

Auditor of State Advisory Memo

To: Ohio Local Governments
From: Keith Faber, Ohio Auditor of State
Date Issued: April 24, 2020
Subject: COVID-19 Economic and Budgetary Impacts

On March 9, 2020 Governor DeWine issued Executive Order 2020-01D which declared a state of emergency in Ohio due to the COVID-19 worldwide pandemic. Subsequently, the Governor has issued stay-at-home orders for the State of Ohio through May 1, 2020. Due to these orders, business-as-usual has been disrupted. Both the private and public sectors are having to manage a disruption to the provision of services, including essential services, which may be impacted by changes in revenues. During these times, the Auditor of State recognizes that local governments are faced with unique challenges.

This memo is meant to provide awareness to a variety of issues that your entity may encounter in the months ahead. It is not meant to be a roadmap for navigating each unique case; the way forward for each entity must be driven by local officials with help from their legal counsel. Opportunities do exist for assistance however, the Ohio Revised Code establishes the Auditor of State's (AOS) role in providing assistance to entities in a state of fiscal caution, watch, or emergency through our Local Government Services. Additionally, Local Government Services and the Ohio Performance Team are available to provide consulting services and performance audits to work through financial or operational challenges that political subdivisions may face.

Economic Impacts

The COVID-19 pandemic is leading to significant international and national economic dislocation. As a result of sweeping stay-at-home orders across the country, the United States has seen severe economic disruption in March and April. Some level of disruption is likely to continue for the foreseeable future. Most economists believe there will be a significant economic contraction in the second quarter of 2020, following likely negative growth in the first quarter.

Two consecutive quarters of negative economic growth is generally indicative of a recession. What we don't know at this point is how long or how deep a recession would be. But, even without knowing that, we know there will be dramatic impacts on state and local revenue sources. A recession would put untold pressure on state and local budgets and dramatically impact public finances.

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State Revenue Impacts

The economic disruption is already beginning to affect state revenues. For example, we began to see a slowdown of **sales tax** in March, but the full effect will not hit until April and beyond, as a result of so much commercial activity shutting down or reducing operations in compliance with stay-at-home orders.

With commercial activity slowing, companies will lay people off, which we have already seen. Over the past five weeks, 964,566 people made new claims for unemployment which is almost a quarter-million more than the 715,512 people who initiated claims in years 2018 and 2019 combined. As people lose their jobs, **personal income tax** withheld from employee paychecks is going to drop, decreasing a major state revenue source. Additionally, the April 15th due date for federal, state, and local tax filings (annual and quarterly-estimated payments) has been extended to July 15th which delays the receipt of those tax revenues. For the state and any other entity with a June 30 fiscal-year-end, the delayed date will move receipt of these revenues into the next fiscal year.

Beyond the state sales and personal income tax, there are other state general purpose taxes that will likely be impacted by the economic slowdown, including the **commercial activity tax** and **kilowatt hour tax**. Reduced state general purpose taxes deposited in the general revenue fund will result in a reduction of the money distributed through the local government fund and the public library fund, impacting local revenues when paid in the month following state collection.

It is also expected that gas tax collections will be depressed during the stay-at-home order which would then affect distributions of gas taxes to local governments. On the state expenditure side, the Governor has already announced a series of budgetary controls including an expectation for budget reductions in state appropriations for both FY 2020 and FY 2021. Local governments and schools should expect that state assistance provided through a number of programs will be impacted by these budget reductions.

Local Revenue Impacts

Based on the economic effects discussed and information on state revenues, the following are some various sources of revenues that local entities need to also consider during this challenging time:

Permissive sales tax, like the state sales tax, is likely to be affected. It is important to remember that receipt of these revenues at a local level has a three-month lag time so the full impact may not be recognized immediately.

The **municipal income tax**, received monthly, and the **tax on net profit** from businesses, received annually, will both be affected by the abovementioned economic impacts. Both the delay in Tax Day and the change to working from home may have significant implications for local governments, particularly those who have a heavy reliance on non-residents for income tax purposes.

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School district income taxes, which are collected by the state and distributed quarterly, will see significant timing-related reductions associated with annual payment delays in the second quarter payments received in July. Annual payment collections will be received by the state in July and distributed in the October payment. **School district income taxes** will also likely see reductions in withholding collections as mentioned above.

Casino revenue distributions to schools and local governments will be less than expected. With casinos closed since March 14th, the semi-annual school payments received in August and the county and city payments received in July will all be reduced.

Lottery profits will also be affected by the closure of racinos, with stay-at-home orders and business closures potentially further reducing lottery profits used to support school funding. **Lodging and admissions taxes** will both likely see impacts from economic slowdown. **Utility collections** may experience significantly increased rates of delinquencies which may affect operations as well as the ability to make debt payments.

Real property tax collections in 2020 are based on 2019 valuations and rates. Because of this, no immediate impact on property tax is expected other than any potential delays in the timing of payments that may be sought by counties through the Tax Commissioner and any potential increase in delinquencies. Some of this impact may be offset by advances where possible. Local governments need to consider that the current economic climate and uncertainty may affect the ability to pass levies, and this needs to be taken into account as they plan.

Local Expenditure Impacts

In addition to keeping track of revenue changes, it is vital that entities carefully monitor how expenditures may be impacted. For most local governments the largest item of expense is salaries and benefits. During these times, entities need to account for overtime or hazard pay, collective bargaining agreement requirements, and other potential salary-related effects.

If personnel changes are considered, the effects of unemployment and severance costs must be examined. Jurisdictions should know federal eligibility for stimulus dollars from the CARES Act before decisions are made. There may be additional costs of supplies, information technology, telecommunications, etc., related to work-at-home arrangements. However, there may also be savings related to reduced or no travel, fuel, utilities, training, etc., due to the closure of offices or the rescheduling of events. Local governments that have outstanding debt or are looking to issue new debt need to look at economic effects of their ability to do so, as well as work with lenders related to any cash flow payment issues.

With each entity having its own expenditure changes, it is important to track separately and review expenditures that have increased due to the COVID-19 emergency in order

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to properly plan and budget moving forward. Entities need to be aware of and properly track opportunities to access state and federal emergency funds. The use of these funds will be audited and need to strictly comply with the rules of each program.

We have been receiving questions regarding the use of local government carry forward funds and restricted purpose accounts. General Revenue Funds may generally be used for other purposes while special use or restricted accounts cannot. You should track your fund use carefully and use funds for their collected purposes. If this is an issue for you, please seek legal guidance. Our Local Government Services and Ohio Performance Team are ready and willing to help.

I hope this memo gives a deeper understanding of the many national, state, and local issues affecting revenues and expenditures for entities during and after the COVID-19 emergency. There are clearly going to be budgetary concerns in the short-term, but political subdivisions also need to consider the longer-term budgetary and operational issues they may face.

My office stands ready to be a resource to help with the challenges that undoubtedly lie ahead and encourage you to visit the AOS website to review the COVID-19 FAQ document that is continuously being updated as additional information becomes available. Local Government Services and the Ohio Performance Team can serve as resources as you navigate this uncertainty. Stay safe and healthy.