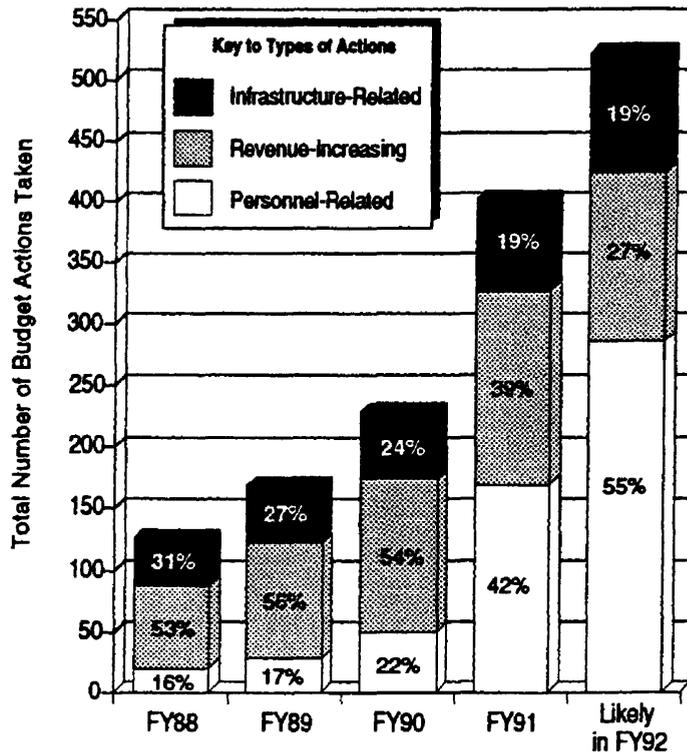
Source: JLARC staff analysis of Department of Accounts data.

Frequency of Budget Actions. The JLARC staff survey asked local officials to note the number of budget actions they took in the past four fiscal years as well as those they were planning to take in FY 1992. Survey responses indicated that local governments have been taking an increasing number of budget actions to control or reduce local expenditures. The number of budget actions taken from FY 1988 through FY 1991 increased by more than 200 percent. If actions planned for FY 1992 are included, the increase is more than 300 percent (Figure 10).

Another indicator of a worsening economic climate at the local level is the number of localities taking three or more budget actions to control expenditures. Twice as many localities took three or more budget actions in FY 1991 compared to the number taken in FY 1990 (Figure 11). This indicates that local government officials are having to use a combination of budget reducing actions to enable them to deliver local services within available revenues.

Figure 10

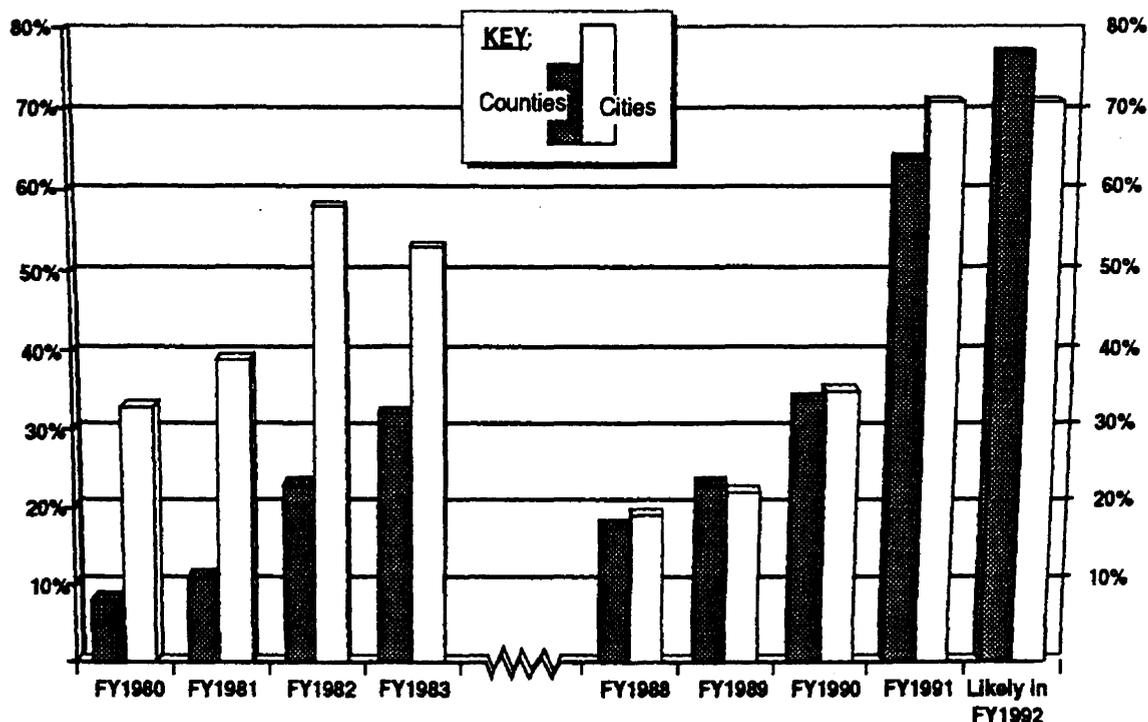
Number and Types of Budget Actions Taken by Local Governments (FY 1988 - FY 1992)



Source: JLARC staff survey of cities and counties, summer 1991. Survey data based on a response of 38 cities (93 percent) and 70 counties (74 percent).

Figure 11

Percentage of Cities and Counties Taking Three or More Budget Actions By Fiscal Year



Source: FY 1980 through FY 1983 data from 1983 JLARC report, *State Mandates on Local Governments and Local Financial Resources*; FY 1988 through FY 1992 data from JLARC staff survey of cities and counties, summer 1991.

In FY 1983, 32 percent of the counties and 53 percent of the cities in Virginia reported taking three or more budget actions to control expenditures. As reflected in Figure 10, more cities than counties were still taking three or more budget actions in FY 1991. However, the difference between the two had narrowed considerably. In FY 1991, about 70 percent of cities reported taking three or more budget actions and more than 60 percent of counties reported taking three or more budget actions. In FY 1992, more counties than cities planned to take three or more budget actions to control expenditures.

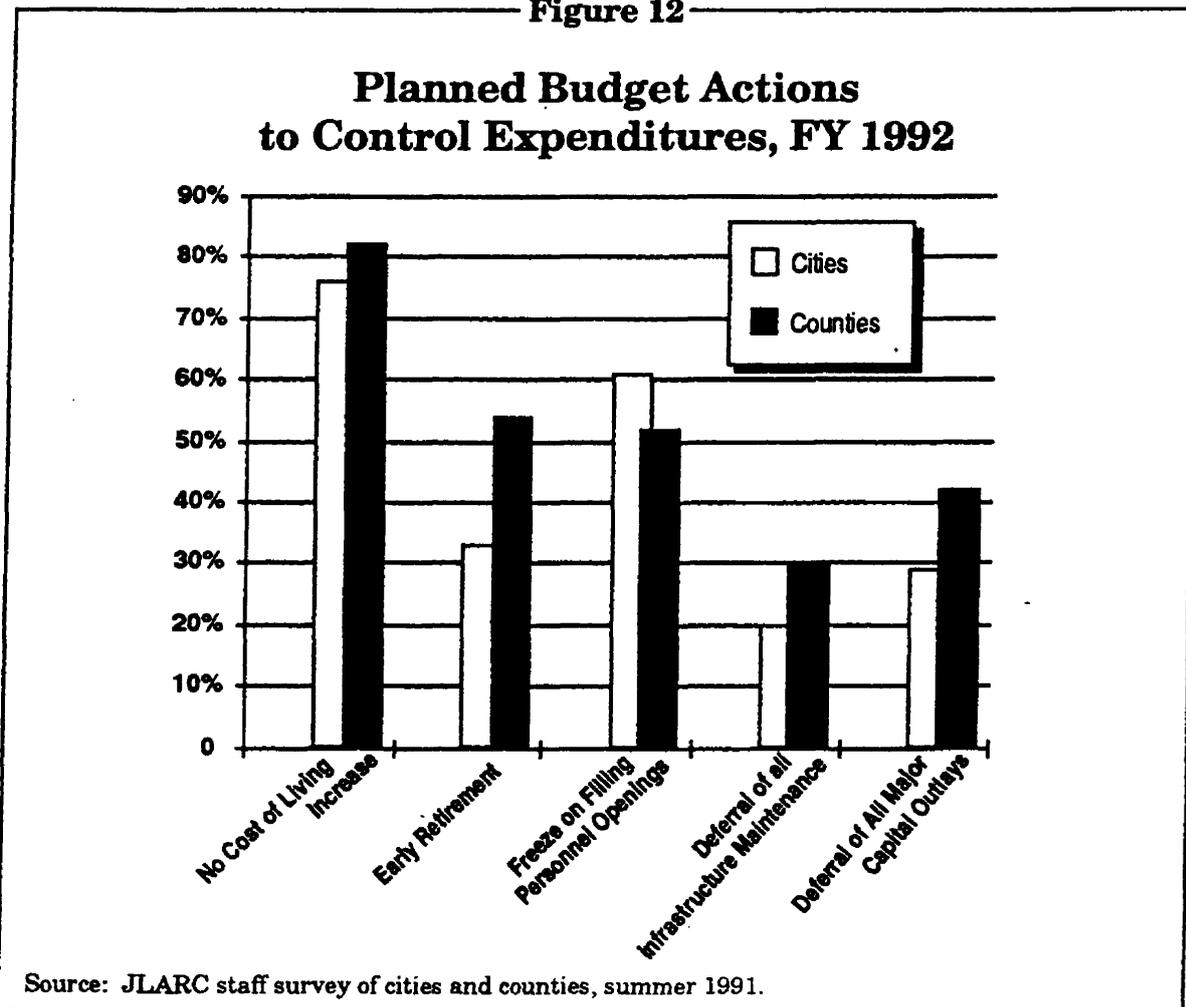
This narrowing of the frequency with which cities and counties are taking multiple budget actions is important. Clearly, both cities and counties are facing increasing strain in providing local services within their available revenues. Counties, as measured by the fiscal stress index, revenue capacity, and revenue effort measures, are considered to have overall better fiscal conditions than cities. Yet their responses to

the JLARC staff survey indicate that they are dealing with many of the same problems as cities. It is also noteworthy that the localities in the Northern Virginia area, which had high and rapidly growing revenue capacities and decreasing revenue efforts during the late 1980s, have taken the most budget actions to control expenditures since FY 1991.

Types of Budget Actions. The specific types of budget actions taken by local governments are also important. In FY 1992, both cities and counties will rely extensively on personnel actions and, to a lesser extent, deferral of all capital outlays and infrastructure maintenance to control expenditures (Figure 12). The most frequently used personnel actions include eliminating cost-of-living increases for employees and use of early retirement to reduce staff positions. For example, more than 75 percent of cities and counties anticipate providing no cost-of-living increase in salaries of full-time staff.

These actions, while necessary, can have implications for both the level and quality of service delivery at the local level. Reductions in staff levels can result in a decreased level of services or an increase in the time necessary to deliver the services. Deferring maintenance or construction of infrastructure can also negatively affect

Figure 12



operations and services. Capital needs cannot be postponed indefinitely. In fact, delaying infrastructure maintenance can lead to a situation where portions of the infrastructure deteriorate to the point where very costly replacement, rather than less costly repairs, is necessary.

Conclusion

The available data appear to indicate that local revenue growth statewide for FY 1991 and beyond will likely slow substantially from rates achieved in previous years. This indicates that local governments may have to reduce expenditures in local option programs, increase taxes, or turn to other revenue-raising alternatives in order to continue providing mandated services. Because local governments will likely not have the increasing fiscal capacity of the FY 1985 through FY 1990 period, the necessity of imposing State mandates on local governments should be carefully considered.

Chapter III: Mandates on Local Governments

State and federal mandates have been a long-standing concern to local government officials in Virginia and nationally. Federal and State officials generally view mandates as a legitimate and necessary tool for implementing needed policies and ensuring some level of basic services. While local officials also tend to recognize the necessity of some mandates, they have been critical of the manner in which mandates are implemented and of the continuous enforcement of mandates without, as they perceive, sufficient monetary resources to comply.

Evidence suggests that although the State has taken steps to mitigate the impact of mandates on localities, mandates are still a problem for local governments. Some of the more problematic mandates originated at the federal level, and therefore, few immediate changes can be made to streamline and reduce the impact they have on local governments. However, there are some actions that the State can take to help ensure that local governments are able to adequately meet mandate requirements and to better inform the General Assembly of the potential impact of proposed legislative mandates.

LOCAL CONCERNS ABOUT MANDATES

Local officials were asked on the JLARC local government survey whether they considered State and federal mandates to be a problem. Over 90 percent of the localities that responded stated that mandates, in general, were a problem. Localities cited five broad-based concerns with mandates:

- the cumulative impact of mandates,
- the lack of local input into the development of mandates,
- inflexibility of mandates,
- overlapping mandates, and
- inadequate funding to meet mandates.

In addition, local governments rated specific mandate areas by indicating the extent to which they considered the mandates to be reasonable or unreasonable.

Analyses indicate that in some cases, local officials' concerns are warranted. Specifically, JLARC staff found:

- Mandates are extensive, covering most areas of local government activity.
- The number of mandates imposed on local governments increases yearly.
- In some cases, mandates do not allow local governments sufficient flexibility in implementation.
- Some mandates issued by State agencies overlap with each other.

However, the State has taken actions to address some of the problems cited by local governments. These include recent steps by the executive branch to relieve administrative burdens placed on local governments. Local concerns regarding the adequacy of funding for mandates will be addressed in Chapter IV.

Extensiveness of Mandates

State and federal mandates on local governments are extensive, affecting most areas of local government activity. As of December 1991, a total of 338 State and federal mandates have been identified as affecting local governments.

Although individual mandates can have a great impact on localities, when viewed collectively they generate even greater concern. Figure 13 shows the proportion of mandates imposed on local governments by functional area. The area most affected by State and federal mandates is health and welfare — 26 percent of all mandates on localities. Within health and welfare, mandates imposed on local social services departments are particularly extensive. A substantial proportion of mandates also pertains to local school systems. Few mandates are imposed in the areas of parks, recreation, and libraries, and the administration of the judicial system.

There are three types of mandates which affect local governments: those which are required regardless of any funding; those required as a condition of aid; and those required if the locality chooses to perform an optional activity. The following examples illustrate each mandate type.

Required Regardless of Funding (Compulsory Orders): Localities must adopt ordinances regulating the subdivision of land and its development.

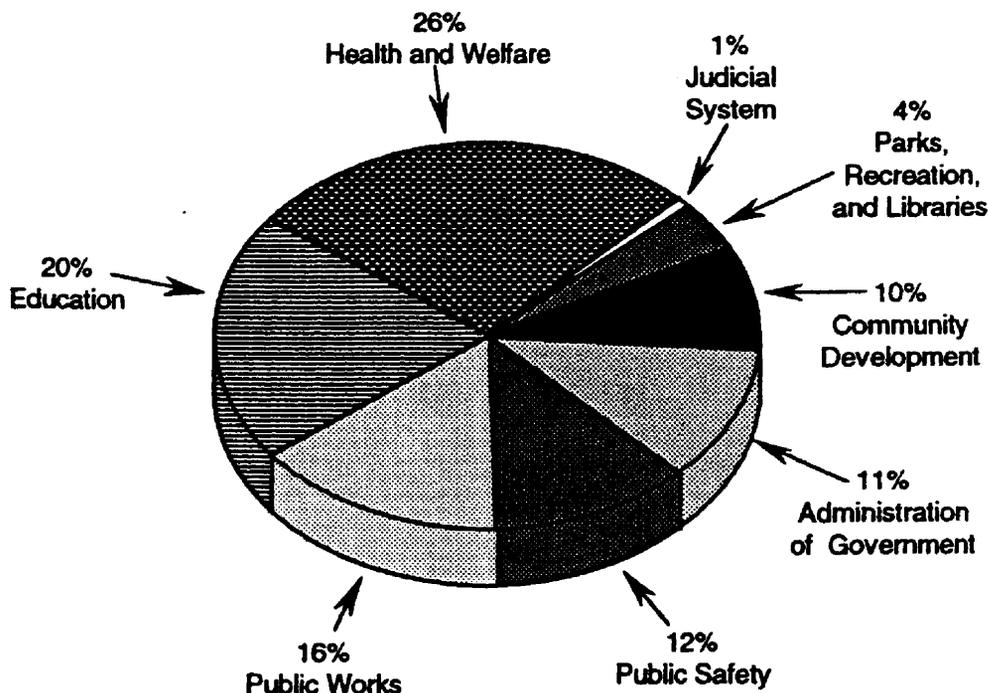
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Required as a Condition of Financial Aid: Local governments must have new model buses tested at a facility in Altoona, Pennsylvania, in order to receive federal mass transit grant funding.

* * *

Figure 13

Proportion of State and Federal Mandates on Localities by Functional Area, 1991



N = 338

Source: JLARC staff analysis of *Code of Virginia*; survey of cities and counties, summer 1991; and survey of State agencies, summer 1991.

Required if a Locality Chooses to Perform an Optional Activity: If transportation of non-handicapped children is provided, school divisions must conform to State regulations regarding equipment, insurance, and driver qualifications.

Table 7 summarizes the number of mandates imposed on local governments by functional area and according to the type of mandate. Most of the mandates identified — 61 percent — are required regardless of whether a locality receives any funding for the mandated program. Over one-fourth of the mandates which are conditions of aid or of a

Table 7

**Number of Mandates by Functional Area
and by Type of Mandate, 1991**

Functional Area	Total Number of Mandates	Required Regardless of Funding	Required as Condition of Aid	Required if Activity Performed
Health and Welfare	89	66	9	14
Education	68	57	9	2
Public Works	53	19	16	18
Public Safety	40	15	17	8
Administration of Government	37	35	2	0
Community Development	35	8	18	9
Parks, Recreation, and Libraries	13	2	6	5
Judiciary System	<u>3</u>	<u>3</u>	<u>0</u>	<u>0</u>
Total	338	205	77	56

Source: JLARC staff analysis of *Code of Virginia*; survey of cities and counties, summer 1991; survey of State agencies, summer 1991.

locality choosing to perform an activity are accounted for through public works activities. Though optional, most localities are in fact affected by these mandates, since they pertain to such activities as the construction and operation of water and wastewater facilities, and the construction and maintenance of streets.

A companion JLARC report titled *Catalog of State and Federal Mandates on Local Governments* lists each of the 338 mandates and identifies whether each is required regardless of funding, required as a condition of aid, or required if a locality chooses to perform an optional activity. The report also identifies localities' concerns about individual mandates.

Mandates on Local Governments Have Increased Since FY 1983

Local governments repeatedly cited that, although any one mandate may not be burdensome, the cumulative effect of new mandates issued on top of existing mandates can result in a substantial burden to local governments. To address this concern, JLARC staff examined the dates mandates were instituted to identify new mandates imposed on local governments since the 1983 JLARC mandates study. Based on this examination, 81 new mandates were identified, an increase of 32 percent.

Most areas of government have been affected to varying degrees by new mandates. These new mandates ranged from requiring a new major program of recycling to requiring training for animal wardens, custodians, or animal control officers engaged in the operation of an animal pound. Revisions to existing mandates have also affected the scope of activities performed by local governments. Much of this new mandating activity was due to State rather than federal initiatives. However, the State has recently taken steps to streamline and reduce the number of mandates on local governments.

New Mandates on Local Government Since FY 1983. Table 8 identifies the number of new mandates imposed in each functional area annually since 1984. Over two-thirds of the mandates implemented since 1983 originated at the State level. The remaining one-third were based on federal initiatives. Most of the new mandates affected education, health and welfare, and environmental protection.

The increase of 19 mandates in the area of education was largely the result of State initiative. Only one of the mandates originated at the federal level. In 1988, the State responded to concerns over elementary and secondary school performance by developing more stringent education requirements. New standards included greater emphasis on writing, speaking, listening, and mathematics skills; reduced class sizes in certain grades; and literacy testing. Eleven of the new education mandates can be accounted for by the educational Standards of Quality.

Both State and federal initiatives have produced significant new mandates in the area of environmental protection. For example, at the federal level the Clean Water Act required the implementation of mandates in 1988 concerning wastewater discharge and underground storage tanks. In addition, the Clean Water Act requires initiating a stormwater discharge permitting process. Though these permitting regulations have not yet been developed by the State, many local governments expect them to have a negative fiscal effect on their localities.

Virginia's growth and increasing urbanization during the 1980s have contributed to the State's interest in improving and preserving the environment. For example, substantial new mandates have been implemented by the State regarding solid waste management. Through mandates issued in 1988 and 1989, the General Assembly required localities to submit 20-year solid waste management plans and meet certain recycling requirements by 1991, 1993, and 1995. Another State environmental initiative was the Chesapeake Bay Preservation Act, which was implemented in 1988 to protect and improve the Chesapeake Bay and its tributaries.

Table 8

**Number of New Mandates Since 1983
by Functional Area and Year**

<u>Functional Area</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>Total</u>
Public Works	1	0	2	6	6	4	1	2	22
Education	0	1	1	0	13	2	2	0	19
Health and Welfare	4	2	2	0	0	2	4	1	15
Community Development	0	0	1	2	2	2	3	2	12
Public Safety	0	2	3	0	2	1	1	3	12
Parks, Recreation, and Libraries	0	0	0	0	1	0	0	0	1
Judiciary	0	0	0	0	0	0	0	0	0
Administration of Government	0	0	0	0	0	0	0	0	0
Total	5	5	9	8	24	11	11	8	81

Source: JLARC staff review of *Code of Virginia*; survey of cities and counties, summer 1991; survey of State agencies, summer 1991; and interviews with State agencies.

With the exception of 1988, in any one year the number of new mandates may not appear significant. However, local government officials have stated that the cumulative effect of mandates can become a significant burden on local governments' personnel and financial resources. In the "Local Governments' Mandates Manifesto" developed by the Virginia Municipal League (VML) and local administrators, officials expressed the concern that when viewed collectively, "mandates can be quite detrimental often resulting in serious budgetary impacts and political discord." Local officials also noted that this burden is compounded during downturns in the economy, when financial resources may be reduced while the mandates remain intact.

Revised Mandates Also Impact Local Governments. In addition to the increasing number of new mandates, local governments were also affected by mandates that had been revised or expanded since their original enactment. JLARC staff did not systematically identify all revisions to existing mandates. However, some local governments

cited examples in which existing mandates had been expanded, and subsequently imposed additional requirements on localities.

As with new mandates, local officials noted that revised mandates can have a substantial effect on the level of local resources needed to provide the mandated program. For example, changes in federal eligibility requirements for Medicaid have resulted in increased caseloads and an increase in the amount of staff time that must be spent on each case. The following official's comment reflects the opinions of many localities.

The Medicaid program contains too many categories of eligibles, too many different income levels, and too many different resource limits. It has become very difficult for a social service agency to provide expedient services to its clients because applicants must be screened against each of these criteria to determine their categorical placement

On the other hand, some mandates have been revised in such a way as to reduce the impact on local governments. For example:

Local governments over 3,500 population are eligible to participate in the State urban highway construction program. In 1989, project eligibility requirements were changed by reducing the local funding match from five percent of the project cost to two percent of cost.

As mentioned earlier, mandates viewed individually are generally not considered burdensome. However, considered collectively, new and revised mandates can have a significant impact on local governments.

State Actions to Lessen the Impact of Mandates. In a recent Executive Memorandum, the Governor stated interest in examining and improving State-local relations through the streamlining of administrative requirements imposed on local governments. The Administration is interested in improving communication and cooperation between State and local governments and hopes through these efforts to eliminate any unnecessary burdens on local governments. Also, as part of Project Streamline several State agencies have instituted actions designed to provide more coordinated services. For example:

Prior to Project Streamline, the regulation of asbestos was fragmented among five agencies: Department of Labor and Industry, Department of Commerce, Department of Air Pollution Control, Department of Waste Management, and the Department of Housing and Community Development. Local governments had a great deal of trouble determining which agency to contact for various problems. As part of Project Streamline, these departments met and subsequently submitted recommendations to the Governor as to how the asbestos-related responsibilities of the various agencies could be consolidated. The Governor is currently reviewing the proposal.

Agencies in the Natural Resources Secretariat have also examined procedures to streamline existing agency processes.

In an attempt to find ways to simplify the environmental permitting process and to better inform the public about the process, the State Water Control Board, Department of Air Pollution Control, Marine Resources Commission, and Department of Waste Management held ten permitting conferences around the State. The conferences were held at eight community colleges, most of which were located in rural areas and small cities. During each stop, the four agencies gave a step-by-step explanation of their permit process. The total attendance was approximately 600, of which 60 percent were from small businesses, 30 percent from local governments, and ten percent from State agencies, large businesses, and others. In addition to the conferences, these agencies are currently examining ways to improve the multi-agency inspections process through consolidation, coordination, and cross-training of staff.

These actions may result in less confusion as to which agencies local government officials should contact for various technical assistance, and less overlap between agencies as to the mandates administered by each.

Lack of Local Input in the Development of Regulations

Many local government officials voiced concerns to JLARC staff that State agencies do not solicit and use local government input in the development of regulations. Local government officials stated:

The process used to arrive at mandates is a concern. Local input often is not sought which results in conflicts between the state and localities.

* * *

For the most part, State agencies do not listen to or consider the comments of localities in the development of regulations. This is true even when the locality is charged with administering the final regulations

This may seem to suggest that State agencies do not consider local government input a major concern when developing agency regulations.

However, detailing the procedures they use to develop regulations, many of the 14 State agencies interviewed by JLARC staff provided examples of how they exceed Administrative Process Act requirements in gathering public input. Many agencies stated they form advisory groups, or convene workshops or meetings of interested parties, including local government officials, to help in the development of proposed

regulations or changes to existing regulations. These agencies stated that local government participants had substantive input in the process since they were essentially working on the first draft of the regulations.

The agencies also noted that local officials were able to provide additional input into the development of the regulations through the public hearings required as part of the Administrative Process Act. For example:

The Department of Waste Management provided JLARC staff with a copy of the comments from public hearings on the proposed solid waste management regulations issued in 1988. These comments identified concerns raised by local government officials and the Department's response to these concerns. Analysis of these comments revealed that several substantive changes in the proposed regulations were made based on local government input. For example, some local governments commented that the time period for existing facilities to comply with the regulations was excessive. As a result of local comments, the compliance time was changed from five years to three years. Local government comment also resulted in an extension of the storage time for recyclables. In addition, the Department made changes based on the comments of private businesses and environmental groups. In particular, the requirement that sanitary landfills have double liners was added to the regulations based on concerns voiced by environmental groups.

Though agencies have cited examples of "meaningful" participation by local officials, further examination of the level of public input into the development of agency regulations is warranted. To that end, JLARC is currently conducting a study of the Administrative Process Act as mandated by HJR 397. The study is scheduled to be completed and released in 1992. As part of that study, JLARC staff will be conducting a systematic assessment of the extent to which public participation has resulted in changes to proposed regulations.

Lack of Flexibility in Implementation of Mandates

States typically mandate to promote statewide uniformity and to ensure a minimum level of services statewide. However, variations in the resources and capabilities of the 136 cities and counties in Virginia make implementation of some mandates burdensome to some localities. This variation among localities includes differences in size, population density, and fiscal capacity. In some cases State agencies take these differences into account by granting mandate waivers to individual localities.

Insufficient Flexibility. Currently, most State and federal mandates impose certain standards or procedures uniformly across all localities, regardless of the differing effects of those mandates and the ability of various localities to comply with the mandates. Smaller, more rural localities may face unique problems in implementing certain mandates. As one local official noted:

Recycling goals are clearly necessary and desirable, but the mandatory 10% in 1991, 15% in 1993, and 25% in 199[5] are clearly arbitrary and not reflective of local needs. Some localities will meet the 25% relatively easily because of particular industrial activities, while rural areas with insufficient residential density to make curbside household solid waste separation and collection economically feasible will never meet the mandate or only meet it with extraordinarily expensive and inefficient operations.

On the other hand, larger more urbanized areas may have the capacity to provide a service at levels beyond those required. Some local governments reported, however, that mandates sometimes had the effect of limiting local governments from exploring alternative approaches which would better suit their locality. For example,

The State Board of Elections worked with the Department of Information Technology and representatives from various local governments to design, develop, and implement an automated voter records management system. At the time, Fairfax County had already developed their own automated management system. Once the State system was implemented, use of the system tailored specifically for Fairfax County was denied. The State Board of Elections does not authorize use of programs requested by individual localities. As a result, the county is unable to use the advanced capabilities previously developed. However, according to staff at the Board of Elections, the current system used by the State is more advanced than any local system previously used. It is considered by the Board to be one of the best automated management systems in the country.

Generally speaking, large, urban localities have larger staffs and a greater level of expertise to comply with mandates. In addition, they have access to advanced technology which makes implementation of mandates in some areas relatively simple. Rural localities, on the other hand, usually have less staff and fewer resources. For example, Highland County has the smallest population of any county in Virginia. The county employs a total of 29 staff. Implementation of sanitary landfill requirements have been a major concern to the local government. As the county reported:

Engineering services do not exist without contracting outside of the County. The County does not have sufficient staff to monitor landfill activities. The amount of funds required to comply with State mandates does not exist with such a small tax base. The amount of refuse produced by the small population does not justify the stringent requirements being imposed on the County.

Although mandates are meant to establish uniformity among localities, "blanket" mandates may not be practical in all circumstances. There are mechanisms in place such as waivers, designed to allow local governments more flexibility in the implementation of mandates. However, other methods should be considered. These include

allowing localities with high levels of staff and expertise to develop their own programs while requiring certain outcomes or goals, and giving localities without staff resources more direction and technical assistance.

Waivers and Exemptions from Mandates. During interviews with 14 State agencies, data were collected on agency policies for granting waivers and exemptions from mandates and the extent to which they are granted. Several of the agencies identified formal procedures to grant waivers, as illustrated by the following examples:

The Department of Education requires that special education teachers be endorsed in areas corresponding to the disability conditions of students assigned to their classrooms. The Department allows for waivers from this requirement "when school divisions have made every reasonable effort to employ a qualified teacher endorsed in the appropriate area." Of the 785 special education waiver requests in FY 1991, 783 waivers were granted.

* * *

Local law enforcement personnel are required to attend a certain number of hours of training within a 12-month period. The Department of Criminal Justice Services (DCJS) grants waivers in the form of extensions of time for local law enforcement officers to complete required training. During FY 1991, 111 exemptions or waivers were authorized by DCJS due to illness, injury, military service, or other extenuating circumstances.

The large number of waivers or exemptions from mandates may reflect the difficulty local governments have in meeting some requirements. It appears, however, that many State agencies are aware of the need for local flexibility, and where possible some do attempt to mitigate the effect on local governments through waivers and exemptions.

Overlapping Mandates Can Negatively Impact Local Governments

Over 60 percent of the localities that responded to the local government survey said that they could identify mandates issued by one agency that they thought were conflicting or duplicative of mandates issued by other agencies. JLARC staff examined these mandates to determine the extent to which they were conflicting or overlapping.

Analysis of local concerns revealed that there appears to be some overlap in the requirements of certain agencies. Clear evidence of conflicting mandates is still being assessed. Other perceived problems were due to a lack of clear identification of the respective responsibilities of various State agencies and to a lack of communication between the State and localities. Recognizing the potential confusion that can arise from requirements involving similar issues, some State agencies have taken steps to clarify the distinctions between their requirements.

Overlapping Mandates. There are some cases where mandates of one agency overlap with those of another agency. This is a concern for local governments who have to comply with requirements they consider redundant. In some cases two agencies may appear to provide identical services. In the area of environmental protection, many of the functions of State agencies are similar in nature. For example:

Until recently, both the Health Department and the State Water Control Board performed technical and administrative inspections of treatment facilities. The same checklist was utilized by each agency.

Use of the same checklist for two different inspections led to confusion among local governments as to why two inspections were necessary.

Table 9 lists examples of overlapping responsibilities between agencies in the area of environmental protection. Some local governments are confused when complying with mandates that involve the same activity, but are promulgated by different agencies. For example, two State agencies have initiatives involving stormwater management.

The Department of Conservation and Recreation (DCR) stormwater management regulations establish criteria and procedures for the control of precipitation runoff from land development projects. Every local government that establishes a local stormwater management program and every State agency that is involved in an activity which involves soil movement or land development must comply with these regulations. One purpose of the stormwater regulations is to protect the quality and quantity of State waters in land development projects. The regulations are designed to control nonpoint source pollution by establishing technical criteria that must be met by all State agency and local stormwater management programs.

The Chesapeake Bay Preservation Area Designation and Management regulations, administered by the Chesapeake Bay Local Assistance Department, establish criteria which govern the use or development of land in Chesapeake Bay preservation areas to protect the quality of State waters. All localities in Tidewater Virginia are required to adopt such development criteria. The purpose of the land use and development criteria is to:

. . . prevent a net increase in nonpoint source pollution from new development, achieve a 10% reduction in nonpoint source pollution from redevelopment, and achieve a 40% reduction in nonpoint source pollution from agricultural and silvicultural uses.

Many local governments questioned the need for both sets of regulations, given their similarity. Realizing the confusion regulations that are similar in nature can cause, State agencies sometimes issue memoranda of understanding which delineate the responsibilities of each agency in the administration of the mandate.

Formal Agreements among State Agencies. Some agencies that have joint or similar responsibilities for regulations issue memoranda of understanding in order to

Table 9

Overlap in State Agency Responsibilities Regarding Environmental Protection

Responsibilities	Department of Conservation and Recreation	Department of Health	Chesapeake Bay Local Assistance Department	State Water Control Board	Department of Waste Management
Protection of water quality	✓	✓	✓	✓	✓
Groundwater management	✓	✓		✓	✓
Stormwater management	✓		✓	✓	
Protection of wetlands and shorelines	✓		✓	✓	
Regulation of wastewater facilities		✓		✓	
Erosion control	✓		✓		
Regulation of nonpoint source pollution	✓		✓		
Hazardous Waste Management		✓			✓

Source: *Code of Virginia; Code of Virginia / Administrative Law Appendix 1990-1991; HJR 460 Study submitted by the State Water Control Board to the State Water Commission June 1991; agency regulations.*

consolidate efforts or enumerate responsibilities. For example, as mentioned earlier, both the State Water Control Board and the Department of Health are involved in the inspection of sewerage systems and sewage treatment works. The memorandum of understanding signed by the two agencies is intended to facilitate cooperation between the agencies and spells out the role each agency plays in the inspection process.

Similarly, the Department of Conservation and Recreation and the Chesapeake Bay Local Assistance Department signed an agreement in February 1991, which addresses each agency's responsibilities for assisting local governments in the administration of Chesapeake Bay Preservation Act regulations. The memorandum of understanding states that both agencies agree to identify areas of program overlap and resolve conflicts between their regulations. Further, reviews of agency projects will be held in an attempt to minimize conflicts in program objectives and requirements. VML, VACO, and the Tidewater localities were notified of this arrangement.

As mentioned earlier, the Department of Labor and Industry has also issued memoranda of understanding with the Department of Air Pollution Control and the Department of Commerce regarding asbestos abatement. The purpose of both of these memoranda is to "achieve a systematic flow of information and documentation pertaining to the on-site inspections conducted by the Department of Labor and Industry."

While State agencies appear to recognize the overlap in responsibilities, and have taken steps to clarify their respective roles, the results are not always communicated to local governments. The agreements are public information and are available upon request. However, if the agencies do not take steps to inform local governments, the localities are possibly unaware that the agreement exists.

Reasonableness of Mandates

On the JLARC local government survey, local officials were asked to rate the extent to which they considered State mandates to be reasonable or unreasonable in specific mandate areas. An unreasonable mandate was defined as one which (1) required an inappropriate type or level of service for the locality, (2) was inflexible or restricted local ability to implement cost-effective alternatives, or (3) was antiquated or no longer relevant. A total of 30 major mandate categories and 46 subcategories were rated by local governments. Comparisons with 1983 data were made where applicable.

Unreasonable Mandates. No one mandate category was judged to be unreasonable by a majority of local officials. However, certain functional areas were repeatedly cited as problematic. They included social services, education, and environmental protection. In 1983, areas of local concern focused primarily around social services and education.

Table 10 lists the major mandate areas cited most frequently as unreasonable by cities and counties. Appendix I contains a complete listing of mandate areas and the percentage of local governments rating each area as unreasonable.

Three of the major governmental areas listed as unreasonable in Table 10 are within the area of social services. Social services includes financial assistance to the needy, social services for the needy, and social services administration. Financial assistance to the needy and social services for the needy were also considered unreasonable by a substantial number of local governments in 1983.

Table 10

**Percentage of Cities and Counties Citing
Mandate Areas as Unreasonable**

<u>Governmental Activity</u>	<u>1983</u>	<u>1991</u>
Financial Assistance to the Needy	34%	46%
Special Education	53	45
Social Services Administration	NR	43
Social Services for the Needy	31	39
Refuse Disposal	31	37
Storm Water Management	NR	35
Refuse Collection	5	27
Wetlands Management	NR	20
Wastewater Treatment	24	20
Corrections and Detention	45	19
Elementary and Secondary Education	17	19

Note: "NR" denotes that the mandate area was not rated by city and county officials in 1983.

Source: JLARC staff surveys of cities and counties, 1983 and 1991.

Table 11 lists the major mandate subcategories cited most frequently as unreasonable by localities. Program requirements within financial assistance to the needy were considered unreasonable by over 50 percent of all responding localities. Reporting requirements under social services administration, and service requirements for social services for the needy were also cited as unreasonable by a substantial proportion of localities. As the following examples illustrate, local governments reported that requirements in these areas could be cumbersome, complex, and time consuming.

The number of reports which must be completed is voluminous, and the types of reports so varied. The locality must maintain separate accounting systems to meet State as well as local accounting and reporting requirements.

* * *

Local agencies are seriously understaffed, client levels are at historic highs, and programs keep increasing in complexity and administrative detail.

* * *

The paper work requirements of the social services programs prohibit the most efficient use of the social workers' time. If paper work

Table 11

Percentage of Cities and Counties Citing Mandate Subcategories as Unreasonable

<u>Subcategory</u>	<u>Government Activity</u>	<u>1991</u>
Sanitary Landfill Requirements	Refuse Disposal	58%
Program Requirements	Financial Assistance to the Needy	52
Recycling	Refuse Collection	46
Reporting Requirements	Social Services Administration	46
Service Requirements	Social Services for the Needy	46
Staff-to-Pupil Ratio Requirements	Special Education	46
Eligibility Requirements	Financial Assistance to the Needy	44
Personnel Requirements	Social Services Administration	43
Staff Certification Requirements	Special Education	39
Permit Requirements	Wastewater Treatment	33

Source: JLARC staff survey of cities and counties, summer 1991.

requirements were reduced then more time could be spent helping families resolve their problems. The current system mandates that the paper work be completed in order to receive funding for the programs.

Problems cited in the education area dealt primarily with special education. Under special education, staff-to-pupil ratio requirements were reported as unreasonable by almost one-half of all responding localities. Specifically, local governments were concerned with the lack of local flexibility to provide programming based on the individual needs of students.

Special Education staff-to-pupil ratio requirements are absolutely rigid and deny schools the opportunity to provide flexible instructional programming based upon a child's needs on a case by case basis. The state regulations assume all handicapped children fit the same fixed instructional mold.

While waivers granted by the State indicate that the requirements are not "absolutely rigid," the perception of inflexibility nonetheless exists for numerous localities.

Five of the governmental areas listed as unreasonable relate to environmental protection. Three of the five areas were also rated by local government officials in 1983. They include refuse disposal, refuse collection, and wastewater treatment. Discontent among localities increased somewhat in the area of refuse disposal since 1983. Within

this area, 58 percent of the responding localities said that sanitary landfill requirements were unreasonable. This is most likely due to the adoption of new sanitary landfill regulations in 1988. According to one local government:

The requirement for municipal solid waste landfills to have double liners (the same as hazardous waste landfills) is unreasonable for localities. The cost to implement the double liner requirement will double the present cost of landfilling. Dry cell development has not shown any excessive leachate at landfills. Products now available have not proven to be puncture resistant and soil ion exchange should be taken into consideration. Also, landfill design should be flexible to accommodate location and geology.

Over five times as many local government officials felt that mandates in the area of refuse collection were unreasonable in 1991 compared to 1983. Forty-six percent of the localities felt that recycling mandates, instituted in 1989, were unreasonable. As one locality noted:

The State's mandate that localities recycle 10% by 1991, 15% by 1993 and 25% by 1995 is unreasonable in that it does not allow enough time for a recycling program to gear up and become established Recycling mandates are justified but with no assistance from the State, they have caused significant financial burdens on localities.

Many local governments stated that requirements in this area are too stringent and costly:

Although the intent of State recycling mandates is recognized, it has resulted in significant financial burden to localities. Lacking markets for recyclable material, local governments are bearing the burden

Local governments were generally more concerned with newer mandates such as recycling, because start-up costs are often quite high.

Only 19 percent of local governments cited mandates in the area of corrections and detention as unreasonable in 1991, as compared to 45 percent in 1983. One reason for this could be the 1989 State provision which increased the maximum reimbursement amounts for local jails by 50 percent, and provided monetary incentives promoting regional jails. In addition, State financial support for personnel costs in sheriffs' offices and regional jails has increased substantially since 1985. The number of staff positions in sheriffs' offices funded by the State to operate local jails has also increased.

Reasonable Mandates. Table 12 lists the five governmental areas which local officials rated as having the most reasonable mandates. The majority of local governments that responded to the survey reported that mandates in the area of public libraries were reasonable. This may be due to the relatively low number of State and federal

Table 12

Percentage of Cities and Counties Citing Mandates as Reasonable

<u>Governmental Activity</u>	<u>Reasonable</u>
Public Libraries	60%
Inspections	52
Planning and Community Development	47
Elections	46
Voter Registration	46

Source: JLARC staff survey of cities and counties, summer 1991.

mandates in this area. Localities also repeatedly cited mandates involving inspections as well administered. Regarding building code enforcement, one local official wrote:

Codes are clear cut — good communication between Federal, State and local government. People know what is expected of them and building inspector knows what is expected of him. State provides for inspector, paid by the County. Excellent cooperation between all levels of government and the public

The majority of the mandates in the area of planning and community development are conditions of aid or regulations of optional activities, which may partially account for its favorable rating. Generally, it appeared that areas with fewer mandates were rated more favorably.

ESTIMATING THE COST OF LEGISLATIVE MANDATES

In order to provide legislators with information about the potential cost of mandates, a process to provide estimates of the potential fiscal impact of proposed legislative mandated services on localities was established in Virginia. The Commission on Local Government (COLG) is currently the agency responsible for preparing cost estimates of proposed legislation affecting local governments. However, the COLG has other responsibilities in addition to preparing local fiscal impact estimates. These duties include, among others, reviewing local government boundary changes, mediating interlocal issues, analyzing local fiscal conditions, and providing staff assistance to the Virginia Advisory Commission on Intergovernmental Relations.

There are constraints inherent in any legislative cost estimating process. For example, the Legislature may propose a mandate pursuant to regulations to be developed

by a State agency. The cost of the mandate would be largely dependent on the specific contents of the agency regulations rather than the bill's provisions. Another constraint is the relatively short time period of Virginia's legislative session. There simply is not much time to prepare cost estimates of some legislation.

Given these constraints, the COLG's fiscal notes appear to be well developed and presented in an appropriate manner. However, other problems, many out of the direct control of the COLG, negatively affect the cost-estimating process and its ability to provide the legislature with timely data concerning the potential impact on local governments of proposed legislative mandates. The current cost-estimating process does not:

- provide cost estimates to the legislature in as timely a manner as desirable, and
- identify all bills with a potential fiscal impact on local governments due to statutory constraints.

There are two primary options available to enhance the effectiveness of the current process. First, the process could be modified to ensure fiscal notes are completed in time for use by legislative committees reviewing the proposed legislation. Second, criteria for selecting proposed legislation could be expanded to ensure legislation with a negative fiscal impact on local governments is appropriately identified.

Overview of the Cost Estimating Process

In 1980, the General Assembly established a process in §30-19.03 of the *Code of Virginia* whereby proposed legislation that requires one or more local governments to render a new service or expand existing services, including the furnishing of capital facilities for State or State-related facilities, would be subject to a fiscal impact estimate. The COLG was given responsibility for preparing fiscal impact estimates of proposed legislation identified by the Division of Legislative Services (DLS). The COLG prepared six fiscal impact estimates during the 1991 General Assembly Session.

There are a number of participants in the process in addition to the COLG. These participants include DLS, the Virginia Municipal League (VML), and the Virginia Association of Counties (VACO) as well as a number of local governments. In early October, VML and VACO are each asked by the COLG to designate 30 localities to assist the COLG in preparing cost estimates during the upcoming General Assembly Session. DLS is responsible for identifying legislation meeting the criteria established in §30-19.03 of the *Code of Virginia*.

Once the COLG has been notified by DLS that there is legislation requiring a cost estimate, the COLG mails copies of the introduced legislation to each of the 60 localities selected by the associations. Localities are asked to respond within 48 hours by telephone facsimile with an analysis of the proposed legislation's estimated fiscal

impact to their locality. COLG also asks applicable State agencies to provide data on the impact to local governments of the proposed legislation.

In addition, during the General Assembly Session, staff from the COLG attend weekly VML and VACO meetings where completed fiscal impact statements are posted and a status report of legislation undergoing a fiscal impact analysis is provided. Further, the COLG requests that VML and VACO invite all their member localities to comment on the bills' fiscal impact. These actions are taken to ensure that local governments not formally contacted by COLG for a cost estimate are aware of legislation requiring a fiscal impact analysis and can provide input to the COLG. COLG then evaluates and compiles the responses and distributes the findings to the Clerk of the House of Delegates, the Speaker of the House, VML, VACO, and DLS.

Cost Estimates Could Be Available Sooner in Legislative Process

The value of fiscal impact statements is reduced if the committees initially considering the bills are unable to review them before voting on the legislation. The COLG's written policy requires completion of the statements within seven days of receipt of notification from DLS. While some states have policies that require completion of cost estimates in a prescribed time period, other states use the schedule of the committee with jurisdiction over the bill as a deadline for completion of the cost estimate. To enhance the COLG's ability to complete the estimates in sufficient time for committee review, the COLG should be notified sooner that legislation has been introduced requiring a fiscal note.

Cost Estimates Should Meet Committee Schedules. Because scrutiny and debate over proposed legislation is often more intense in committee, it is important that cost-related information be available to all participants at this stage of the legislative process. Of the six bills for which the COLG completed an estimate in 1991, only two were completed in sufficient time for review by the applicable legislative committee.

The U.S. General Accounting Office (GAO), in a recent study of the federal government's cost estimating process, found that the majority of states with cost estimating responsibilities prepared estimates before the full legislative committee voted on the bills. Most state legislatures, however, have significantly longer legislative sessions than does Virginia. GAO also noted that in these states the estimates were "used to a greater extent than when prepared later...and were considered to be timely and influential." The Department of Planning and Budget (DPB), while allowing a fixed number of days for completion of its cost estimates, also informs its analysts that:

the due date should be adjusted if a bill has been docketed before the scheduled due date so that the [impact statement] will be available to the committee when they consider the bill.

The current goal of completing estimates within seven days appears reasonable, given the short length of Virginia's Legislative Session. However, completion of cost

estimates before full legislative committee review of the proposed legislation should be adopted by the COLG as the primary goal.

Cost Estimating Process Could Be Initiated Sooner. In order to ensure that fiscal notes are completed in time to meet committee schedules, initiation of the cost estimating process should begin as soon as possible. DLS is responsible for selecting and notifying the COLG that legislation warrants a fiscal impact analysis. According to both DLS and COLG staff, initial contact with the COLG regarding a bill that requires a cost estimate is often by telephone. Even in cases where the notification is by telephone, a formal letter follows.

According to provisions developed by the COLG and distributed to all participants in the process, "DLS will notify this agency by telephone of bills being referred as soon as such are identified." These procedures do not identify a deadline for referring initial legislation. Yet in its own procedures addressing the development of fiscal notes, the COLG states that "the DLS shall refer such legislation to the Commission no later than the day following the day of introduction"

However, there has been a gap between bill introduction and initiation of the cost-estimating process. For legislation introduced in the 1991 General Assembly Session requiring a COLG fiscal analysis, more than five days elapsed on average between bill introduction and notification of the COLG (Table 13). According to DLS staff, this gap between introduction of the bill and notification of the COLG can occur for a number of reasons. First, most bills are introduced in a short period of time early in the Session, which requires staff to review a large number of bills at one time. Second, there may be delays due to the preliminary evaluation of bills by the COLG at the request of DLS.

Table 13

Initiation of the COLG Legislative Cost Estimating Process

Bill	Date Bill Introduced	Date DLS Referred Bill	Date COLG Received Notification	Date COLG Initiated Process	Date Estimate Completed
SB 548	January 10	January 16	January 16	January 16	January 23
SB 565	January 10	January 19	January 22	January 22	January 31
HB 1442	January 17	January 19	January 22	January 22	February 1
HB 1495	January 18	January 19	January 22	January 22	January 30
HB 1680	January 22	January 25	January 29	January 29	February 19
HB 1827	January 22	January 25	January 25	January 25	February 1

Source: Commission on Local Government and Division of Legislative Services.

Finally, three of the six bills referred to the COLG during the 1991 Session were referred on a Saturday, which led to the COLG receiving the notification on the next Tuesday.

The preliminary evaluation procedure developed by DLS and the COLG was adopted in the late 1980s to assist in determining definitively which bills had a fiscal impact on local governments. In cases where a preliminary review is used, legislation for which DLS cannot conclusively determine whether there is a local fiscal impact is forwarded to the COLG for their opinion. If the COLG determines that the bill does qualify for a fiscal impact analysis, DLS then formally refers the bill to the COLG. Four of the six bills receiving a fiscal impact analysis were identified through this preliminary evaluation procedure.

Other delays can be partially attributed to the fact the DLS decision to refer was made on a Saturday. Three bills, SB 565, HB 1442, and HB 1495, were all referred to the COLG on a Saturday. In addition, the following Monday, January 21, was a State and federal holiday. Since there was no U.S. mail pick-up or State inter-agency mail delivery on the holiday, COLG was unable to initiate the process until January 22. For SB 565, some of the delay appears to be the result of the bill being referred to the COLG by DLS at the request of the Virginia Municipal League.

Because legislative deadlines are so short, it is important that a bill requiring a fiscal impact analysis be referred as quickly as possible to the COLG. To the extent possible, all participants in the process should attempt to meet the stated goal of referral to the COLG within one day of the bill's introduction. If situations arise where referral has occurred before the bill is commercially printed, the COLG should use bills printed from the legislative bill status system to expedite the initiation of the cost-estimating process. In addition, in cases of a State holiday, the COLG should initiate contact with DLS to determine whether bills have been referred, and thus lessen reliance on inter-agency mail.

Bill Selection Criteria Should Be Modified

Section 30-19.03 of the *Code of Virginia* specifies the criteria a bill must meet in order to be subject to a COLG cost estimate. The *Code of Virginia* requires DLS to notify the COLG of any legislation mandating localities to either render a new service or to expand any existing service, including the furnishing of capital facilities for State activities or State-related activities. Under current guidelines, a bill does not qualify for a fiscal impact assessment if it provides permissive or optional authority or affects taxes or other locally-generated revenue sources. There is a great deal of concern from local governments that bills not meeting the current criteria do impose a fiscal impact on local governments.

While it is reasonable to expect no cost estimate for proposed legislation with permissive language, legislation reducing a locality's revenue can have an impact comparable to a mandate that requires a locality to expend additional revenue. Legislation reducing a locality's ability to raise revenue reduces its ability to provide locally-initiated services. For example, legislation introduced during the 1991 Session proposed

restricting the taxable tangible personal property of a business to property subject to depreciation for federal income tax purposes. This had the potential to reduce locally-generated revenues. For example:

The Department of Taxation noted that this bill would "result in some increase in administrative costs and some loss of revenue for localities. Reductions in revenue may be substantial for some localities."

* * *

One locality reported that, had this legislation passed, the estimated revenue loss (fiscal impact) to the local treasury would have been \$632,000 per year.

As a result, localities would have had to reduce services or increase taxes to account for the decreased revenues.

According to the GAO, 80 percent of all states with cost estimating units prepare cost estimates for local tax or revenue-related mandates. The GAO found that excluding these types of mandates from the cost estimating process "ignore[s] substantial costs passed on to local governments." In addition, completing cost estimates on these types of mandates provides legislators with a "more complete picture of the potential mandate burden imposed."

Because of the potentially significant impact of revenue-related bills on local governments, fiscal impact statements should be prepared for these bills. However, not all revenue-related bills would likely have a major fiscal impact across localities. For example, a number of bills are introduced each year in accordance with the provisions of §58.1-3610 through §58.1-3621 of the *Code of Virginia* which exempt certain property from taxation.

These bills typically exempt one entity from a locality's property tax for religious or charitable purposes. Examination of all such bills would hinder the process and reduce COLG staff time available to prepare fiscal impact statements for those bills having major fiscal impacts on localities statewide. Therefore, bills of this type should not be required to have a COLG fiscal impact estimate.

Chapter IV: State Assistance to Local Governments

Virginia's local governments are dependent upon the State to fund its aid commitments. As noted in Chapter II, reductions in State aid to local governments which were precipitated by the State's revenue shortfall have in part contributed to increasing financial pressures at the local level. Long-term declines in the level or share of State and federal financial assistance to local governments, over time, can also negatively impact local governments' ability to provide services.

Some troublesome trends were observed during this review. The 1985 JLARC fiscal stress report found that the State's share of total local revenues had increased to 32 percent, allowing the local share to remain stable despite continuing reductions in federal funding. In FY 1990, the State continued to maintain its share of local funding at 32 percent. However, while the State share has been maintained, local governments have increased the locally-raised share of revenues from 60 percent to almost 63 percent. This increase reflects, in part, local efforts to mitigate the effect of a declining share of federal revenue.

Although State financial assistance has remained a stable portion of local budgets, localities are having to raise additional revenues to provide desired or required levels of services. Imposing additional State and federal mandates without adequate levels of funding increases the likelihood localities will have to raise additional revenues or forgo local option services in order to implement the mandates. State financial assistance should be an integral part of any decision to either mandate or regulate activities at the local government level.

LOCAL GOVERNMENT EXPENDITURES

Although most local governments provide a wide array of services and facilities, the budgets of local governments are dominated by five functions: education, public safety, public works, capital outlay and debt services, and health and welfare. Cities and counties continue to devote varying proportions of their budget for each of the identified functional areas of government. Still, the relative importance of each functional area in relation to total local expenditures has remained constant since FY 1985.

FY 1990 City and County Expenditures

For both cities and counties, education was the primary recipient of local government funding. In FY 1990, education accounted for more than 52 percent of all local expenditures. However, counties spent a significantly higher proportion of their

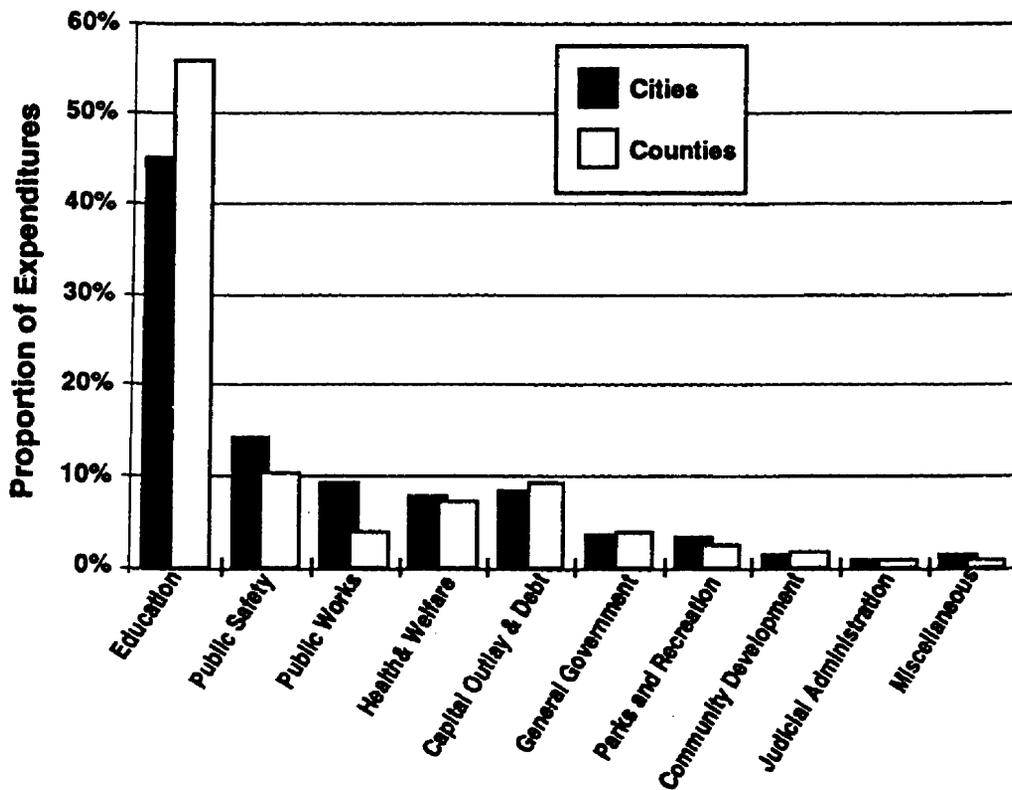
budget on the education activity (Figure 14). This may be due to the fact that for many counties, education is the principal public service provided.

Cities, however, continued to spend substantially more for public safety and public works. City budgets reflected these higher expenditures by showing larger proportions of total spending in these categories. Many of these differences can be attributed to the service needs of densely populated areas. Demands for urban services include additional law enforcement protection, more extensive road networks, and sewer and water services.

In 1983, JLARC determined that cities provided a larger proportion of spending for health and welfare activities than did counties. In FY 1990, however, cities and counties provided about the same proportion of spending for the health and welfare function. This change could be the result of the continuing urbanization of some counties and the fact that the urban counties could be providing health and welfare services similar to those traditionally provided in cities.

Figure 14

City and County Expenditures, FY 1990



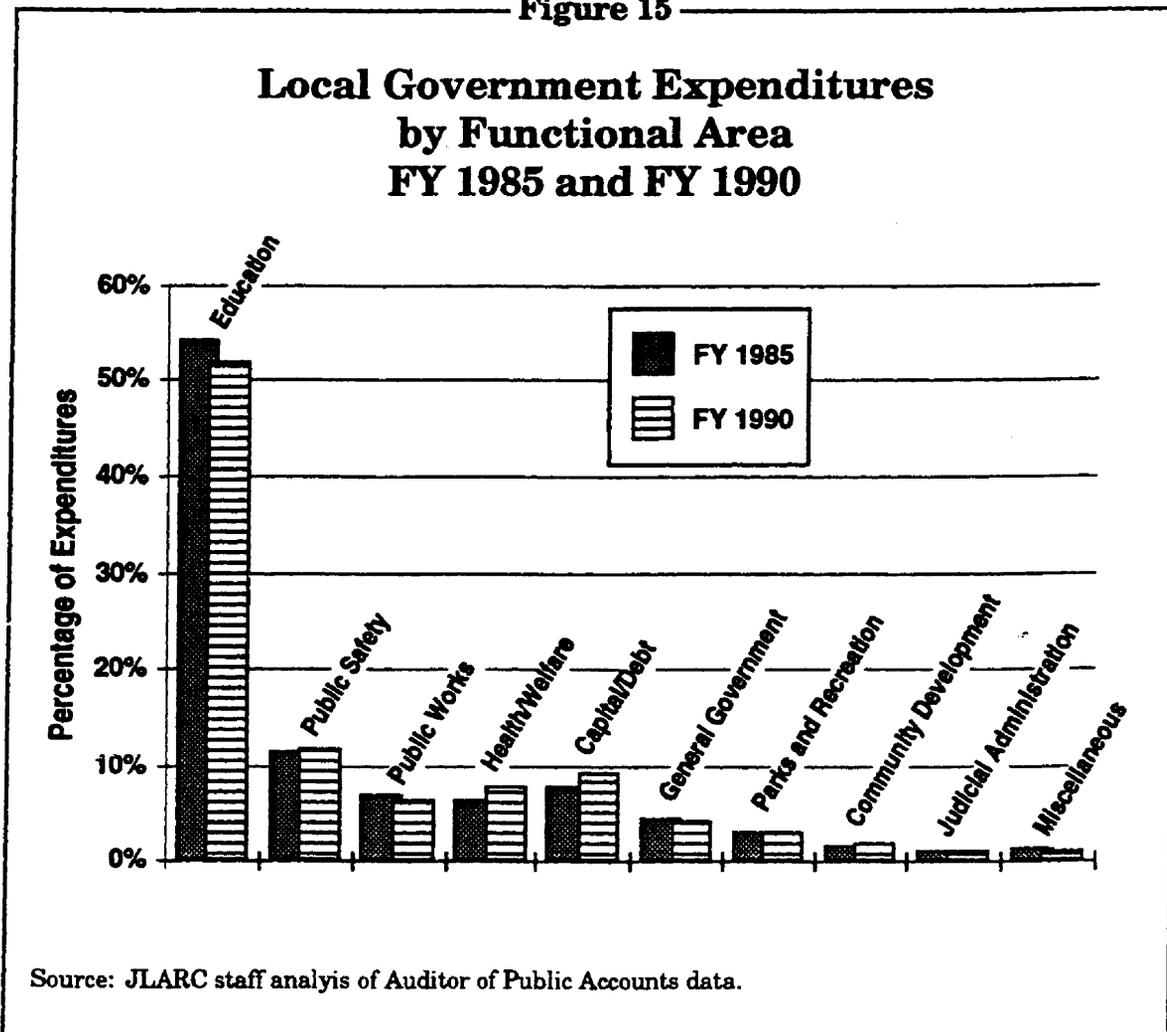
Source: JLARC staff analysis of Auditor of Public Accounts data.

Local Government Expenditures Since FY 1985

Expenditures for elementary and secondary education continue to dominate local government spending (Figure 15). The relative importance of each functional area in relation to total local expenditures has remained fairly constant since FY 1985. However, there have been some changes in the proportion spent on each functional area. For example, spending for elementary and secondary education as a proportion of total expenditures decreased slightly since FY 1985. In FY 1985, local governments directed about 54 percent of their total expenditures to elementary and secondary education. In FY 1990, this percentage decreased to 52 percent.

Other changes in the proportion spent on each functional area were also noted. For example, the proportion of funds spent on health and welfare increased slightly since FY 1985. In addition, the proportion of funds spent on capital outlay and debt also increased slightly. Other functional areas, however, have seen relatively little change in expenditures as a proportion of total local expenditures since FY 1985.

Figure 15



TYPES OF STATE ASSISTANCE

Virginia devotes a major portion of its annual budget to providing aid to localities. The majority of this aid is in the form of financial assistance to local governments. In FY 1990, Virginia provided more than \$3.4 billion in financial assistance to local governments — a 110 percent increase from FY 1982.

In addition to financial assistance, the State also provides direct assistance to local governments. In FY 1990, the State provided more than \$1.2 billion in direct assistance to local governments. Examples of direct assistance are the road construction and maintenance program and funding for local health departments. Some State agencies also provide technical assistance to local governments.

State Financial Assistance to Local Governments

State financial aid to local governments accounts for the largest portion of State assistance to localities. Growth in State financial aid from FY 1982 to FY 1990 was 110 percent, about 2.5 times the rate of inflation for government goods and services. Since 1985, both revisions to existing programs and the implementation of new programs have in part added to the State's continuing commitment to providing aid to localities. Revising and implementing new programs add to the State's obligation to fund existing aid programs. Yet local governments have continuing concerns over the adequacy of State aid for specific programs.

State Financial Aid, FY 1982 - FY 1990. In FY 1982, the State distributed more than \$1.6 billion in State and federal financial aid to local governments. In FY 1990, over \$3.4 billion was distributed by the State to local governments (Table 14). Of this amount, about \$3 billion was State funding and about \$430 million was federal funding. According to estimates provided by the Department of Accounts, the total amount of financial assistance in FY 1991 distributed to local governments is about \$3.6 billion.

As in 1982, State financial aid is concentrated in five agencies — the Department of Education, the State Compensation Board, the Department of Social Services, the Virginia Department of Transportation, and the Department of Mental Health, Mental Retardation, and Substance Abuse Services. In total dollars, the funding distributed by the Department of Education accounted for more than 68 percent of the aid disbursed to localities in FY 1990.

A review of the percentage increase in total funding distributed by State agencies shows that local governments and community services boards receiving aid through the Department of Mental Health, Mental Retardation and Substance Abuse Services witnessed the largest increase. Next were programs receiving aid through the State Compensation Board, such as funding for sheriffs and Commonwealth's attorneys offices.

Table 14

**Financial Assistance Distributed
to Local Governments
FY 1982 and FY 1990
(dollars in millions)**

<u>Agency</u>	<u>FY 1982 Disbursed</u>	<u>FY 1990 Disbursed</u>	<u>Percent Increase</u>
Department of Education	\$1,152.4	\$2,343.5	103%
State Compensation Board	96.4	264.5	174
Department of Social Services	149.7	228.1	52
Virginia Department of Transportation	76.2	185.4	143
Department of Mental Health, Mental Retardation, and Substance Abuse Services	45.8	153.5	235
Other State Agencies	<u>122.2</u>	<u>272.0</u>	<u>123</u>
Total	\$1,642.7	\$3,447.0	110%

Source: Department of Accounts, June 1991 and *State Mandates on Local Governments and Local Financial Resources*, JLARC, 1983.

All of the programs highlighted in Table 14 saw growth in State aid to local governments greater than the rate of inflation for government goods and services for the FY 1982 through FY 1990 period. However, growth in funding distributed by the Department of Education (103 percent) and the Department of Social Services (52 percent) was below the statewide average growth of 110 percent for total financial aid to local governments.

New State Financial Aid Programs. A number of new programs have been initiated since 1985. Many are in the areas of law enforcement and the environment. New programs which have provided funding for the law enforcement community's effort in the control of illegal drugs include the local anti-drug task force program and the drug enforcement assistance program. These programs are administered by the Department of Criminal Justice Services.

New programs in the environmental area provide local governments funding for coastal management, underground petroleum tank removal, and local implementation

of the Chesapeake Bay Preservation Act. Another new program that has the potential to increase the level of aid provided localities is the distribution of the recordation tax. This program was established by the 1990 General Assembly, but funding has been withheld due to the reduction in State general fund revenues. It is estimated that, had the program been implemented, funding for the 1990-1992 biennium would have been about \$60 million.

Revisions to Existing Financial Aid Programs. Revisions to existing State aid programs since 1985 have been numerous. Based in part on recommendations made in related JLARC reports, programs distributing the bulk of State aid — elementary and secondary education, local health departments, and city and county street maintenance — have all been reviewed and revised since FY 1985. In most cases, the increase in funding to local governments has been significant. For example, revisions to the educational Standards of Quality recommended by JLARC resulted in the provision of more than \$490 million in additional education funds. In addition, primarily as a result of revisions to the city street maintenance funding program, State aid to localities for that program increased more than \$23.5 million, or 30 percent, from FY 1985 to FY 1986.

Other program revisions could also result in a significant financial commitment by the State. For example, State reimbursement levels for the construction of local jails have been increased three times since FY 1981. The most recent revision removed the cap on the maximum amount of funding the State will provide for the construction of a regional jail that has three or more participating localities.

This incentive was provided in part to influence localities with older and smaller jails, which are very expensive to maintain and operate, to consolidate into larger, more efficient jail facilities. Still, this enhanced funding incentive has resulted in a potential \$253 million future funding obligation for the State. This figure, developed by the Joint Subcommittee on State Support for Jail Construction, is based on estimates of approved, planned, and proposed jail construction projects.

Local Government Opinions on the Adequacy of State Aid. The JLARC staff survey of local governments asked local officials to rate the adequacy of State financial aid in implementing mandates in a number of program areas. As in 1983, the results indicate that local officials believe funding is inadequate for a majority of the program areas.

Some of the responses to this question show similarity to the responses to the 1983 JLARC staff survey of local governments. For example, in 1983 funding for special education was rated as inadequate by almost 82 percent of the respondents, and funding for elementary and secondary education was rated inadequate by 86 percent of the respondents. In 1991, State aid for these programs was rated inadequate to implement mandates by 77 and 76 percent, respectively (Table 15).

In addition, some new governmental areas have been highlighted by local officials as having insufficient financial aid to implement mandates. Funding for refuse disposal was rated inadequate by more local government officials — 87 percent — than

Table 15

**Percentage of Cities and Counties Citing
State Financial Aid as Inadequate**

Area	1991 Statewide
Refuse Disposal	87%
Special Education	77
Elementary and Secondary Education	76
Social Services Administration	74
Social Services to the Needy	72
Wetlands Management	69
Storm Water Management	68
Law Enforcement	67
Financial Assistance to the Needy	65
Corrections	65

Source: JLARC staff survey of cities and counties, summer 1991.

any other area. In fact, of the ten program areas most frequently cited as having inadequate State financial assistance, three were in the environmental area.

There are also some aid programs that local governments rated more favorably in 1991 as compared to 1983. In 1983, 75 percent of local government officials rated funding for street maintenance as inadequate. In 1991, only 58 percent rated the funding as inadequate.

State Direct Services to Local Governments

Direct services are services provided to local clients or local governments by State agencies. These services are often described as expenditures on behalf of local governments, since there is no transfer of funds to local treasuries. Direct services do, however, constitute a major benefit to local governments. Direct services free local financial resources which otherwise might have to be expended in providing these services.

Data that enable a complete accounting of the value of direct services are not available. However, examples of major services provided to local governments and their citizens are provided in Table 16. Two State agencies — the Virginia Department of Transportation (VDOT) and the Department of Social Services (DSS) — provided the majority of direct services to local governments. In FY 1990, these two agencies expended more than \$1.1 billion in providing direct services.

Table 16

**Major Direct Services to Localities
FY 1982 and FY 1990
(dollars in millions)**

<u>Program</u>	<u>FY 1982 Estimated Value</u>	<u>FY 1990 Estimated Value</u>	<u>Percent Increase (Decrease)</u>
Construction of Non-Interstate Roads	\$150.9	\$544.1	260%
Maintenance of Non-Interstate Roads	182.7	375.1	105
State Administration of ADC/Fuel Payments	235.4	200.2	(15)
Funding of Local Health Departments	32.6	77.5	138
Funding of the State and Local Hospitalization Program	5.6	11.2	100

Source: *State Mandates on Local Governments and Local Financial Resources*, JLARC, 1983; Virginia Department of Transportation; Department of Social Services; Department of Health; *Funding the State and Local Hospitalization Program*, JLARC, 1987; and *Directory of Local Government Assistance*, Commission on Local Government, 1990.

VDOT's expenditures were for the construction and maintenance of non-interstate roads, streets, and bridges. During this period, expenditures for these programs grew at a robust rate. The growth rate for both programs was more than 175 percent. During this time period, the funding distribution methods were reviewed and modified. In addition, a major transportation initiative was passed by the General Assembly in 1986 that generated substantial additional revenue for State road construction.

Direct services are not typically considered when discussing State aid to local governments. Still, as evidenced by the level of State expenditures, these services are of significant benefit to local governments. State provision of these direct services helps ensure State priorities are met while leaving local funds free for other local priorities.

State Technical Assistance

Technical information, advice, or training provided to local governments is another form of State assistance to local governments. Many local governments request technical assistance from State agencies in an attempt to meet mandated requirements.

Technical assistance is particularly valuable to smaller localities which often lack large or specialized staffs or the expertise to comply with certain mandates.

Most State agencies have a formal procedure for information-sharing and advice-giving, and all provide information to local officials on an informal basis. However, local governments voiced concerns with the adequacy and timeliness of some of the assistance.

Provision of State Technical Assistance. On the JLARC staff survey of State agencies, agencies and institutions were asked to list the types of technical assistance they provided to assist local governments in meeting mandated requirements. Fifty-three percent of the agencies surveyed said they provided technical assistance to local governments. Most of the agencies which administer mandates to local governments reported providing technical assistance.

The type of technical assistance listed most often in survey responses was training. Thirty-two of the responding agencies and institutions listed the availability of some sort of training program. A training program regarded very highly by local governments was training for building officials and inspectors provided by the Department of Housing and Community Development (DHCD). As one locality noted:

The Division of Building Regulation, Department of Housing and Community Development, provides excellent training sessions, both for entry level inspectors and for continuing education of trained inspectors. The provision of this training is of great benefit to localities, particular smaller localities that do not have individual resources to train their own personnel.

The training is provided through the Uniform Statewide Building Code Academy and is funded in part from building permit fees collected by local governments.

In addition to training, most agencies reported providing advice to and consultations with local governments. Agencies reported that requests for general information can usually be handled by telephone. However, more complicated requests involve formal meetings.

Local Government Opinions on the Adequacy of State Technical Assistance. Eighty-nine percent of the officials responding to the local government survey reported that they requested technical assistance from at least one State agency in FY 1991. Overall, localities stated that the State technical assistance they received was both adequate and timely. DHCD was rated the most favorably by local officials (Table 17). However, some agencies which primarily play a regulatory role were rated less favorably.

As Table 17 indicates, three of the agencies identified most frequently as providing inadequate and untimely technical assistance were in the area of environmental protection. Local government officials were most dissatisfied with technical assistance received from the Department of Waste Management (DWM). Many localities

Table 17

Local Assessments of State Technical Assistance

State Agency	Was the Assistance Timely?		Was the Assistance Adequate?	
	YES	NO	YES	NO
Department of Housing and Community Development	99%	1%	99%	1%
Department of Criminal Justice Services	97	3	91	9
Department of Conservation and Recreation	96	4	96	4
Council on the Environment	96	4	92	8
Department of Transportation	96	4	85	15
Department of Education	92	8	92	8
Department of Mental Health, Mental Retardation, and Substance Abuse Services	82	18	81	19
Department of Air Pollution Control	82	18	79	21
Department of Health	82	18	77	23
Department of Corrections	78	22	79	21
Department of Social Services	70	30	57	43
State Water Control Board	62	38	57	43
Chesapeake Bay Local Assistance Department	57	43	59	41
Department of Waste Management	51	49	36	64

Source: JLARC staff survey of cities and counties, summer 1991.

reported that DWM is understaffed and unable to respond to questions. In addition, they have expressed frustration over the timeliness of the review and approval of landfill permits and assistance in meeting recycling requirements, as the following examples illustrate:

[DWM is] understaffed; unable to review, unable to answer questions. State budget cuts have rendered DWM unable to process material required for submission under their regulations. It is extremely frustrating to be forced to meet unreasonable deadlines with submissions while having no realistic hope of having those submissions reviewed in any particular amount of time.

* * *

When asked what method(s) could be used to estimate commercial waste, we were told by the DWM to come up with a method and they would tell us if it was acceptable. The planning assistance program provided by DWM gave no guidelines on how to prepare such estimates. This was a key piece of data which most small jurisdictions had no experience with yet the State could provide no help.

A new director of the DWM was named in August 1991, after the position had been vacant for five months. In an interview with JLARC staff, the director acknowledged that problems exist within the agency, and they are working toward improving agency policies and programs. Currently the department is dealing with the enforcement of many new complicated regulations and is backlogged in processing permits.

However, in 1990 DWM did conduct 22 two-day workshops on solid waste management planning — one within each regional planning district. During the workshops, the statutory and regulatory aspects of recycling and waste management planning were discussed as well as programmatic information for recycling operations. Based on the sign-in sheets provided at each meeting, representatives of 54 cities and counties attended these workshops. DWM has also prepared several solid waste management and recycling manuals for distribution to local governments and other affected parties. All 327 cities, counties, and towns were notified of and invited to attend the workshops. Further, all localities received solid waste management-related documents and manuals in advance of the workshops.

Although the Chesapeake Bay Local Assistance Department (CBLAD) lists as one of its principal responsibilities to “provide technical assistance to local governments,” some localities reported that they have received limited assistance in implementing the Chesapeake Bay preservation requirements. Localities commented that the guidance they have received is confusing and sometimes contradictory, and staff response to local inquiries is generally untimely.

Providing guidance to localities on program implementation has been slow and sometimes confusing. This is due, in large part, to implementation of a new State mandate and the staff's inability to provide consistent direction and guidance. It is anticipated that this situation will improve as the agency matures.

* * *

The problem with generally untimely and inadequate technical assistance is attributed to inadequate staffing of the State agency and unrealistic deadlines for local implementation.

CBLAD staff reported that they provide several types of technical assistance to help ensure local governments are able to adequately implement the Chesapeake Bay preservation requirements. To help address localities' unique needs, the department reported it groups localities by geographic region and assigns a staff liaison to each group. In addition, the department provides a "Local Assistance Manual" to all Tidewater local governments to assist them in the designation and management of preservation areas. The 386-page manual includes, among other information, guidance on mapping natural resources, implementing the performance criteria, and designing a comprehensive plan which protects water quality. Further, CBLAD staff noted that they initiate written contact with VML, VACO, and the Tidewater localities to inform them of new developments and other relevant matters.

Regarding the State Water Control Board (SWCB), many local governments commented that the agency is not providing the guidance and assistance localities need to meet various permit requirements. Part of the problem may be due to different perceptions of the role of the agency. In responding to the JLARC staff survey of State agencies, the SWCB reported that "[the board] is a regulatory agency and therefore does not provide technical assistance to local governments." However, it is clear from local government comments that localities expect technical assistance to be a function of the agency. This expectation is supported by the 1990-1992 executive budget document, which lists technical assistance as part of the agency's responsibilities.

Local officials also commented on the SWCB permit process, stating that there is a very long review time for permit applications. According to one locality:

The permitting process is not working. Response times for Virginia Water Control Board VPDES permit issuance can take 2 to 3 years. Communication from [SWCB] during the permit development period is minimal and, consequently, permit requirements are a surprise to the municipality.

In response to local concerns about the permit timetable, the SWCB stated that delays in their permitting process are often due to incomplete applications. According to SWCB staff the permit process does not begin until the local government application is complete. SWCB staff reported that they receive many applications from local governments that have not been signed or are missing information. Forms are often passed back and forth between the locality and SWCB until the application is complete. SWCB noted that these actions can delay the process by several months. Although the agency informs the locality of the nature of the problem before the survey is returned for completion, the agency does not tell them how to go about getting that information. No assistance is provided in completing the application.

On the local government survey, officials were also asked to identify any types of technical assistance that were needed but not currently provided by the State. In many cases, local governments listed assistance that State agencies reported they already provide. For example:

One locality responded that the State should provide assistance in finding markets for recyclable materials and attracting recycling facilities to localities. However, the DWM reported that one staff position is devoted solely to the development of recycling markets in Virginia. The department also issues a quarterly newsletter to all localities entitled "Recycling Markets Update." This newsletter informs local governments of marketplace activities, including the current prices for various recyclable products. Further, the department maintains a database of recycling companies operating throughout the State.

Similarly, there was concern among a few localities that adequate training programs for local social services employees were lacking.

One locality reported that they needed training for eligibility and service staff. The local official stated that "training is not provided by the State and State dollars are insufficient to purchase outside training." The Department of Social Services (DSS) reported, however, that multiple training courses are provided through their Divisions of Benefits Programs, Service Programs Management, Human Resource Management, Financial Management, and Information Systems. In some cases, training is provided on a quarterly basis. Other training is provided by request.

Local comments regarding the lack of technical assistance programs suggest a communication problem between the two levels of government. Some State agencies reported that they do not publicize the technical assistance they provide. They simply respond to requests as they are received. On the other hand, some agencies actively seek out opportunities to provide assistance. For example, the Department of Education (DOE) provides weekly memos to all local school divisions, informing them of technical assistance that is available. DOE receives daily requests for technical assistance. Few localities identified the DOE's assistance as inadequate.

As mandates become more technical and complex, there is an increasing need for State technical assistance to ensure local government compliance with mandates. Based on the comments of local governments and agencies, it is apparent that additional two-way communication is necessary. Agencies need to inform local governments of the technical assistance available. Reciprocally, local governments should inform agencies of their technical assistance needs. This increased communication will help ensure that the technical assistance provided by State agencies is indeed the technical assistance required by local governments.

TRENDS IN STATE FINANCIAL AID TO LOCALITIES

State financial assistance comprises a relatively large portion of local governments' revenues — more than 30 percent. In addition, the State has provided this share over a relatively long period of time. Because State financial assistance to local governments has become an ongoing, priority commitment of the State, examining trends in State aid to local governments is a useful tool in assessing the adequacy of State financial assistance. Two primary comparisons are presented here: (1) State aid to State revenues, and (2) State aid to local revenues.

Growth in State aid to localities has been relatively consistent with growth in the State's projected general fund revenues. As a percentage of local revenues, State aid continues to be a very stable source of funding for local governments. Since FY 1981, the State has provided about 32 percent of local revenues. Still, for the FY 1985 through FY 1990 period, growth in State aid has trailed the growth in local revenues. This appears to be, in part, a response to a rapidly declining share of federal financial aid.

Growth In State Aid Has Been Consistent With Growth In State Revenues

Specific amounts of State aid are dependent upon the Governor's recommendations in the executive budget and legislative appropriations. Assessing the level of State aid provided to local governments against the State's general fund revenues is a useful approach in determining whether the State has given consistent priority to financial aid for localities.

From FY 1984 through FY 1989, growth in State aid to localities matched or slightly exceeded growth in the State's general fund revenues (Figure 16). In FY 1990, growth in State aid exceeded growth in State general fund revenues, as the State tried to maintain support for local programs while its own revenues were leveling off. By this measure, the State's funding commitments to local governments have been consistent during this time period.

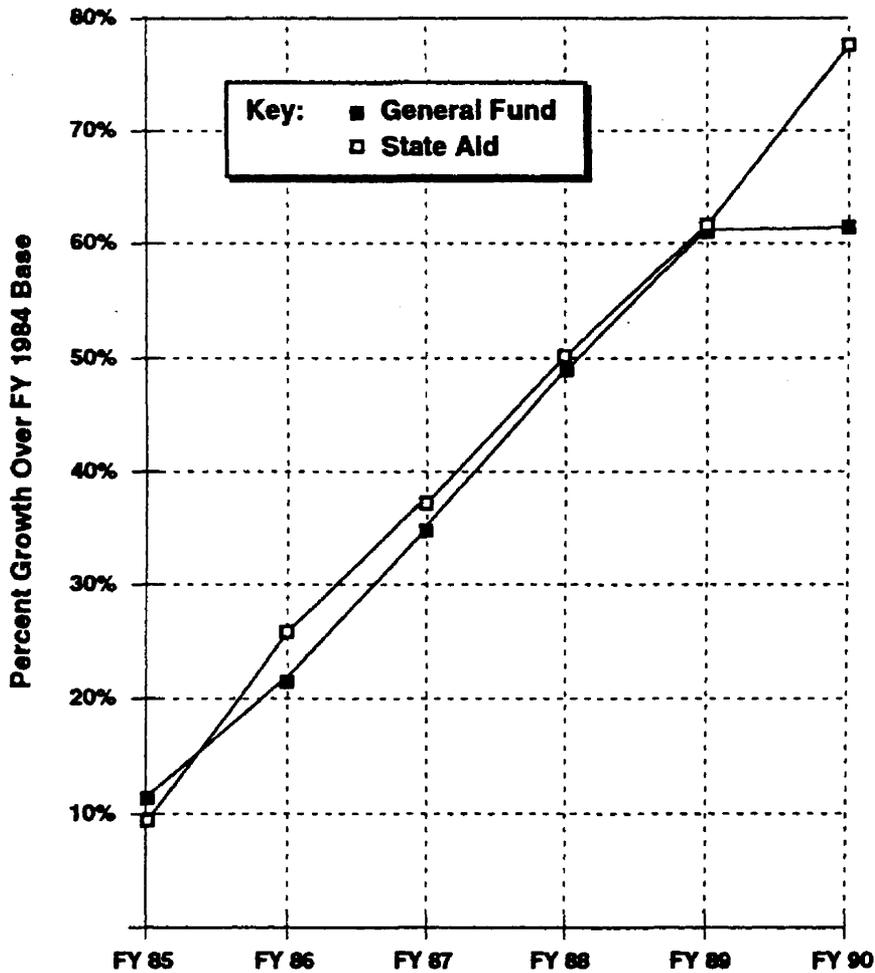
State Aid to Local Governments Has Been Stable Since FY 1981

To determine the characteristics of the funding trends, JLARC staff examined the mix of local, State, and federal revenues for local governments for the FY 1971 through FY 1990 period. In addition, JLARC staff also examined the funding trends for urban and rural localities for the FY 1985 through FY 1990 period.

Revenue Sources for Cities and Counties. State aid as a percentage of total local revenues for cities and counties combined has exhibited increases as well as decreases (Figure 17). Many of the major gains and losses in State aid as a percentage of total local revenues occurred during the FY 1971 through FY 1980 period. Since 1981, however, the State has provided local governments a relatively stable source of funding — about 32 percent of local revenue.

Figures 16

Growth in State Aid and General Fund Revenues



Source: Auditor of Public Accounts; and Secretary of Finance Presentation to Senate Finance, House Appropriations, and House Finance committees on August 23, 1991.

The absolute growth in State aid (533 percent) from FY 1971 through FY 1990 has nearly kept pace with the absolute growth in locally-generated revenues (560 percent). The absolute growth in federal aid to local governments, however, was only 167 percent. This overall trend masks some interesting differences in growth of each funding source. From FY 1971 through FY 1980, the largest percentage increase in local funding sources was in federal aid (176 percent). Between FY 1980 and FY 1990, growth in State aid to local governments exhibited the largest percentage increase (165 percent) in local funding sources. For the same period, locally-generated revenues increased about 153 percent.