Local Government Fiscal Condition and Use of Federal COVID-19 Stimulus Funds

AGENCY: Department of Finance and Administration

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PURPOSE OF HEARING: Local Government Fiscal Conditions and Use of Federal COVID-19 Stimulus Funds

WITNESSES: Debbie Romero, Acting Secretary, Department of Finance and Administration; Steve Kopelman, Executive Director, New Mexico Association of Counties; AJ Forte, Executive Director, New Mexico Municipal League; Louie Bonaguidi, Mayor, Gallup

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Local Government Fiscal Conditions

There is considerable uncertainty about the long-term economic impact of the COVID-19 public health emergency on local governments, given ambiguity around future federal support for state and local governments, as well as uncertainty around the path of the virus and changes in consumer behavior. The state experienced a 3.1 percent contraction in real gross domestic product (RGDP) in the first quarter of 2020, Moody's Analytics predicts a 29.4 percent contraction in the second quarter, with RGDP not recovering until 2022. However, there is some indication that revenue impacts on local governments may not be as severe as anticipated, at least in the near-term.

Local Government Revenues. Economic activity in April and May declined less than expected, with Matched Taxable Gross Receipts (MTGR)[1] down 6 percent and 1.5 percent, respectively, from prior year in April and May, and up by 0.1 percent in June, compared to the prior year. While three-quarters of municipalities saw overall growth in total GRT distributions in FY20, 40 percent of municipalities saw declines in GRT distributions in April and May, and 50 percent saw declines in June, suggesting that while economic growth was strong for most municipalities prior to the public health emergency, more and more municipalities began to experience declining revenues as a result of the pandemic. See Table 1 for changes in FY20 GRT distributions for selected municipalities. On average, GRT made up over half of municipalities' revenues in FY19.

While local governments have a number of locally imposed revenue sources – including property tax, local option gross receipts tax, and other taxes and fees – they also rely on revenues from the state.

In addition to GRT levied by local governments, cities and counties receive a share of state GRT. Of the 5.125 percent GRT rate imposed by the state, municipalities receive approximately a quarter of revenues, or 1.225 percent. In FY19, this distribution totaled $484.3 million. Municipalities also receive a municipal equivalent distribution – $4.9 million in FY19 – in lieu of imposing a compensating tax. Cities and counties also receive "hold harmless" payments, totaling $120.4 million in FY19, to offset losses from GRT deductions for food and medical services.

Table 1. Change in GRT Distributions

	Apr 2020 vs Apr 2019	May 2019 vs 2020	June 2019 vs 2020	FY20 vs FY19
Albuquerque	-12.5%	-44.1%	-1.7%	3.8%
Santa Fe	-19.2%	49.6%	-12.3%	3.8%
Las Cruces	-4.3%	7.6%	2.8%	6.9%
Rio Rancho	10.4%	28.3%	13.6%	20.4%
Farmington	-8.3%	-5.3%	-9.0%	7.2%
Gallup	12.1%	-2.0%	-20.9%	2.1%
Hobbs	-24.1%	5.0%	-33.4%	-6.5%
Roswell	2.0%	30.7%	-4.0%	12.5%
Clovis	2.6%	-19.9%	-5.3%	15.7%
Alamogordo	18.7%	-45.5%	1.3%	23.7%
Carlsbad	-17.6%	-25.4%	-46.5%	5.8%

Source: TRD RP-80 data

Notes: GRT distributions include local option GRT, municipal share of state GRT, hold harmless distributions, municipal equivalents, and other local GRT increments

[1] Matched taxable gross receipts (MTGR) are taxable gross receipts matched to tax payments that best represent overall economic activity in the state

Hold harmless payments to local governments were higher during the months of April, May, and June – averaging $10.4 million per month, compared to $8.6 million in prior months of FY20 – reflecting increased grocery sales, as well as a one-time increase from an amended taxpayer return.

Analysis from the National League of Cities found that each percentage point increase in the unemployment rate would mean an additional revenue loss of 3.3 percent for cities

However, there is still considerable uncertainty around future GRT revenues. Federal stimulus actions – in particular, the Paycheck Protection Program (PPP), $1,200 stimulus checks and the additional $600 weekly unemployment benefit – likely supported consumer spending, even amidst job losses. Reduced federal support could lead to sharp drops in consumer activity, and more layoffs, adversely affecting municipalities' GRT revenues in FY21. Analysis from the National League of Cities found that for each percentage point increase in the state unemployment rate, New Mexico municipalities would see an additional revenue loss of 3.3 percent. New Mexico ranked eighth in the analysis for municipalities' sensitivity to increases in the unemployment rate.

In addition, local governments with significant oil and gas activity are likely to experience a greater decline in GRT, due to lower oil prices and decreases in rig counts. For example, Lea and Eddy counties saw declines in June GRT distributions of 34 percent and 29 percent, respectively, compared to the prior year. Local economies that rely heavily on tourism and hospitality may also see a greater impact. MTGR for arts, entertainment and recreation were down by 63 percent in May, compared to the prior year, while accommodations and food services were down by 33 percent.

Overall, county governments may experience less of an adverse impact than city governments, given greater reliance on stable property tax revenues than volatile GRT revenues. Early indication from counties suggests that property taxes at the end of FY20 were at similar levels as FY19. Legislation during the 2020 special session (Laws 2020 (1st S.S.), Chapter 4) waives penalties and interest for non-payment of property taxes for one year, effectively extending the payment deadline. However, since the legislation didn't take effect until after the April 10 property tax deadline, extensions likely did not have a significant impact on county revenues. According to the Tax Policy Center, property taxes may be relatively immune from effects of the public health emergency, in part because property tax assessments often lag market prices due to caps on allowable annual increases in assessment values. Because of this, even declines in market values of properties may not lead to meaningful changes in assessed values. Furthermore, according to real estate website Zillow, the median home value in New Mexico increased by almost 6 percent over the past year, and is predicted to fall by just 1 percent in the next year.

Table 2. County Share of General Fund Revenue by Source, FY19

County	GRT Share of Revenue	Property Tax Share of Revenue
Bernalillo	50%	43%
Los Alamos	42%	10%
Curry	42%	50%
Doña Ana	29%	54%
Socorro	26%	42%
County Average	*14%*	*53%*

Source: DFA

However, while GRT revenues make up just 14 percent of county revenues, on average, some counties are more reliant on GRT (Table 2). These counties' revenues may be more volatile in FY21, depending on factors like consumer behavior and business activity.

Local Government FY21 Budgets. Of local governments' FY21 budgets reviewed by LFC, nearly all decreased general fund spending levels, with decreases ranging from 1 percent to over 20 percent. Las Cruces' FY21 budget increases general fund spending slightly, citing an increase in GRT revenues above projections (Table 3).

Table 3. Local Government FY21 Budgets

	General Fund Budgeted Expenditures		
Local Government	FY21	% Change from FY20	Budgeted FY21 GF Reserves as % of Budgeted GF Expenditures
Santa Fe	$92,800	-10%	10%
Las Cruces	$97,000	1%	17%
Albuquerque	$636,281	-1%	8%
Roswell	$32,351	-21%	18%
Farmington	$56,316	-9%	13%
Hobbs	$60,317	-13%	41%
Rio Rancho	$59,563	-2%	25%
Bernalillo County*	$314,000	-1%	32%
Dona Ana County	$59,017	-1%	25%
Lea County	$29,988	-18%	123%
Eddy County	$59,802	-6%	
San Juan County	$29,618	-1%	25%

*Bernalillo County's FY21 approved budget was $340 million; the county plans to reduce the budget to $314 million. General fund reserve levels may be adjusted as well.
Note: Some local governments adjusted their FY20 budgets; the percentage changes from FY20 do not reflect adjusted budgets
Source: Local government published budgets, websites (figures based on best available public information as of mid-August)

Based on information in local government budgets, it appears that most local governments do not plan to lay off employees. Some have already implemented furloughs or plan to do so. For example, Santa Fe plans to extend existing staff furloughs through September, with most employees furloughed for four hours per week. Rio Rancho announced furloughs of 15 percent of city employees in April. Roswell's FY21 budget includes a 10-day furlough for all employees, while Farmington furloughed 129 temporary employees.

For FY21, the Department of Finance and Administration (DFA) granted a waiver of state required reserves for FY21 in order to give counties and municipalities more flexibility in preparing and submitting a balanced budget. Typically, the state-required reserves are 3/12th of general fund expenditures for counties and 1/12th for municipalities. All city and county budgets reviewed by LFC maintained reserves above required levels in their FY21 budgets (see Table 3). DFA will review and approve all local government budgets by September 7.

Federal Stimulus Funding for Local Governments

Coronavirus Relief Fund. The federal Coronavirus Aid, Relief, and Economic Security (CARES) Act provided $1.25 billion of stimulus funding to New Mexico, through the Coronavirus Relief Fund (CRF). Of this amount, Albuquerque received $150 million and Bernalillo County received $31.8 million, under a formula that provided direct transfers to cities and counties with populations over 500 thousand. The U.S. Department of the Treasury encourages states to transfer 45 percent of remaining funds allocated to the state to local governments with populations under 500 thousand. For New Mexico, this would mean a transfer of approximately $480 million to local governments, although transfers to local governments are not required under current guidance.

Figure 1. Proposed Federal Legislation

The Senate Republican-proposed **HEALS Act** would amend CRF requirements by:

- Extending the deadline to spend CRF money through September 30, 2021
- Allowing up to 25 percent of CRF funding to be used to cover budget shortfalls, if a government receiving a direct allocation transfers at least 25 percent of its allocation to localities within its jurisdiction

The House **HEROES Act** (H.R. 6800, passed in May) would create a new stimulus fund by:

- Providing an additional $375 billion in funding for local governments, which could be used to replace foregone revenue, as well as cover direct COVID-19-related expenditures

Under current Treasury guidance, CRF monies can only be used to cover "necessary expenditures" incurred between March 1 and December 30, 2020 as a result of the COVID-19 public health emergency, and that were not accounted for in the most recent budget approved as of March 27, 2020. Eligible expenditures include:

- Medical expenses – COVID-19 testing, emergency medical expenses, temporary medical facilities, COVID-19-related expenses of public health facilities
- Public health expenses – communication and enforcement efforts, PPE costs for public workers, technical assistance for mitigation of COVID-19 threats, quarantine expenses
- Payroll expenses for public workers whose services are focused on mitigating or responding to COVID-19
- Other expenses such as food delivery, distance learning facilitation, telework facilitation, economic support for small businesses, and government payroll support

These restrictions mean that state and local governments cannot use CRF funds to cover budget shortfalls, although new proposed federal legislation would change the requirements to allow for funding to cover revenue shortfalls, and would also extend the period in which governments could spend funds (see Figure 1). In general, local governments have had minimal direct expenditures related to COVID-19. Revenue decreases represent a much more significant impact on local government finances.

Local governments have considerable flexibility in spending CRF money on public safety payroll expenses

However, there may be considerable flexibility for local governments in spending CRF money on allowable payroll expenses. The most recent guidance from the Treasury specifies that because funding is intended to address unforeseen COVID-19-related risks, governments "may presume that payroll costs for public health and safety employees are payments for services substantially dedicated to mitigating or responding to the COVID-19 public health emergency," meaning that CRF monies can be used to offset general fund payroll costs for these employees. The Albuquerque Journal reported that Albuquerque is charging approximately $43 million in 2020 payroll costs to its $150 million CRF allocation. Covering health and safety payroll costs with CRF money represents significant cost coverage for most local governments. For example, budgeted FY21 salaries and benefits for the fire and police departments alone are approximately $36 million in Santa Fe, while personnel costs (representing salaries and benefits, as well as training and staff development) total approximately $42 million in Las Cruces and $11 million in Roswell.

Figure 2. DFA Application for Local Government CRF Awards

Applications for local government CRF funding include questions about the following:

- How government business was affected by COVID-19
- Whether local government offices were closed to the public
- How the government attempted to mitigate the spread of COVID-19 and any enforcement measures taken
- How the government complied with Public Health Orders
- The impact on the community due to closure or decline of business operations
- Preventative policies and practices in place to mitigate the spread of COVID-19
- Contingency plans for mass exposure
- Expenses for public health and safety
- How funding would be used for housing or rental assistance
- Amount of GRT revenue lost during the pandemic

State CRF grant awards for local and tribal governments. The state plans to distribute $150 million in CRF funding to local governments with populations under 500 thousand, and $28 million to tribal governments. DFA sent applications to local and tribal governments in late July to apply for CRF funds to reimburse eligible expenses related to the public health emergency, including purchase of PPE, public health and safety personnel costs, childcare assistance, and housing assistance. Applications ask local governments how they have been affected by COVID-19, how they have mitigated the spread of the virus and enforced health orders, and how much they have spent on COVID-19-related expenses (see Figure 2). However, DFA did not provide information on specific evaluation criteria used to determine grant award amounts. Treasury guidance specifies that states cannot impose additional restrictions on transfers of funds to local governments beyond requirements set out in the CARES Act, which does not mention requirements related to how governments have enforced public health orders.

DFA plans to distribute funds on a reimbursement basis. Local and tribal governments that receive funding must adhere to the same Treasury guidance that governs transfer of funds to the state. See Table 4 for tribal distributions. DFA has not made award announcements for local governments, but indicated in the media that 53 municipalities and 29 counties applied for a total of $191 million, with some local governments submitting joint applications.

DFA plans to distribute $150 million in federal stimulus funds to local governments, including $50 million for small businesses

Small business grants. Of the $150 million for local governments, $50 million is intended for small business continuity grants, which would allow local governments to award funding to small businesses in their communities that meet the following criteria:

- 50 or fewer full-time equivalent employees
- Annual revenue of $2 million or less prior to the impact of COVID-19
- Headquartered in New Mexico
- Forced to close or severely curtail business operations as a result of state closure orders

Local governments will be responsible for evaluation of applications (DFA provided a suggested application) and awarding funds, which can be spent on business continuity activities, such as employee payroll, rent, insurance, utilities, and marketing, or business redesign activities, such as reconfiguration of office space, PPE for employees, and technology to facilitate teleworking. While there is no limit to how much a small business can request, requests may be prorated if requests total more than $50 million. Local governments will also be responsible for monitoring of small business grants.

Table 4. State CRF Distributions to Tribal Governments ($ thousands)

Tribal Entity	Amount	
Pueblo of Pojoaque	$	2,000
Santa Clara Pueblo	$	1,700
San Felipe Pueblo	$	1,700
Pueblo of Santa Ana	$	1,700
Pueblo of Sandia	$	1,700
Pueblo of Tesuque	$	1,700
Pueblo of Acoma	$	1,700
Jicarilla Apache Nation	$	1,700
Navajo Nation	$	1,700
Pueblo of Zuni	$	1,400
Pueblo of Jemez	$	1,400
Pueblo of Picuris	$	1,400
Pueblo de Cochiti	$	1,400
Pueblo of Nambe	$	1,400
Santo Domingo Pueblo	$	1,400
Zia Pueblo	$	1,400
Mescalero Apache Tribe	$	800
Pueblo of Laguna	$	600
Pueblo of Isleta	$	400
Ohkay Owingeh	$	400
Taos Pueblo	$	400
TOTAL	**$**	**28,000**

Source: DFA

Other state and federal support. In the 2020 special legislative session, Senate Bill 3 (Laws 2020 (1st S.S.), Chapter 6) created a loan program for local governments to provide emergency economic relief. The legislation requires 1 percent of the state's Severance Tax Permanent Fund, or approximately $50 million, to be provided in loans, administered by the New Mexico Finance Authority. Local governments are eligible for loans if they experience at least a 10 percent decline in local option GRT revenue during the fourth quarter of FY20, and may borrow up to 50 percent of their projected budget shortfall. Loan proceeds can be used for general operating expenses and revenue replacement, at a 2 percent interest rate. However, local governments must pledge GRT revenue to secure loans, a potentially risky move given potential for GRT revenues to fall further. Based on preliminary data, 35 municipalities, including Gallup and Santa Fe, and seven counties, including Santa Fe, Eddy, and Lea, saw declines of local option GRT of greater than 10 percent in the last quarter of FY20, compared to the last quarter of 2019. The deadline for applications is December 31, 2020.

The Federal Emergency Management Agency (FEMA) will reimburse local governments for costs associated with emergency protective measures, which include costs such as emergency operations centers, emergency training, emergency medical care, medical sheltering, and emergency distribution of food and water. In general, local governments must provide a 25 percent match for costs reimbursed by FEMA, which can be covered by CRF funds.

Suggested Legislative Questions

- What criteria did DFA use to determine local and tribal government CRF awards?
- What was the total amount of CRF award applications from local governments? If total requests exceeded total allocated funding, how did DFA decide to allocate funds?
- When will local governments begin to receive CRF award reimbursements?
- Will local governments receive technical assistance in awarding, monitoring, and auditing small business continuity grants?