Report to the Governor and the General Assembly of Virginia

Local Government and School Division Consolidation

JLARC
JOINT LEGISLATIVE AUDIT AND REVIEW COMMISSION

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COMMONWEALTH of VIRGINIA

Joint Legislative Audit and Review Commission
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December 15, 2014

The Honorable John C. Watkins, Chair
Joint Legislative Audit and Review Commission
General Assembly Building
Richmond, Virginia 23219

Dear Senator Watkins:

In the 2013 Appropriation Act, the General Assembly directed the Joint Legislative Audit and Review Commission to study and make recommendations regarding local government and school division consolidation. This report was briefed to the Commission and authorized for printing on September 8, 2014.

On behalf of Commission staff, I would like to thank the staff of the Commission on Local Government and Department of Education for their assistance during this review. I would also like to acknowledge staff of other state agencies and local governments, and local elected officials who provided information and assistance.

Sincerely,

Hal E. Greer

Hal E. Greer
Director

CONTENTS

Report summary

Local Government and School Division Consolidation

WHAT WE FOUND

Local structure and local identity impede consolidation

Counties and cities generally perform the same services for their citizens. Consolidating these services can potentially reduce the funds per citizen necessary to provide local services. This is particularly the case when both the county and city have relatively small populations.

However, the Constitution of Virginia establishes independent cities, counties, and towns as entities of local government. Local identity has been a major impediment to local government or school division consolidation. Citizens and local elected officials typically express concern about losing local identity and control.

Fiscal outlook improved, but services improved only minimally

The three most recent local consolidations (which have actually been cities reverting to towns and consolidating with a county) in Virginia occurred primarily to address concerns about the fiscal sustainability of the cities involved. In each case, the cities avoided potential insolvency by reverting to town status and transferring the cost of most local government services to adjacent counties. While additional state funds were not among the reasons cited for consolidation, these funds did help facilitate agreements and equitable terms between the localities.

All three consolidations have had only minimal impact on K-12 educational services because each of the three cities and counties already jointly operated their school divisions for all or most services prior to consolidation. There have been improve-

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WHY WE DID THIS STUDY

The 2013 Appropriation Act directed JLARC to review options for additional funding to encourage local government and school consolidations. Interest in the topic was spurred by the consolidation of the City of Bedford and Bedford County.

ABOUT LOCAL GOVERNMENT AND SCHOOL DIVISION CONSOLIDATION IN VIRGINIA

Virginia has 95 counties, 38 cities, and 191 towns. In recent years, there have been three consolidations. Each occurred when a city reverted to a town and consolidated with the surrounding county.

The state uses two funding strategies to support local consolidation. The first maintains local funding at pre-consolidation levels for services such as constitutional officers, human services, and general registrars. This prevents a newly consolidated locality from experiencing a funding reduction and removes a possible deterrent to consolidation. The second is the option to use the lower composite index of the two consolidating localities when calculating K-12 funding; this results in the state paying a higher share of K-12 costs for the combined locality.

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ments reported for some other types of services. For example, water, sewer, and solid waste services reportedly improved in Halifax County.

Net savings to state are minimal or will not materialize

Since 1996, the three localities have received about $13 million in special state funds for consolidation (in 2014 dollars). About $7.6 million of this amount has been additional K-12 education funding. The remainder has been funding localities were able to maintain to offset potential state savings, primarily for public safety and constitutional officers.

Moving forward, net state savings from consolidation are either minimal or not likely to materialize even over the very long term. Over 30 years, the state will realize about $1.6 million in savings from the Clifton Forge and Alleghany County consolidation. In contrast, the Bedford County consolidation could cost the state nearly $80 million over 30 years.

State savings minimal for Alleghany and will not occur in Bedford

	Additional state funding (30 years)	State funding reductions (30 years)	Net state savings (30 years)
Clifton Forge & Alleghany County	$1.4M	$3.0M	$1.6M
City of Bedford & Bedford County	$6.2M to 81M	$1.6M	$-4.6M to -79.4M

Source: JLARC staff analysis of data provided by VDOE, DCJS, SCB, OCS, and SBE.
Note: All amounts shown are adjusted to 2014 dollars.

Virginia's current approach is potentially high-cost and arbitrary

Virginia's current policy was developed in an ad hoc manner during the early 1980s to address a specific local circumstance. It was not intended to be used in future consolidations. Today, neither the purpose of providing additional funds for consolidation, nor the process by which interested localities approach the state is clearly defined.

There are potential local consolidations in which K-12 funding differentials between the city and county could increase the state's funding obligations by substantially more than the Bedford consolidation. Under the state's current approach, there are four potential consolidations in which state funding for K-12 could increase by at least $32 million annually. There are another six which could each result in between $5 million and $10 million annually.

Virginia's current approach has a minimal analytical basis and does not correspond to the actual cost of each consolidation. Rather, additional funding is based on the difference between the two locality's local composite index scores and number of students in each school division. Neither of these factors has a clear relationship to the costs and benefits of a given consolidation. Virginia's current approach also provides funding for an arbitrary period of time with little relationship to the complexity of the consolidation.

WHAT WE RECOMMEND

Legislative action

- Provide grants to assess the feasibility of consolidation, likelihood of improving fiscal sustainability and local services, and state or local savings.

- Amend the Code of Virginia and the Appropriation Act to remove references to additional state funding for consolidation based on the local composite index for future consolidations.

- Amend the Code of Virginia to direct the Commission on Local Government to prepare and submit proposals through the Governor's budget, as necessary, for additional state funding for localities that consolidate based on the cost of each specific consolidation as it is proposed.

Executive action

- Develop a new process to determine the amount and duration of additional state funds, to be based primarily on the projected cost and complexity, for local consolidation.

See the complete list of recommendations on page v.

Recommendations

Local Government and School Division Consolidation

1. The General Assembly may wish to consider setting forth in the Code of Virginia the state's goal to provide special funding to facilitate amicable consolidations that improve local fiscal sustainability, and when possible realize state or local savings and local service improvements (Chapter 4, page 19).

2. The General Assembly may wish to consider providing grants through the Appropriation Act to localities to assess whether consolidation is feasible, and the likelihood of improving fiscal sustainability and local services, and achieving state or local savings (Chapter 4, page 19).

3. The General Assembly may wish to amend § 22.1-25 of the Code of Virginia and item 139, A.4.c.1 of the Appropriation Act to remove references to additional state funding for future consolidations based on the local composite index (Chapter 4, page 21).

4. The Commission on Local Government should develop a new process to determine the amount of additional state funds for local consolidation. The amount of additional funding for local consolidation should be based primarily on the projected cost of consolidation. The length of time additional funding is provided should be based primarily on the complexity and length of time necessary for the consolidation. The process should be developed in coordination with the Department of Education and state Board of Education (Chapter 4, page 22).

5. The General Assembly may wish to amend the Code of Virginia to direct the Commission on Local Government to prepare and submit proposals through the governor's budget for additional state funding for localities that wish to consolidate. The amount of additional funding requested should be based primarily on the projected cost of the specific consolidation being proposed. (Chapter 4, page 23).

1 Local Government and School Division Consolidation in Virginia

SUMMARY The state uses two strategies to provide special funding to localities that consolidate. One is a provision that maintains local funding at pre-consolidation levels for services such as constitutional officers and general registrars. This prevents a newly consolidated locality from experiencing a funding reduction and removes a possible deterrent to consolidation. For a set period of time, typically 15 years, this offsets any potential state savings that might otherwise occur. The other strategy is to use the lower composite index of the two consolidating localities when calculating K-12 funding; this may result in the state paying a higher share of K-12 costs. Despite this special funding and potential benefits of local consolidation, there have been only three such consolidations in Virginia in recent years. The desire to maintain local control and strong citizen interest in preserving local identity have been significant barriers to consolidation.

The General Assembly's mandate for this study directs JLARC to review options for additional funding for local government and school consolidations (Appendix A). Interest in the topic was spurred by the consolidation of the City of Bedford and Bedford County. To address this mandate, JLARC staff interviewed local and state agency staff, local elected officials, and experts on consolidation. Staff collected and analyzed information related to prior consolidations in Virginia and researched other states' approaches to consolidation (Appendix B).

State provides special funding to localities that consolidate

Virginia has 95 counties, 38 cities, and 191 towns. Contiguous localities have consolidated for various reasons throughout the state's history. In recent years consolidation has occurred when economically distressed cities reverted to towns and then consolidated with the surrounding counties. If a city files a petition to revert to town status and certain conditions are met, the Code of Virginia requires a court to grant the city status as a town. Counties and cities can also consolidate, but this has not happened since the cities of Suffolk and Nansemond consolidated in 1974.

The governance and administrative structures of the respective localities are the main entities affected under consolidation. When a city reverts to a town, for example, its city council and city government are subsumed by the existing county structure. School division administration, which is one of the most significant services provided by local governments, is also likely to transfer to the county. Certain town charters, though, may allow the town to continue to provide services such as law enforcement.

"Hold harmless" provision maintains consolidating localities' funding at levels prior to consolidation

Incentives and special funding

The study mandate refers to "incentives" for consolidation. This report uses the term "special funding" rather than incentives to more accurately reflect the state's current approach.

For many types of state funding provided to localities, formulas are used to calculate funding amounts. Because of the economies of scale that are possible through consolidation, localities in most cases would receive less state funding if they consolidated. For example, the State Compensation Board (SCB) allocates state funding for constitutional officers. This funding is determined using a formula that includes workload indicators, such as the number of felony cases handled by a Commonwealth's Attorney office. Upon consolidation, a locality would likely be eligible for fewer total funded positions because of the economies of scale that would occur when consolidated.

The Code of Virginia includes a general hold harmless provision that removes this potential disincentive to local consolidation (§ 15.2-1302). This provision applies to all state funds except for K-12 funding. State funds subject to this provision include constitutional officer, transportation, social services, general registrar, and "599" funds for local police departments.

The provision allows localities that consolidate to maintain the same level of funding, even if economies of scale are achieved and less funding is required. Consolidated localities can continue to receive this same level of funding for a predetermined period of time, typically 15 years. This provision has the effect of offsetting any potential state savings.

Localities may receive additional K-12 funding if they consolidate school divisions

For several decades, there have been either statutory or budget language provisions allowing additional K-12 education funding for school divisions that consolidate. These provisions have evolved over time but generally allow the consolidated divisions to use the lower local composite index of the two localities to calculate the local share of Standards of Quality (SOQ) funding. The local composite index measures a locality's ability to generate local revenue. Localities with lower scores are responsible for paying less of the total SOQ costs than localities with higher scores. A newly consolidated division is permitted to use the lower of the two local composite index scores, so the locality receives more state SOQ funding than if the two divisions remained separate.

School divisions that operate jointly but are not technically consolidated because they still maintain separate school boards are not eligible for this additional K-12 funding. Several school divisions operate jointly, including Fairfax City and Fairfax County. In these cases, the school divisions are technically separate entities, but the city contracts with the county to provide most or all services, including instruction, food service, and transportation.

Three counties consolidated with cities that reverted to towns; received special state funding

There have been three relatively recent local consolidations in Virginia. The City of South Boston and Halifax County began receiving state funds for their consolidation in FY 1996. There were no further consolidations until FY 2001, when the City of Clifton Forge reverted to a town and consolidated with Alleghany County (Alleghany, though, did not begin receiving additional K-12 funds until FY 2005). The only other consolidation occurred in FY 2014, when the City of Bedford reverted to a town and consolidated with Bedford County.

These three local government consolidations occurred after the hold harmless provision was codified in 1991. The three consolidated localities maintained the same levels of state funding, other than K-12 funding, they had before consolidation, typically for a period of 15 years.

The state's policy on additional K-12 funding has evolved since 1982, when the state budget provided that consolidating school divisions would receive additional funding during the biennium in which the consolidation became effective. Funding was to be provided "on the basis of a composite index determined by the Board of Education which shall not be less than the lowest composite index of any individual school divisions involved in such funding" (Appropriation Act of 1982).

Various and minor changes have been made to this policy for additional K-12 funds over the years. For example, in 2004, the Code of Virginia was amended to establish that state funding for new school divisions that result from consolidation would be based on the lower composite index of the two consolidating school divisions for a period of five years (§ 22.1-25). Other changes include those made after the Bedford consolidation, when the 2013 Appropriation Act mandated that the local composite index would be "no lower than the lowest nor higher than the highest composite index" of the two consolidating divisions for a period of "no less than five nor more than 15 years." This provision applies to all direct aid education funding as well as interest on Literary Fund loans.

Bedford County will receive substantially more, even when adjusting for inflation, in additional K-12 funds than Halifax or Alleghany County received. Two factors in the Bedford consolidation not present in the two prior consolidations account for this difference. First, the City of Bedford's local composite index was 36 percent lower than Bedford County's (0.3132 v. 0.4268). Second, Bedford County had more than 10 times as many students as the City of Bedford (9,413 v. 809). Applying the City of Bedford's much lower local composite index score to the combined 10,222 students in the consolidated division resulted in about $6.2 million in additional K-12 funding for Bedford County in 2014.

Local collaboration through state incentives

In 2012 JLARC staff reported that even when the potential benefits of collaboration are apparent, local officials and residents often oppose collaboration because they believe it will diminish their local identity (*Encouraging Local Collaboration Through State Incentives*).

All reports are available on the JLARC website.

Local structure and desire to maintain local identity often impede consolidation

Virginia has a longstanding local government structure. The Constitution of Virginia establishes independent cities, counties, and towns as entities of local government. Local officials are elected by, and are accountable to, citizens who live within the boundaries of their localities.

Counties and cities are generally required to perform the same services for their citizens. Consolidating these services can potentially reduce the funds per citizen necessary to provide local services. This is particularly the case when both the county and city have relatively small populations.

Historically, though, local identity has been a major impediment to local government and school division consolidation despite its potential benefits. Citizen concern about losing local identity and control have been cited as reasons for the failure of efforts to consolidate school divisions in two areas: Wise County and the City of Norton; and Rockbridge County and the City of Lexington.

The City of Martinsville recently considered reverting to a town and consolidating with Henry County. Projections indicated that Martinsville would need to double its real estate tax rate within five years if it did not consolidate with Henry County, but again, local concern over loss of the city's identity apparently took precedence over other concerns. During a public comment period, one citizen said,

> We fought for this country. Why can't we fight for this town? I love saying I came from Martinsville and I'm a Bulldog. I love the fact that Martinsville and Carver used to fight after every [football] game. I want to fight for my city.

The City of Covington and Alleghany County recently explored consolidation to create the City of Alleghany Highlands. The Commission on Local Government recommended approval of the citizen-initiated consolidation agreement in May 2011. The consolidation was also approved by the special court appointed to review the agreement. Because this proposal involved the full consolidation of a city and a county, rather than a reversion of a city to town status, a referendum was required. Citizens rejected the consolidation agreement in November 2011, in part because of concerns about loss of local identity.

2 Virginia's Current Approach: Special State Funds for Consolidation

SUMMARY The three most recent local consolidations in Virginia occurred primarily to address concerns about the fiscal sustainability of the cities involved. In each case, the cities avoided potential insolvency by reverting to town status and transferring the cost of most local government services to adjacent counties. While special state funds were not among the reasons cited for consolidation, these funds did help facilitate agreements and equitable terms between the localities. All three consolidations have had only minimal, measurable impact on K-12 educational services and costs because each of the three cities and counties already jointly operated their school divisions for all or most services prior to consolidation. There have been reported improvements to some other types of services. For example, water, sewer, and solid waste services reportedly improved. Since 1996, localities have received about $13 million in special state funds for consolidation. Over the long term, the state will realize minimal savings on the Alleghany County consolidation, and never realize savings on the Bedford consolidation.

There appear to be three main reasons for the state government to provide funding to encourage consolidation of certain local governments and school districts.

- Fiscal sustainability: increased likelihood that localities under fiscal stress will continue providing services and citizens will not be subjected to major tax rate increases to maintain services.
- Better services: operational benefits through expanding or enhancing K-12 course offerings or extracurricular activities, as well as improvements in other services, such as water, sewer, and landfill services.
- Cost savings: lower cost of services over the long term, either through economies of scale or reduced state financial assistance over time.

State's interest in fiscal sustainability

The state has expressed its interest in maintaining viable units of local government through various efforts, including the creation of the Commission on Local Government in 1979 to "ensure that all of its localities are maintained as viable communities in which their citizens can live."

Cities reverted to remedy deteriorating finances, and state funding facilitated consolidation

Many factors play into the decision by a city to revert to town status and consolidate with a county. Two major factors are the financial condition of a city and the ability of the county to financially accommodate city citizens and their required services. In some cases, additional financial assistance from the state may encourage voluntary settlement agreements between localities and prevent costly litigation.

When an affected county opposes reversion, a city may file a petition in circuit court for an order granting the municipality town status. State financial assistance is one factor that courts may consider when deciding if "the proposed change from city to town status is, in the balance of equities, in the best interests of the city, the county, the Commonwealth, and the people of the county and the city." This is one of the criteria that must be met before a court orders a reversion (§ 15.2-4106).

Declining financial conditions of cities compelled local government consolidations

There is general consensus among elected officials, local government staff, attorneys, and consultants involved in prior local government consolidations that deteriorating financial conditions in the cities was the main reason these consolidations occurred. Each of the three cities involved in these consolidations, South Boston, Clifton Forge, and Bedford, reverted to town status and consolidated with a surrounding county. In advisory reports written by the Commission on Local Government and submitted to the courts that decide reversion cases, each of these cities was described as having an aging and less affluent population and declining fiscal conditions.

The fiscal stress index measures a locality's ability to generate additional revenue from its current tax base relative to the rest of the state. Each of the three cities involved in consolidations were designated as either high or above average fiscal stress in the year prior to reverting to town status (Table 2-1). Clifton Forge ranked as the state's eighth most fiscally stressed locality prior to consolidating.

TABLE 2-1
Cities that consolidated were under fiscal stress

	Fiscal stress	
City (year prior to reversion)	*Designation*	*Rank*
South Boston (1994)	High	31/136
Clifton Forge (2000)	High	8/135
Bedford (2012)	Above average	23/134

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

State funding facilitated voluntary settlement agreements or was a factor in court decision to approve reversion

State financial assistance played an important role in facilitating voluntary settlement agreements in the two most recent consolidations. Additional state K-12 funding provided to Bedford County was a key factor in the voluntary settlement agreement between Bedford County and the City of Bedford, according to attorneys, elected officials, and local government staff involved in those negotiations. Elected officials from Alleghany County who were involved in negotiating the voluntary settlement agreement with Clifton Forge indicated that the "hold harmless" funding facilitated cooperation between localities.

However, state financial assistance did not facilitate a voluntary agreement between the City of South Boston and Halifax County during the reversion process. It was still likely a factor in the determination by the Commission on Local Government that the terms of the reversion were equitable. South Boston's reversion to town status, which was eventually court-ordered in 1994, only occurred after three years of litigation and nearly $1 million in legal expenses, because the localities were unable to reach agreement on the terms of the reversion. One of the county's arguments against the reversion proposal was that the merger of the two school systems would have a negative impact on school funding and education services. The Commission's advisory report to the court cited assurances that state education funding was not likely to be reduced following reversion, and the court ultimately approved the reversion.

Real estate tax rates decreased in cities but increased in two of three counties

Consolidations can potentially benefit cities that revert to town status because the cost of providing education and most other local government services is transferred to the surrounding counties, which have a broader tax base and can presumably absorb the expense of providing these additional services to citizens. The courts review consolidation proposals to assess whether the terms are equitable for both the city and county involved in a reversion. Still, it is difficult to determine precisely the extent to which a reversion increased the financial burden on the counties.

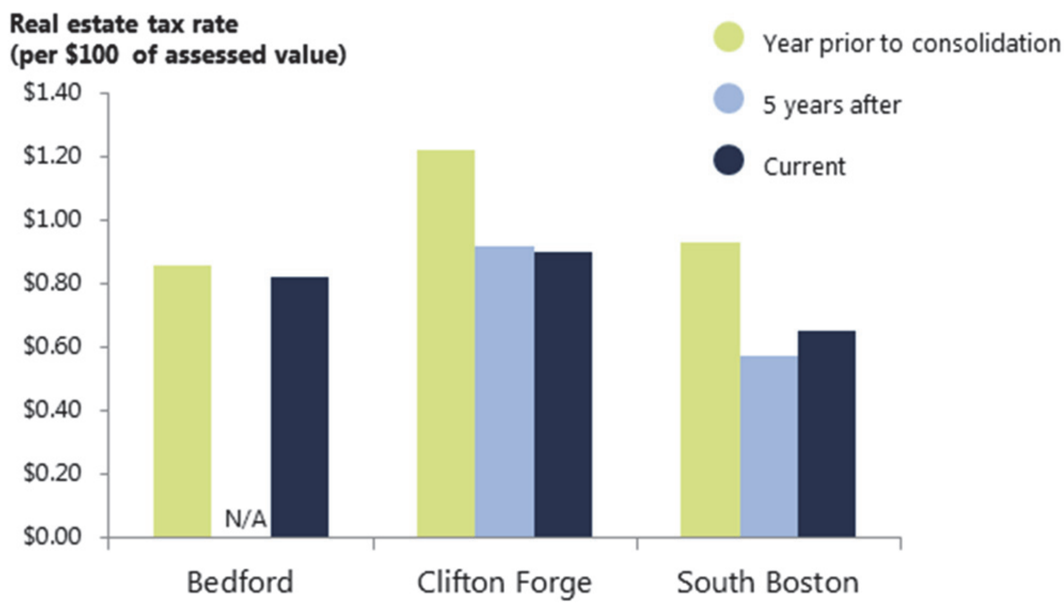
One broad indicator of this burden is whether the consolidation resulted in higher tax rates for county residents to compensate for the additional expenses associated with the expanded population. JLARC staff examined real estate tax rates in cities that reverted to town status, as well as those in the surrounding counties, to determine whether any changes occurred after consolidation. Localities collect a variety of other business and personal property taxes to pay for government services, but real estate taxes, which are the largest single source of revenue for localities, are most likely to be impacted by changes in local government expenses that may occur as a result of reversion.

Town residents pay lower combined real estate tax rates after consolidation

Town residents pay real estate taxes to both the town and the county in which they reside because they receive services from both entities. In most cases, counties provide services such as education, human services, courts, and constitutional officers, while towns provide law enforcement and water and sewer. The change, if any, in these combined real estate tax rates provides some insight into the fiscal impact of consolidation for town residents.

Residents in all three cities pay lower combined real estate tax rates than prior to consolidation (Figure 2-1). Rates (for the town and county combined) were about 25 percent lower for Clifton Forge residents, and about 39 percent lower for South Boston residents five years after consolidation. Although it is difficult to determine all the factors that may have contributed to these real estate tax rate reductions, these declines suggest that the cost per citizen of providing the necessary services is lower.

FIGURE 2-1
Town residents are charged lower combined tax rates after consolidation



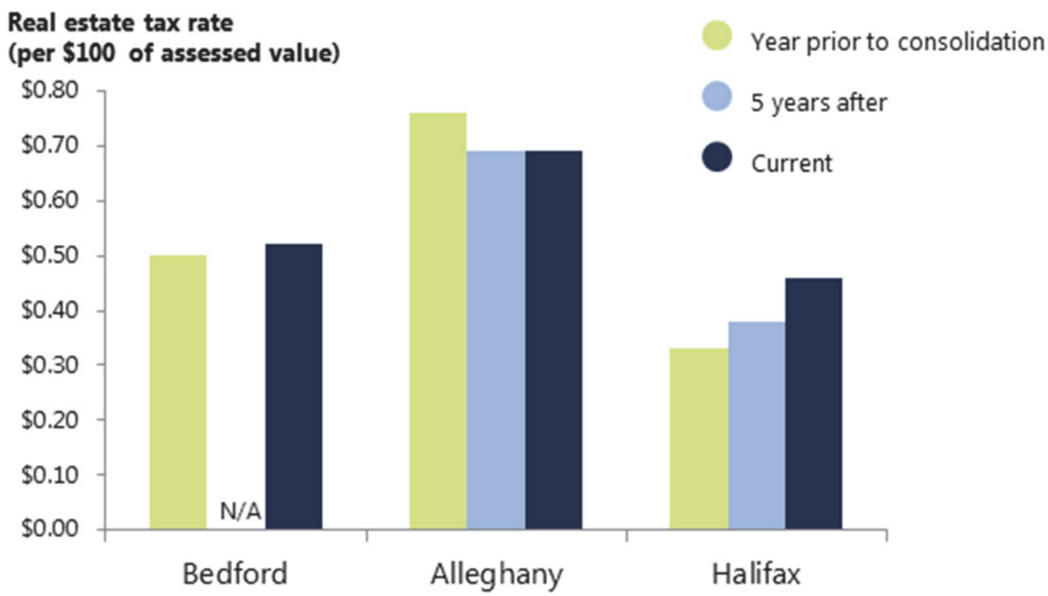
Source: JLARC staff analysis of data provided by towns of South Boston, Clifton Forge, and Bedford.
Note: Rates shown are combined for city and county prior to consolidation, and town and county after consolidation.

Halifax and Bedford County residents pay higher real estate tax rates after consolidation, in part to fund new school construction

Halifax and Bedford County residents paid higher real estate tax rates than prior to consolidation (Figure 2-2). Rates were about 15 percent higher for Halifax residents five years after consolidation, and are currently about four percent higher for Bedford residents. In contrast, Alleghany County residents are charged rates that are about nine percent less than before consolidating with Clifton Forge.

Most of the increase in Halifax County's real estate tax rate occurred in 2005, as a result of new school construction, according to Halifax County officials. A portion of the proceeds from the four percent rate increase in Bedford County, which will not take effect until 2015, will also be used to fund school construction, according to Bedford County officials. Both Halifax County and Bedford County jointly operated their school divisions with the cities prior to reversion, so this school construction was not to accommodate more students. Officials from both counties indicate that this construction is primarily because the cities did not have sufficient funds to adequately maintain aging school buildings.

FIGURE 2-2
Halifax and Bedford have higher tax rates; Alleghany has lower rates



Source: JLARC staff analysis of data provided by Halifax, Alleghany, and Bedford Counties.

Consolidations may result in some service improvements and either minimal or no net state savings

The theory behind local consolidation is that it can improve services, such as K-12 classroom instruction or utilities delivery. Proponents of consolidation indicate that consolidating services can provide economies of scale and reduce the need for state funding over the long term. Under the state's current approach, any state funding reductions would not materialize until at least 15 years after consolidation in most cases.

Consolidation-related improvements to education were minimal, but water and sewer services reportedly improved or might improve

Because each of the cities and counties already jointly-operated their school divisions prior to reversion, consolidation has had a minimal impact on the quality or efficiency of education. There have been some changes, such as the Bedford city and county school boards merging and potentially providing more unified instructional and operating approaches. Bedford County also anticipates that a new school will be built, but construction has not yet started.

Halifax County reported that water and sewer services improved since South Boston reverted to town status. After consolidating these services with Halifax County, the two localities formed the Halifax County Service Authority (HCSA). The HCSA has implemented significant infrastructure improvements that it reports have enhanced the water quality for local residents. According to one local government official "the reversion laid the groundwork for cooperation."

The consolidation in Bedford occurred recently, so it is likely too early to determine the full extent of service improvements. Bedford reports that it believes consolidating is already fostering economic development opportunities. Bedford officials also expect consolidation may eventually result in improved water and sewer services.

State has provided at least $13 million in special state funds for local consolidations

Since 1996, the state has provided about $13.2 million in special funds to localities involved in local government consolidations (in 2014 dollars). The majority of this has been additional funding for K-12. Alleghany and Bedford Counties have received at least $7.6 million in additional K-12 education funding through 2014 (Table 2-2). Localities have also been able to maintain about $5.6 million in funding through the hold harmless provision that offsets potential state savings (Table 2-3). This has included funding for constitutional officers from the State Compensation Board (SCB), 599 funds for police departments from the Department of Criminal Justice Services (DCJS), administrative funding for Comprehensive Services Act (CSA) programs from the Office of Comprehensive Services (OCS), and funding for regional libraries from the Library of Virginia.

TABLE 2-2
Bedford and Alleghany received $7.6 million in total additional K-12 funds

South Boston & Halifax County	Clifton Forge & Alleghany County	Bedford & Bedford County	Total
—	$1.4M	$6.2M	$7.6M

Source: JLARC staff analysis of data provided by VDOE.
Note: Funding between 1995 and 2014, adjusted to 2014 dollars. Funding is expected to continue until at least 2019 for Alleghany County and 2028 for Bedford County. Alleghany County estimate assumes recent trend of no additional funding. K-12 funding is underestimated because VDOE was unable to provide data for Halifax County.

TABLE 2-3
Counties received $5.6 million in hold harmless funds that offset state savings

State funding	South Boston & Halifax County	Clifton Forge & Alleghany County	Bedford & Bedford County	Total
DCJS	$2.1M	$1.2M	$94,605	$3.3M
SCB	0	2.2M	0	2.2M
OCS	0	59,000	7,000	66,000
Totals	$2.1M	$3.5M	$101,605	$5.6M

Source: JLARC staff analysis of data provided by VDOE, DCJS, SCB, and OCS.
Note: Funding between 1995 and 2014, adjusted to 2014 dollars. Hold harmless funding is expected to continue until 2019 for Alleghany County and 2028 for Bedford County. The total for hold harmless funds is underestimated because Library of Virginia was unable to provide data for localities involved in previous consolidations.

Consolidations have yielded minimal state funding reductions thus far

These consolidations have generated minimal state cost reductions because most of the hold harmless incentives are still in effect. State CSA funding was reduced by a total of $75,000 since FY 2007 through the Clifton Forge and Alleghany consolidation. State Board of Elections (SBE) funding was reduced by about $25,000 through the Bedford consolidation. There were some minor reductions following the South Boston reversion through eliminating SBE and Library of Virginia funding in 2010.

Net state savings are minimal from Alleghany County and not likely to materialize from Bedford County

Moving forward, net state savings from consolidation are either minimal or not likely to materialize even over the very long term (Table 2-4). Alleghany County will have received about $1.4 million in additional K-12 funds assuming the funding expires as expected 15 years after consolidation. To determine whether net savings materialize, JLARC staff used a period of 15 years beyond when special funding expires, or 30 years. Over a 30-year period, during which hold harmless funding expires and no longer offsets state savings, state funding will be reduced by about $3 million. This results in the state realizing about $1.6 million in savings.

In contrast, largely because of the substantial additional K-12 funding, the Bedford consolidation will result in net costs to the state over 30 years. Assuming Bedford continues to receive additional K-12 funding for 15 years, the state will have provided $81 million in additional funding. This will only be offset by $1.6 million in funding reductions after the hold harmless funding expires, resulting in a net cost of $79.4 million.

TABLE 2-4
State savings minimal for Alleghany and will not occur Bedford

	Additional state funding (30 years)	State funding reductions (30 years)	Net state savings (30 years)
Clifton Forge & Alleghany County	$1.4M	$3.0M	$1.6M
City of Bedford & Bedford County	$6.2M to 81M [a]	$1.6M	−$4.6.M to −$79.4M

Source: JLARC staff analysis of data provided by VDOE, DCJS, SCB, OCS, and SBE.
Note: All amounts shown are adjusted to 2014 dollars. Estimated state savings are based on elimination of incentives provided by DCJS and SCB 15 years following reversion, elimination of funds provided by OCS five years following reversion, and elimination of SBE funds immediately following reversion. Savings to the state following the reversion of Clifton Forge is underestimated because SBE was unable to provide information on how much state aid was eliminated in that case. The South Boston / Halifax County reversion was excluded from the analysis because information on the education funding provided by VDOE was unavailable.
[a] Low end of range for Bedford assumes no additional K-12 incentives after 2014; high end of range assumes Bedford continues to receive funding for remainder of 15 years.

The minimal or lack of net state savings is attributable to several factors. The total amount of additional state funding provided is not based on any projected savings, and some state funding that was intended to be eliminated or reduced by the consolidation has continued. For example, the 15-year time limit on hold harmless funds for state aid to libraries was removed in 2013, and therefore Clifton Forge and Bedford will continue to receive additional regional library funding indefinitely. The hold harmless provision for 599 funds from DCJS has also been extended. Through subsequent Appropriation Acts, South Boston has received additional 599 funds for a total of 19 years. Similarly, after reversion, the SCB re-allocated funding for constitutional officer positions from the three cities to the three counties. The counties will retain funding for those positions unless the formula indicates they are over-funded, which is unlikely to occur, according to SCB. SCB also indicates that any additional funding provided to localities based on the hold harmless provisions will be redistributed to other localities that have unfunded needs for constitutional officers after the 15-year time period has elapsed. There are similar dynamics with 599 funds provided by DCJS and SBE funds.

3 Consolidation Approaches in Other States

SUMMARY A major impediment to local consolidation in other states is opposition by citizens and local elected officials who wish to retain local control and identity. At least seven states take the same approach that Virginia does to encouraging consolidation by providing additional funding for a period of time after implementing consolidation. Several states offer planning funds to help localities assess the feasibility, costs, and benefits of consolidation before proceeding. Some states provide funding after localities have decided to consolidate, during the transition period before fully implementing the consolidation. These transition funds help localities with one-time or start-up costs such as equalizing salaries or aligning instructional curricula, purchasing new or integrating existing IT systems, or renovating or constructing new schools.

Virginia is already among the more consolidated states, and it is not unique in its interest in facilitating local consolidation when appropriate. Of the 50 states, Virginia has the fifth fewest school districts per 100,000 residents of any state. Some other states with more localities or school districts per capita have significant experience attempting to consolidate. For this review, JLARC staff focused on 13 such states. Their experiences can inform the discussion of Virginia's approach to local consolidation.

Local identity and job losses are often major barriers to consolidation in other states

In Virginia, as in other states, there is a strong desire on the part of citizens and local elected officials to retain local control and identity. This tends to be a major impediment to local consolidation. Some residents express concern about loss of local identity if the names of their city or schools change. Some residents want to reserve the right to make decisions about their local school system. In other states, the issue of closing schools has proven to be particularly challenging because of citizen concerns about children changing schools and losing the part of their local identity that is tied to high school athletics. In one state it was remarked that "the most difficult animal to kill is a school mascot."

The potential for loss of local government or school district jobs is another impediment to consolidation. In other states, small, rural consolidations have resulted in layoffs and lost tax revenue. Further, consolidation often requires approval by local government or school officials who occupy positions that would be eliminated if consolidation were to occur. For example, when two school districts consolidate, there is no longer a need for two superintendents, and officials have to reach agreement on the structure of the new consolidated school board.

Some states offer funds to facilitate local consolidation, and others mandate consolidation

The other states reviewed for this study have four general approaches to local consolidation (Table 3-1). These include funding to assist with planning for consolidation, as well as funding for the transition from multiple localities into a single locality. Some states provide funding after consolidation for varying periods of time. Several states have taken a more directive approach and attempted to mandate consolidation of localities or school districts.

TABLE 3-1
Other states use four basic approaches to consolidation

	Planning assistance	Transition assistance	Post-implementation funding	Mandatory Consolidation
Virginia			✓	
Arkansas				✓
Indiana	✓		✓	
Iowa			✓	
Kansas			✓	
Maine				✓
Massachusetts	✓	✓	✓	
Michigan [a]	✓	✓		
Minnesota		✓		
New York	✓	✓		
Oklahoma [b]		✓		✓
South Dakota			✓	✓
Vermont		✓	✓	
Wisconsin	✓		✓	

Source: JLARC staff analysis of other states.
[a] Michigan operates a single grant program, but applicants can submit proposals for planning and transition assistance. [b] Oklahoma gives its Board of Education authority to consolidate academically at-risk and non-accredited school districts.

Five states reviewed by JLARC staff provide a relatively small amount of funding, typically through a grant, for localities to assess and plan consolidation. This is often used to pay for consultants to assess the financial, educational, and community impacts of consolidation. There are many logistical considerations, including

- eliminating positions or relocating staff,
- equalizing salaries and benefits when there are major differences between what the consolidating localities provide,
- negotiating financial arrangements for existing assets and liabilities, and
- determining whether and how to close or consolidate schools.

Indiana and Wisconsin have provided grants of up to $25,000 and $10,000 respectively for feasibility studies. To stimulate interest in consolidation, one state provided matching funds for localities that conduct feasibility studies. Another state provided funding for localities to study the costs and benefits of consolidation, with the recommendation that localities survey residents during the planning process to gauge their interest in consolidation.

Some states also make available standard documentation about the legal process for consolidation, any state funds that are offered, and additional resources such as reorganization plan templates. States offer this and other types of technical assistance to reduce confusion during the planning process and facilitate more informed local discussions about consolidation options.

Six states (two of which also provide planning funds) differ from Virginia by providing grant funding or reimbursement to cover the cost of transitioning to a single locality. These transition costs can include equalizing salaries or aligning instructional curriculum, IT investments, and capital improvements. Depending on the nature of the consolidation, the need for capital renovation or construction can be extensive and involve years of planning and funding. The amounts states provide vary widely but generally range between $100,000 and $1 million. Three of these six states provide grant funding, two provide funds based on the number of school students, and one provides construction funds within 10 years of the consolidation.

Seven of the states reviewed for this study take the same approach that Virginia does, by providing additional funding after consolidation. Of these seven states, only Massachusetts provides implementation funding in addition to planning and transition assistance funding. Like Virginia, these states each provide funding for a set period of time. The amount of funding varies greatly, and the length of time for the funding is between three and 14 years. Five of these seven states gradually reduce the aid during the last few years of the incentive. Indiana calculates the amount of additional funding as a percentage of the projected cost savings of the consolidation.

The fourth approach is to require localities to consolidate. This is typically done through legislation placing a minimum enrollment requirement on school districts.

For example, Maine, Arkansas, and South Dakota have a statutory minimum number of students in each district of 2,500, 350, and 100, respectively. Oklahoma gives its Board of Education authority to mandate consolidation for academically at-risk or non-accredited school districts.

Attempts at mandatory consolidation are often contentious. In 2008, one state imposed a minimum size requirement on school districts, with penalties for non-compliance. The goal of the policy was to reduce the number of school districts from 290 to 80. Some consolidations did occur, but the penalties for non-compliance have since been repealed, and more than 30 localities have been considering separating from their consolidated districts. (See Appendix C for detail on consolidation in the 13 other states reviewed.)

4 Refining Virginia's Approach to Local Consolidation

SUMMARY The primary outcome of Virginia's recent consolidations has been to ensure local fiscal sustainability. The state should clarify that the primary purpose of providing additional funds is to facilitate amicable consolidations that make local governments more financially sustainable. The state should also better facilitate assessing the feasibility of consolidation by providing planning grants to localities that meet certain criteria. If certain localities were to consolidate and the state's approach remains unchanged, four local consolidations could each result in at least $32 million in additional annual funding. Another six could result in between $5 and $10 million annually. The current approach does not take into account potential cost savings or operational benefits and provides funds for an arbitrary period of time. The state should change its current policy of providing additional funds for consolidation based on the difference between the local composite indexes. The state should instead implement a new approach through which the complexity, cost, and benefits of each consolidation are the basis for determining how much and for how long additional state funds are provided.

The study mandate directs JLARC to make recommendations balancing the cost of incentives for local government and school consolidations with the expected savings and operational benefits. Virginia's experience thus far with local consolidation suggests its current approach can be refined. Other states' approaches to facilitating local consolidation also highlight ways Virginia can refine how it facilitates and funds efforts to consolidate.

State and localities have shared interest in collaboration and consolidation

State government, local governments, and citizens can benefit from local collaboration or consolidation under the right circumstances. Several potential benefits are well documented:

- Local consolidation can potentially improve local fiscal sustainability, reduce costs, and improve services (see Chapter 2).
- Significant opportunities for local collaboration exist in certain local functional areas, including in K-12. Capitalizing on these could reduce state and local costs and improve services.
- Collaborating on procurement can lower costs by increasing local government and school division purchasing power.

The extent to which these benefits can actually be achieved, and whether collaboration or full consolidation is necessary to achieve them, depends on many factors. For example, school divisions and localities can collaborate on functions but not consolidate their governments. In some cases, collaboration can yield the benefits sought through consolidation without the logistical complexity—in particular, citizen concern about loss of local identity. In other cases, though, consolidation may be the only way to materially improve fiscal sustainability.

Lack of clear purpose, process, and planning funds

A clear articulation of state policy objectives with regard to local consolidation would benefit both the state and localities. Virginia's current policy, which was developed in an ad hoc manner, focuses on providing special funds to the county after consolidation has occurred. Moving forward, the state can build on this initial approach.

Purpose of special funding not clearly articulated

According to one state education funding expert, Virginia's current approach has its genesis in an attempt to help Alleghany County provide K-12 services to the City of Clifton Forge in the early 1980s, when Clifton Forge could not meet the minimum financial commitment for education. The approach developed for Clifton Forge was not intended to be used in future consolidations.

The purpose of consolidations in recent years was apparently to ensure local fiscal sustainability. In those cases, consolidation served its purpose, as the cities successfully integrated their tax base, assets, and liabilities with the surrounding counties. Although state funding did not play a primary role in these three cases, it did seem to facilitate amicable agreements between the localities.

The Code of Virginia addresses local government consolidation in several ways. With regard to state funding, the Code stipulates that funding to localities should not be reduced for a period of time after a local consolidation (§ 15.2-1302). This removes one potential obstacle to consolidation.

With regard to K-12 school division consolidation, the Code of Virginia stipulates that proposals address the ability of the proposed combined school division to offer "a comprehensive program for kindergarten through grade 12 at the level of the established standards of quality" and to maintain "efficiency in the use of school facilities and school personnel and economy in operation" (§ 22.1-25). It may be inferred from this statute that the state's interest in school division consolidation is to maintain, if not improve, educational services and reduce costs. In Virginia, these particular benefits of consolidation have thus far not been realized in a substantial, measurable way because the school divisions were already jointly operating their school systems.

The state would benefit from a clear articulation of its policy objectives with regard to local consolidation. These objectives could then be more effectively implemented through statute.

RECOMMENDATION 1

The General Assembly may wish to consider setting forth in the Code of Virginia the state's goal to provide special funding to facilitate amicable consolidations that improve local fiscal sustainability, and when possible realize state or local savings and local service improvements.

State could better facilitate local process to assess potential consolidations

In interviews with JLARC staff, officials from several localities, including those that have considered but not proceeded with consolidation, noted that there is no clearly defined process by which localities approach the state about consolidation. The ambiguity appears to have been exacerbated by the policy changes made in 2013. Localities can no longer be certain about which local composite index will be used to calculate K-12 funding or about the number of years incentives will be provided. Some local officials and several other experts noted that the process of consolidation is complex, and begins with legal counsel and analysis, consultant projections of the costs and benefits of consolidation, and educating citizens and obtaining their feedback.

Several other state governments provide more guidance for localities about the consolidation process. Some make planning grants available so that localities can fully assess the legal, financial, and other logistical issues involved in consolidation. Having good information early in the process—information about whether consolidation is likely to improve fiscal sustainability, reduce costs, and improve services—may facilitate better decisions.

The General Assembly may wish to consider providing grants of $25,000 to $100,000 to localities that may benefit from consolidation. Grant eligibility criteria would include some measure of high fiscal stress, the likelihood that consolidation would improve fiscal sustainability, and the extent of potential state or local savings and local service improvements.

RECOMMENDATION 2

The General Assembly may wish to consider providing grants through the Appropriation Act to localities to assess whether consolidation is feasible and the likelihood of improving fiscal sustainability and local services, and achieving state or local savings.

Funding amounts and time frames do not correspond to complexity, costs, or benefits of consolidation

Potential consolidations

To gain insight into how much additional funding the state might be obligated to provide under the current approach, JLARC staff identified 33 combinations of (1) cities eligible to revert to towns that are also rated as above average fiscal stress, and (2) the surrounding counties with which each of these cities could consolidate.

The state's current approach of not reducing state funds for non-education funding for a period of time after consolidation seems reasonable. The amount of funds provided and length of time the state provides this funding, though, does not necessarily ensure an effective and equitable use of state and local funds when consolidation occurs.

Additional state K-12 funding could be substantial if certain localities chose to consolidate

There are potential local consolidations similar to the Bedford consolidation in which K-12 funding differentials between the city and county could increase the state's funding obligations by substantially more than the Bedford consolidation. Under the state's current approach, there are four potential consolidations in which state funding for K-12 could increase by at least $32 million annually (Table 4-1). (Appendix D illustrates the potential increase in state Standards of Quality (SOQ) funding for 33 possible combinations of cities and counties.) Historically, localities have rarely attempted to consolidate, so the likelihood of many localities consolidating in the near term seems low.

TABLE 4-1
Estimated increases to annual state SOQ contribution in the event of certain city-county consolidations

Number of city-county combinations	Possible additional annual state SOQ contribution per consolidation
4	$32M–77M
6	$5.1M–10M
11	$1M–5M
12	Less than $1M

Source: JLARC staff analysis of school division SOQ spending, FY 2013.
Note: Assumes each consolidation is allowed to use the lowest local composite index of the two consolidating localities. Excludes State Lottery and Literary funds, as well as non-K-12 funding through hold harmless provision in the Code of Virginia.

Current approach has minimal analytical basis or link to cost, benefits, or complexity

The 2013 Appropriation Act directs JLARC staff to "make recommendations going forward regarding the most effective balance between the costs of incentives for government and school consolidations [and] the expected resulting savings and operational benefits." Whether there has been an "effective" balance of these factors for prior consolidations is largely a policy judgment. It appears that the state funding policy has facilitated amicable agreements and may have prevented litigation in some cases on the path to consolidation. However, state savings have been minimal or will not occur.

Virginia's current approach to additional funding to facilitate consolidation has no analytical basis and does not correspond to the cost of consolidation or to potential cost reductions over the long term. Rather, the amount of additional funding is based on the difference between the two localities' local composite index scores and number of students in each school division. Bedford received a large amount of additional K-12 funding, but two localities with similar local composite index scores would receive little additional funding.

The approach also provides funding for an arbitrary period of time with little relationship to the complexity of the consolidation. The extent and nature of collaboration already under way in the localities is a major factor that determines how complex and lengthy the consolidation will be.

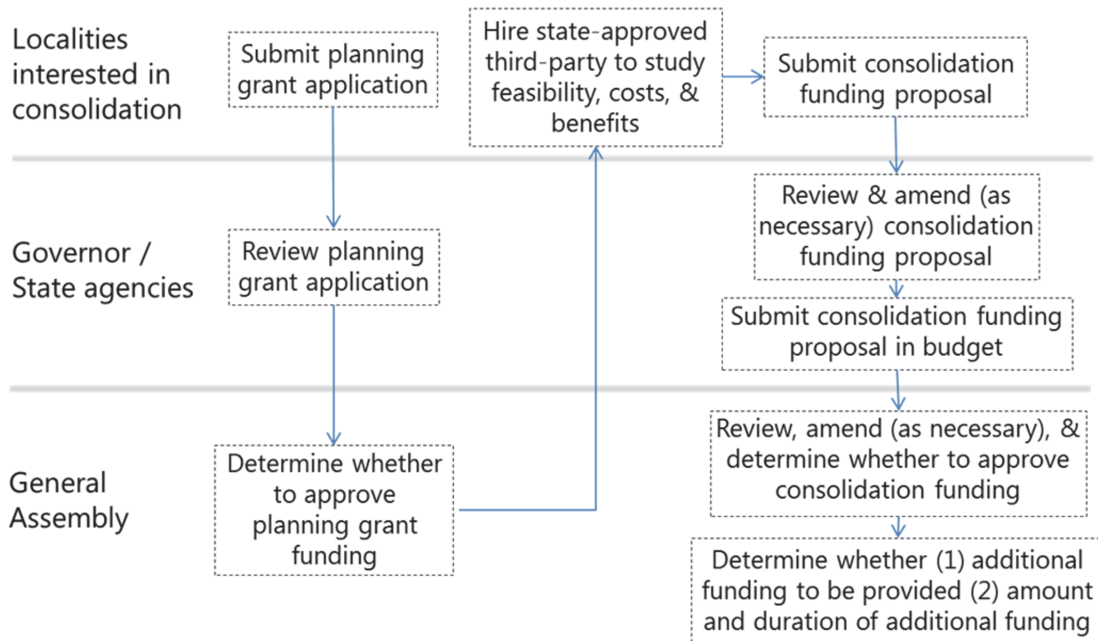
RECOMMENDATION 3

The General Assembly may wish to amend the Code of Virginia (§ 22.1-25) and the Appropriation Act (Item 139, A.4.c.1) to remove references to additional state funding for future consolidations based on the local composite index.

The state could benefit from a new approach to determining whether to provide additional state funds for local consolidation, and if provided, how much and for what period of time. The Commission on Local Government should develop a new process in coordination with the state Department of Education and state Board of Education (Figure 4-1). The process should use estimates of how the consolidation would affect fiscal sustainability, state or local savings, and local services. The primary basis for the amount of additional state funding should be the funds necessary to transition toward and implement consolidation. The new process should ensure sufficient clarity and consistency for both local and school division consolidation.

The amount and duration of state funding available for localities that consolidate should be based primarily on the funding needed to implement the consolidation. Recent consolidations or consolidation attempts, including the 2013 effort in Martinsville, have been informed by projections of the costs and benefits of consolidation. While such projections are available during public hearings and used to discuss consolidation, they have not been used to determine how much in state funds should be provided. These projections, typically conducted by third parties, should be the basis for determining how much state funding should be provided for future consolidations. The state could maintain a list of approved third parties that have experience reliably and objectively conducting this analysis.

Figure 4-1
Recommended process to plan for and determine state consolidation funding



Source: JLARC staff conceptual illustration.
Note: Court would continue to determine the terms of consolidation outside of additional state funding.

This approach would likely result in varying amounts of state funding for consolidations, as has historically been the case. The amounts provided would be based on the specific circumstances of each consolidation. The primary objective of all consolidations would be to improve local fiscal sustainability. The extent of cost reductions, service improvements, and additional state funding would vary. For example, a city under fiscal stress that is not already collaborating with a county on K-12 and other services may need more funding for a longer period than a city that is already collaborating with its neighboring county.

Local consolidation: prior JLARC recommendations

In 2012, JLARC staff recommended using targeted planning grants to facilitate local collaboration (*Encouraging Local Collaboration Through State Incentives*).

In 2011, JLARC staff recommended assessing and facilitating opportunities for large collaborative purchases, in particular health insurance (*Use of Cooperative Procurement by Virginia School Divisions*).

All reports are available on the JLARC website.

RECOMMENDATION 4

The Commission on Local Government should develop a new process to determine the amount of additional state funds for local consolidation. The amount of additional funding for local consolidation should be based primarily on the projected cost of consolidation. The length of time additional funding is provided should be based primarily on the complexity and length of time necessary for the consolidation. The process should be developed in coordination with the Department of Education and state Board of Education.

In 2012, JLARC staff made a number of recommendations for facilitating local collaboration, requiring state agencies to (1) provide technical assistance, (2) monitor implementation, and (3) evaluate the impact of collaboration. Consolidation is more complex than collaboration and may require even more state agency support and oversight. Depending on the number of future consolidations, the Commission on Local Government and the Department of Education may need funding for an additional staff member to manage this process.

RECOMMENDATION 5

The General Assembly may wish to amend the Code of Virginia to direct the Commission on Local Government to prepare and submit proposals through the governor's budget for additional state funding for localities that wish to consolidate. The amount of additional funding requested should be based primarily on the projected cost of the specific consolidation being proposed.

The General Assembly could retain the discretion to appropriate funds in excess of the estimated cost of the consolidation in order to encourage a particular consolidation or to compensate counties for short-term burden and disruption resulting from the consolidation.

Appendix A: Study Mandate

Appropriation Act of 2013

JLARC is hereby directed, with assistance from the Commission on Local Government, to analyze and make recommendations going forward regarding the most effective balance between the costs of incentives for government and school consolidations with the expected resulting savings and operational benefits, and how best to structure such state incentives to achieve both clarity for localities as well as justification that incentives are adequate, but not more than necessary. JLARC shall complete its study and submit a final report no later than October 1, 2014.

Appendix B: Research Activities and Methods

JLARC staff conducted the following primary research activities for this review:

- interviews with state agency and local government staff and other experts.
- survey of localities identified as likely candidates for consolidation;
- analysis of data on state financial incentives provided to localities involved in previous consolidations and real estate tax rates of localities involved in previous consolidations;
- review of legislative history, documentation, and research literature on local consolidation.

STRUCTURED INTERVIEWS

JLARC staff conducted structured interviews with a variety of individuals involved in or knowledgeable about local government and school division consolidations. Extensive interviews were held with staff from state agencies that have been directly involved in local government and school division consolidations, as well as other experts on school division and local government consolidation issues. Local government staff and elected officials from localities involved in previous consolidations were also interviewed. These interviews informed each of the research issues that were the focus of this study.

State agencies and entities

In compliance with the mandate for this study, the Commission on Local Government provided information on a variety of topics for this review, including the purpose and history of state incentives for local consolidation and the legal process and requirements for local government consolidation. The Commission on Local Government is the primary state entity responsible for reporting on local government consolidations to the courts and providing technical assistance to localities involved in consolidations. Administrative staff of the Department of Housing and Community Development, of which the Commission is a part, also provided information. Staff of the Virginia Department of Education provided information on the purpose and history of school division consolidation incentives, as well as the amount of state incentives provided to localities involved in previous school division consolidations, including Halifax County, Alleghany County, and Bedford County. They also offered opinions on the effectiveness of the current structure and suggestions for improving the current incentive structure.

Experts on school division and local government consolidation issues

JLARC staff conducted background interviews with several local government advocacy groups and other experts to obtain historical information on local consolidation incentives and additional perspectives about the effectiveness of the current incentive structure.

Local government staff and elected officials

JLARC staff surveyed former city managers, county administrators, attorneys, and elected officials involved in previous local government consolidations to obtain the following information:

- reasons for previous consolidations;
- the role of incentives in previous consolidations; and
- suggested changes to state consolidation incentives structure.

JLARC staff interviewed current local government staff and elected officials from localities involved in previous consolidations to determine the operational and financial impact of the consolidation on the localities and citizens. Information obtained from these interviews included the following:

- operational advantages and disadvantages associated with consolidations;
- impact of consolidation on education funding and expenses for county school division; and
- collaborative agreements for local government services prior to reversion.

SURVEY

JLARC staff surveyed local government officials in localities identified as likely candidates for future local consolidations to determine which of them had recently considered school division or local government consolidation and to evaluate the role of incentives in local consolidation decisions. In localities where consolidation proposals were explored but ultimately not pursued, respondents were asked to identify what factors contributed to decisions not to consolidate. Respondents were asked to provide suggestions for improving the current system.

DATA ANALYSIS

JLARC staff analyzed data from all state agencies that provide funding to localities to examine how state aid to localities is impacted by local government consolidations. This information was used to determine the cost of state financial incentives in previous consolidations, as well as savings to the state after consolidations. JLARC staff analyzed real estate tax rates in localities where previous consolidations occurred to determine if there were any changes before and after consolidation.

Analysis of state funds

JLARC staff contacted all state agencies that provide funding to localities to identify any state aid impacted by previous local government consolidations. These included the following:

- Virginia Department of Education
- Virginia Department of Transportation
- Virginia Department of Fire Programs
- Library of Virginia
- Virginia Department of Social Services
- Virginia Department of Health
- State Board of Elections
- State Compensation Board
- Virginia Department of Criminal Justice Services
- Virginia Department of Behavioral Health and Developmental Services
- Office of Comprehensive Service

Of those 11 agencies, five indicated that funding to localities has been impacted by previous consolidations. Virginia Department of Education provided information on the total amount of additional funding that has been provided to Alleghany County and Bedford County as a result of reversions, but this information was not available for Halifax County. State Compensation Board, Department of Criminal Justice Services, and the Office of Comprehensive Services each indicated that the funding they provide to localities is subject to hold harmless provisions following local government consolidations and provided estimates on the amount of additional funding localities have received as a result of those provisions.

This information was used to estimate the total cost of financial incentives provided to consolidated localities, the total amount of cost savings to the state following elimination of those incentives that have expired to date, and future cost savings to the state following elimination of current incentives that are expected to expire. This data was also used to determine how long it will take to recover the total cost of state financial incentives through future cost savings. Cost savings include funding provided to cities by the State Board of Elections for General Registrar salaries and Electoral Board compensation that is completely eliminated following reversion because it is not subject to the hold harmless provisions.

Analysis of real estate taxes for localities involved in previous consolidations

Because real estate taxes typically provide the bulk of locally generated revenue for local governments and are likely to be impacted by any changes in local government expenses, JLARC staff examined changes in real estate tax rates for localities involved in previous consolidations. Town residents must pay real estate rate taxes to both the town and the county in which they reside. Therefore the combined town and county real estate tax rates in FY 2014 were compared to city real estate tax rates prior to reversion. Real estate tax rates prior to reversion were likewise compared to real estate tax rates in FY 2014 for counties involved in previous consolidations.

REVIEW OF LEGISLATION, DOCUMENTS, AND RESEARCH LITERATURE

JLARC staff documented historical changes to consolidation incentives in all Virginia Acts of Assembly beginning in 1982, when local school division consolidation incentives were first introduced, through 2014. Amendments to the Code of Virginia for school division consolidation incentives (§ 22.1-25), as well as hold harmless incentives for local government consolidations (§ 15.2-1302), were examined and documented.

JLARC staff reviewed Commission on Local Government advisory reports provided to special courts for each of the reversions and consolidation proposals submitted since 1995 to collect information on the reasons for consolidation and the terms of the consolidation agreements. Virginia Municipal League's 1996 report *Reversion From Cities to Towns* was reviewed for additional information on the consolidation of South Boston and Halifax County. Consultant reports related to previous consolidation efforts, including the 2013 reversion proposal for the City of Martinsville, were likewise reviewed.

JLARC staff also reviewed numerous academic studies and public policy reports on school division and local government consolidations.

Appendix C: Other State Consolidation Incentives

Arkansas

Policy: All school divisions with enrollment below 350 for two consecutive years are required to consolidate.

Context: This law was a result of an emergency legislative session called in response to a 2003 Arkansas Supreme Court decision that the state's school funding system was unconstitutional. The ruling upheld a prior Arkansas Supreme Court ruling that the state's K-12 education funding was inadequate and unequitable. The consolidation requirement was part of a broader set of reforms aimed at creating an adequate and equitable funding system.

Outcome: Almost 60 school divisions were consolidated in the first year after enactment. By 2010, six years after the law took effect, the total number of school divisions in Arkansas was reduced from 308 to 240.

Indiana

Policy: Planning grants of up to $25,000 were available to localities and school divisions. Supplemental state aid equal to 50 percent of the projected cost savings is provided for two years after consolidation, tapering to 30 percent in year three, and 10 percent thereafter.

Context: In 2008 Indiana passed a tax reform law that capped local property taxes, thereby reducing local revenues and leading localities to consider consolidation. The state provided planning assistance for localities to study consolidation and cooperative agreement options in 2008 and 2009. In 2012 the state authorized supplemental state aid through the state mandated property tax caps. The law requires the state to lower a locality's property tax cap if a consolidation or cooperative agreement results in lower costs and therefore lower revenue requirements. The reduced tax cap will only be 50 percent of the proposed cost savings in the first two years, 30 percent in the third year, and 10 percent in each year thereafter.

Outcome: Eight feasibility studies were conducted, resulting in recommendations to share services and undertake consolidation. Data is not available on the number of consolidations that resulted from the supplemental state aid incentive.

Iowa

Policy: Mandatory property tax rates are reduced from $0.54 to $0.44 per $100 of assessed value for consolidated school divisions. Supplemental state aid is provided equal to the property tax reduction, with both the reduction and state aid tapering equally over four years. There are additional supplemental weighting incentives in the state aid formula for cooperative agreements such as whole grade sharing.

Context: The incentives are provided with the policy goal of encouraging school districts to provide equal educational opportunities to all children. The state first enacted incentives in 2002 with limited success. The incentives were reauthorized in 2007, with an increase in consolidations occurring over the last seven years. The structure of the incentive is based on the state's K-12 funding formula. The state sets a foundational per pupil funding level each year and state aid is equal to the difference between the per pupil foundation level and the revenue generated by the locality's mandatory property tax levy.

Outcome: There have been 26 consolidations since the reauthorization of the incentives in 2007, taking the total number of school divisions from 364 to 338. There are eight additional consolidations scheduled to take effect in 2014, which is the consolidation deadline in order to receive the incentive.

Kansas

Policy: State education aid is held harmless at pre-consolidation levels for consolidated school divisions. The length of the hold harmless funding is between three and five years depending on the size and number of consolidating divisions.

Context: The hold harmless incentives were originally enacted in 1999, and they have been modified a number of times. The goal of these incentives is to encourage a more cost efficient K-12 education system while maintaining local control over decision making. The incentive favors the consolidation of larger school divisions. Funding lasts for three years if at least one of the consolidating school divisions has less than 150 average daily membership (ADM), four years if at least one division has less than 200 ADM, and five years if both divisions have greater than 200 ADM or there are more than two school divisions consolidating.

Outcome: There have been 14 school division consolidations since 1999, reducing the total number of school divisions to 286. As of 2013 there were still five school divisions with enrollment less than 100 and 201 school divisions with enrollment less than 1,000.

Maine

Policy: School divisions must have a minimum enrollment of 2,500 students. There are exceptions for high performing and isolated school divisions.

Context: Maine's mandatory consolidation requirement was originally passed in 2007 as a way to address statewide fiscal challenges and rising K-12 education costs. The original statute penalized school divisions that did not comply by reducing their state aid. The goal of the policy was to reduce the total number of school divisions from 290 to 80.

The law met strong local opposition but was upheld in a 2009 statewide referendum. However, continued opposition led to the delay and eventual repeal of the financial penalties and other significant changes to the law. Additionally, with the repeal of the financial penalties, several divisions that consolidated since 2007 have already separated or are considering separation. While many studies have been critical of Maine's approach, a positive aspect to the implementation included the state's proactive technical assistance with consolidation planning. The state set up regional planning committees, funded consolidation facilitators, and provided reorganization templates to assist localities with their consolidation planning efforts.

Outcome: The total number of school divisions fell from 290 in the 2007-08 school year to 164 in the 2011-12 school year.

Massachusetts

Policy: Planning and transition grants are available to both school divisions and local governments through the Community Innovation Challenge program (CIC), operated since 2012. Additionally, capital projects that are part of a regionalization plan are awarded additional points in the evaluation process for state construction funds. There is additional state transportation aid for consolidated regional school divisions.

Context: Local government and school division organization is fragmented. For example, there are 327 school divisions serving 351 cities and towns, and they can be either full K-12 districts, elementary districts serving grades below ninth, or regional secondary districts serving higher grades across multiple towns or cities. In response to fiscal pressures in 2008, the state provided planning grants to 12 regional study groups. A 2011 special legislative commission expanded on this by reviewing a variety of ways to improve school division capacity, regionalization, and collaboration. The CIC is the most recent state effort to spur local collaboration and consolidation.

Outcome: Data on consolidations is not available. However, the CIC funded 74 projects from 2012-2014 across all government service areas, including one school division consolidation. The total amount of grant funding for these projects was $10.25 million.

Michigan

Policy: Planning and transition grants are available to both school divisions and local governments.

Context: The competitive grant program was implemented in response to increasing statewide fiscal stress. The stated goal of the program is to "provide incentive-based grants to stimulate smaller, more efficient government and encourage mergers, consolidations, and cooperation between two or more qualified jurisdictions." Applications for the grants must demonstrate taxpayer benefits through cost savings, efficiencies, or improved services. Proposed grant budgets must show how the funding is necessary to implement the consolidation.

Outcome: Data on full consolidations is not available, but almost $25 million was awarded in 87 grants from 2012 to 2014. Fourteen of the 87 grants were for feasibility studies, and all 87 grants were for non-education government services.

Minnesota

Policy: Consolidated school divisions receive transition assistance equal to $200 per pupil in the first year and $100 per pupil in the second year, to a maximum of 1,500 pupils. The funding must be spent on retirement incentives or to pay down operating debt from the reorganization. There are grants of up to $100,000 for capital projects that can be awarded after the consolidation is complete.

Context: The existing state incentives are part of a long trend of school division consolidation incentives and requirements dating back to 1959. Many of the historical incentives have been altered or repealed, but these transition incentives remain the current policy. A 2012 report by the Office of the Legislative Auditor evaluated the costs and benefits of state incentives for non-education local government consolidations. The report recommended that the state fund feasibility studies and pilot consolidations, but to date no incentives have been enacted.

Outcome: Following the enactment of the current transition assistance incentives in 1993 and 1994, the total number of school divisions decreased from 382 to 345 between 1995 and 2000.

New York

Policy: Consolidated school divisions receive a 40 percent increase in state operating aid for five years with a nine year taper, for a total of 14 years of supplemental aid. State construction aid is also increased by 30 percent, up to 95 percent of the approved project if it is implemented within the first 10 years following consolidation. Planning assistance for feasibility studies is also available.

Context: New York has a fragmented system of local government and school divisions, but there is a long history of cooperation and consolidation. There are more than 700 school divisions statewide, with 37 Boards of Cooperative Education Services providing regional education services to almost all of the school divisions in the state. While incentives for school division consolidation have been available for some time, the governor is currently making a push for property tax incentives for local government consolidations. There are more than 10,000 general and special purpose local governments in New York.

Outcome: Since 1983, 34 school division consolidations have taken place, and between 2006 and 2010, the state provided 15 planning grants.

Oklahoma

Policy: One year of transition assistance is provided to consolidated school divisions for costs such as textbooks, staff, severance pay, and capital improvements. The amount of transition assistance is calculated based on ADM and capped at $1 million. Additionally, the state Board of Education has the authority to mandate consolidation for school divisions that are academically at-risk or non-accredited.

Context: School division consolidation incentives began in Oklahoma in 1989 with the passage of a law entitled the Voluntary School Consolidation Act. This law has been amended numerous times, and the current incentives were put in place in 2006. This change set up the School Consolidation Assistance Fund to pay for transition assistance. This is a continuing fund not subject to fiscal year limitations, meaning any money appropriated for the fund will be available to pay transition assistance in future years.

Outcome: There have been 92 school division consolidations in Oklahoma since 1989 including 23 since 2006. This reduced the total number of school divisions from 609 to 517.

South Dakota

Policy: Consolidation is required for school divisions with less than 100 ADM, with some exceptions. Consolidated school divisions receive supplemental state aid of $1,000, $800, and $400 per ADM, up to a maximum of 400 ADM, for the first, second, and third years after consolidation. Additionally, school divisions can choose to receive hold harmless funding or an additional state aid adjustment for small schools. Both of these incentives continue for four years with a four-year taper, for eight total years of funding.

Context: In 2007 South Dakota passed a law requiring a school division with less than 100 ADM to consolidate unless it is considered a sparse division. In 2013 an exception was added for school divisions that partner with other divisions to lower costs in providing educational services. Supplemental state aid incentives were first enacted in 2001, and they were amended several times with the current incentives being updated in 2010.

Outcome: A total of 25 consolidations have occurred since incentives began in 2001, reducing the number of school divisions from 176 to 151. Eight occurred between 2001 and 2007 when the state incentives were in place but before the mandatory consolidation requirement.

Vermont

Policy: Consolidated school divisions receive a reduction in homestead property tax rates, tapered over four years and five years of hold harmless funding under the state's small school grants. Transition assistance grants of up to $150,000 and certain administrative incentives such as multi-year budgeting are also available. The consolidated school division must have at least 1,250 ADM or be the result of merging at least four school divisions to be eligible for incentives.

Context: Vermont has a fragmented system of school divisions. In 2010 there were 310 school divisions and only about 625,000 residents statewide. The consolidation incentives were enacted in 2010 to encourage voluntary mergers by school divisions. A study released in January 2013 documented the results and concluded that voluntary incentives were not likely to produce many consolidations because of local opposition. It also looked at the potential cost savings and concluded that cost savings were not realized because gains were reinvested in additional education programs.

Outcome: Only one successful consolidation as of the end of 2012. Six proposals were approved by the state, but four were rejected by voters and one was withdrawn by the school board. There were 18 feasibility studies underway as of the end of 2012.

Wisconsin

Policy: Consolidating school divisions receive a 15 percent increase in state aid or hold harmless funding for five years, whichever is greater. There is a two-year taper for seven total years of supplemental state aid. In 2008 the state funded feasibility studies of up to $10,000 each.

Context: There are many rural school divisions in Wisconsin facing fiscal challenges due to declining enrollments and increasing transportation costs. Given that environment, school division consolidation is relatively uncommon but has increased in recent years. Only four consolidations have occurred since 1990 with three of them occurring since 2006.

Outcome: The planning assistance grants funded 11 studies with 25 participating school divisions. Two of the studies resulted in consolidations.

TABLE C-1
Four approaches to consolidation used by other states

	Policy	P	T	PI	M	Results
Arkansas	Minimum enrollment of 350 ADM				ü	68 consolidations (2004–2010)
Indiana	$25,000 planning grants; additional state aid equal to 50% of proposed cost savings tapering to 10%	ü		ü		Eight feasibility studies funded
Iowa	Tapered property tax reductions replaced with state aid for four years; supplemental formula weights apply for other cooperative agreements			ü		34 consolidations since 2007
Kansas	State aid is held harmless for 3-5 years			ü		14 consolidations since 1999
Maine	Minimum enrollment of 2,500 ADM				ü	126 consolidations (2008–2012)
Massachusetts	Competitive planning and transition grants; priority construction funding; increased transportation aid	ü	ü	ü		$10.25 million in grants to 74 projects (2012–2014)
Michigan	Competitive planning and transition grants	ü	ü			$25 million in grants to 87 projects between (2012–2014)
Minnesota	Two years of additional per pupil funding capped at $300,000 and $150,000 per year; capital grants up to $100,000		ü			37 consolidations (1995–2000)
New York	Grants for feasibility studies; 40% increase in operating aid tapering over 14 years; increased construction aid	ü	ü	ü		34 consolidations (1983–1994); 15 planning grants (2006–2010)
Oklahoma	Transition assistance capped at $1 million; state can mandate consolidation for academic reasons		ü		ü	23 consolidations since 2006
South Dakota	Minimum enrollment of 100 ADM; supplemental state aid tapered for three years; hold harmless or small school grants for eight years			ü	ü	25 consolidations since 2001
Vermont	$150,000 transition grants; reduced property taxes tapered for four years; small school grants held harmless for five years		ü	ü		One consolidation between 2010 and 2012
Wisconsin	$10,000 planning grants; 15 percent increase in state aid for five years with a two-year taper	ü		ü		11 feasibility studies in 2008 resulting in two consolidations

Source: JLARC staff analysis.
P=Planning, T=Transition, PI=Post-implementation, M=Mandatory ADM=average daily membership, the aggregate number of days of membership of all students during a school year divided by number of days school is in session during the year.

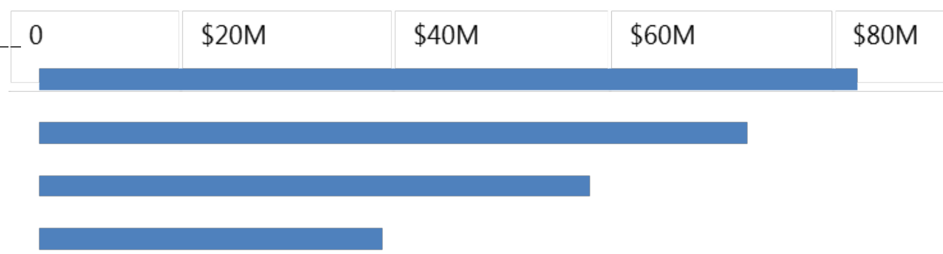
Appendix D: Estimated Additional State K-12 Funds Using Current Consolidation Approach

This appendix estimates the increase in K-12 funding if selected cities consolidated with their contiguous localities. The estimates assume the lowest of the composite indexes between the two localities is used, as was the case with the most recent consolidation of Bedford County and the City of Bedford. The estimates are state Standards of Quality funds only, which are the vast majority of state direct aid to local school divisions. The estimates do not include additional K-12 funding a locality may receive in the form of State Lottery aid or from the Literary Fund.

Cities were selected if they were rated as "above average" fiscal stress. There are 33 possible combinations of these cities and their surrounding counties. Possible consolidations are shown in order from highest potential increase in funds to the lowest potential increase.

TABLE D-1
Additional state SOQ funding for possible local consolidations: At least $30M per year

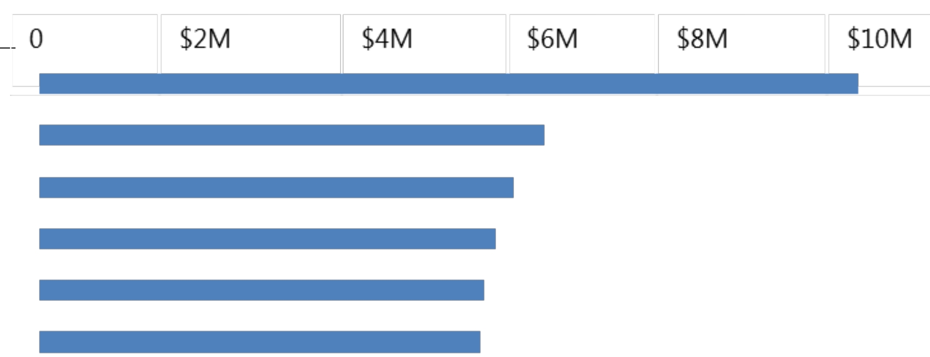
City / Town	County
Manassas Park	Prince William
Petersburg	Chesterfield
Hopewell	Chesterfield
Manassas	Prince William



Source: JLARC staff analysis of FY 2013 school division spending and Commission on Local Government fiscal analysis.

TABLE D-2
Additional state SOQ funding for possible local consolidations: $10M to $5.1 M per year

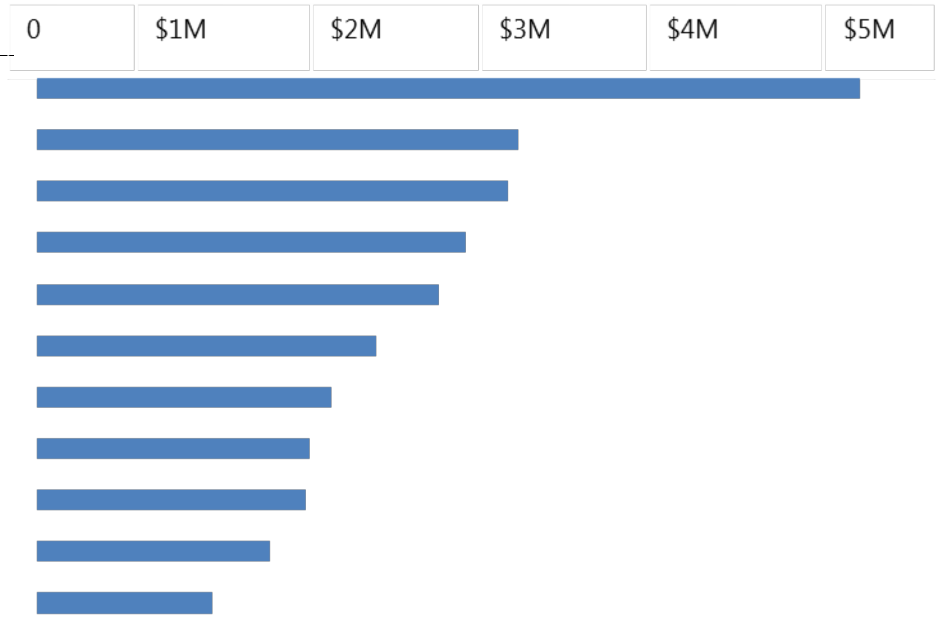
City / Town	County
Franklin	Southampton
Fredericksburg	Spotsylvania
Fredericksburg	Stafford
Buena Vista	Rockbridge
Franklin	Isle of Wight
Radford	Montgomery



Source: JLARC staff analysis of FY 2013 school division spending and Commission on Local Government fiscal analysis.

TABLE D-3
Additional state SOQ funding for possible local consolidations: $5M to $1M per year

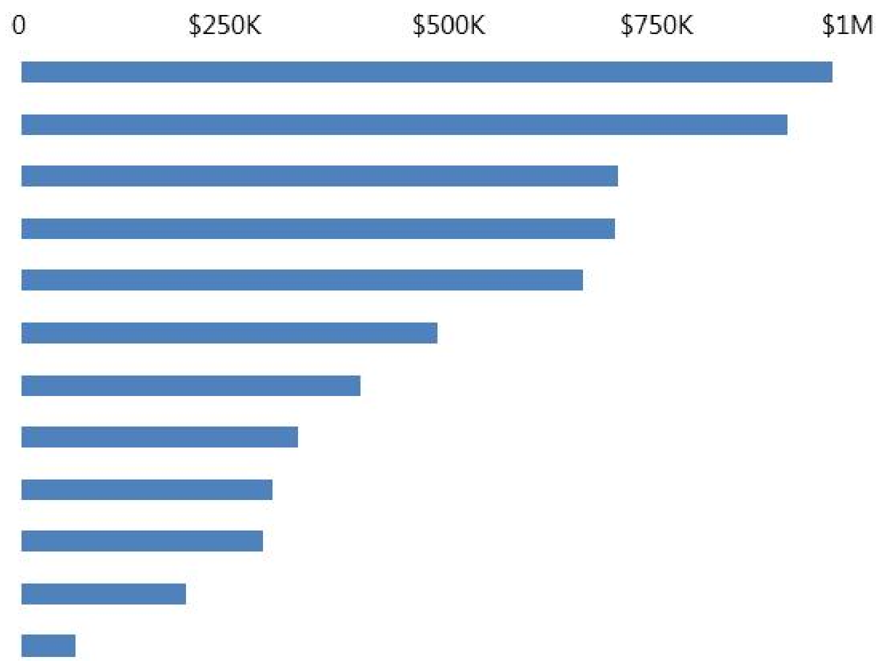
City / Town	County
Bristol	Washington
Colonial Heights	Prince George
Winchester	Frederick
Petersburg	Prince George
Williamsburg	York
Harrisonburg	Rockingham
Charlottesville	Albemarle
Petersburg	Dinwiddie
Williamsburg	James City
Danville	Pittsylvania
Salem	Roanoke



Source: JLARC staff analysis of FY 2013 school division spending and Commission on Local Government fiscal analysis.

TABLE D-4
Additional state SOQ funding for possible local consolidations: $1M or less per year

City / Town	County
Martinsville	Henry
Hopewell	Prince George
Norton	Wise
Colonial Heights	Chesterfield
Galax	Grayson
Galax	Carroll
Emporia	Greensville
Lexington	Rockbridge
Radford	Pulaski
Waynesboro	Augusta
Staunton	Augusta
Covington	Alleghany



Source: JLARC staff analysis of FY 2013 school division spending and Commission on Local Government fiscal analysis.

Appendix E: Agency Responses

As part of an extensive validation process, state agencies and other entities involved in a JLARC assessment are given the opportunity to comment on an exposure draft of the report. JLARC staff provided an exposure draft of this report to the following state agencies and entities:

- Secretary of Education
- Department of Education
- Department of Housing and Community Development

Appropriate technical corrections resulting from their comments have been made in this version of the report. This appendix includes a written response letter provided by the Department of Education and the Department of Housing and Community Development.

SEP 02 2014

COMMONWEALTH of VIRGINIA

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September 2, 2014

Mr. Hal E. Greer, Director
Joint Legislative Audit and Review Commission
201 N. 9th Street
General Assembly Building, Suite 1100
Richmond, Virginia 23219

Dear Mr. Greer:

Thank you for the opportunity to review and comment on the draft report on *Local Government and School Division Consolidation*. I know several Department of Education staff have also provided technical comments on the draft report directly to JLARC staff. We appreciate the thorough research that was conducted and the important recommendations made related to assessing the feasibility of localities considering consolidation, as well as the discussion of alternative approaches to providing state funding to localities in support of consolidation efforts that consider the associated costs and benefits. In addition, the report highlights critical issues that local governments and school divisions face when evaluating local structure and options for consolidation.

We commend the JLARC staff on an excellent draft report that we believe will be helpful to the General Assembly in future deliberations regarding funding approaches that support local government and school division consolidation.

Sincerely,

Steven R. Staples

SRS/SBW

Terence R. McAuliffe
Governor

Maurice A. Jones
Secretary of
Commerce and Trade

COMMONWEALTH of VIRGINIA

DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT

William C. Shelton
Director

August 29, 2014

Mr. Hal E. Greer, Director
Joint Legislative Audit and Review Commission
General Assembly Building, Suite 1100
201 North Ninth Street
Richmond, Virginia 23219

Dear Mr. Greer:

Thank you for allowing us to review and comment on the Exposure Draft of JLARC's report *Local Government and School Division Consolidation* . We look forward to the potential implementation of the report's recommendations to align local government consolidation incentives with savings to the Commonwealth. We appreciate the opportunity to share our experiences with town reversion and local government consolidation with JLARC staff.

We have provided minor technical comments under separate cover, and hope those will be useful as this report is finalized.

Sincerely,

Bill Shelton

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