Projections for State-Collected Local Government Tax Revenue

FY 19-20 & FY 20-21

Prepared by:
Caitlin Saunders, Research Strategist
Chris Nida, Director of Research & Strategic Initiatives
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1 A NOTE TO OUR MEMBERS: CORONAVIRUS UNKNOWNS

This revenue forecast arrives at a time of unprecedented uncertainty, at least in recent memory. A pandemic has been declared across the globe and is changing the face of the world at a rapid pace. The League of Municipalities’ foremost concern is your health and safety. We hope that this document finds you, your friends and family, and your community in good health and good spirits. On behalf of the League, we thank you for your service and your leadership in these circumstances, and we urge you to continue to follow the guidance offered by state and local officials as they navigate the ongoing global pandemic. The League has set up a page on its website dedicated to issues related to COVID-19. You can access those resources at www.nclm.org/coronavirus.

In the midst of this rapidly evolving situation, we present here our annual revenue projections memo. The March distributions of sales and use tax and other revenues distributed quarterly represent sales that took place for the first 6 months of the local government fiscal year, in this case July-December 2019. At this time of the year, we traditionally draw upon that data to take our best guess at how revenues will have grown or declined at the conclusion of the current fiscal year, and make similar predictions for the coming fiscal year. We have tried to do that again below. However, the events of the past weeks have changed circumstances dramatically and in ways that the available data does not yet reflect. We have surveyed the available information and done our best to synthesize that in a way that we think reflects the current reality for North Carolina’s municipalities, but if there is one common thread that runs among recent analyses, it is that this period of economic activity is unlike any seen in recent decades. The Great Recession of 2008-09 is one frequent point of comparison, but so too are World War II, the Great Depression, and the Spanish Flu of 1918.

As a result, you will see even more caveats and ranges of scenarios in our predictions below than usual. Conditions and predictions for the future are changing quickly this last week of March – sometimes by the hour – and we have done our best to reflect the most up to date information available as of the time of this memo’s publishing. However, we recognize that the revenue projection conversation this year will need to be an ongoing one. In recent years, the League has begun providing quarterly updates on local revenues in the form of our Revenue Reports. For the foreseeable future, updates will likely be even more frequent. We will continue to report on data reflecting the current economic disruption as soon as it is available. What form those updates will come in is to be determined. They may be in additional reports. They may be in webinars, conference calls, or additional data gathering that would allow us to hear from you directly regarding your local circumstances. We are open to ideas of what would be most beneficial, so please share your suggestions at any time. Our goal remains to provide you the information that you need to help make the decisions on how to best serve your citizens.

Once again, we thank you for your public service and wish you the best in these challenging times. We hope that you find the information below useful, and we will continue to be here for you as a resource in the weeks and months ahead. Please let us know what we can do to help. And above all, please remain safe.
2 EXECUTIVE SUMMARY

This document summarizes and analyzes state-collected taxes distributed to local governments each year and provides a forecast of these revenue sources for the remainder of the current fiscal year (2019-2020) and the upcoming fiscal year (2020-2021). All statewide projections for each tax revenue source are both summarized in the table below and hyperlinked to the corresponding memo section, for your convenience. More information on the recent legislative history and distribution formulas for each tax listed below can be found in our Basis of Distribution Memo.

The League also now publishes quarterly “Revenue Reports,” which summarize state-collected local revenues as they are distributed throughout the year. All annual projections and quarterly reports can be found on the NCLM State-Collected Revenue Projections page of our website.

<table>
<thead>
<tr>
<th>Revenue Source</th>
<th>Projected Change from FY18-19 to FY 19-20</th>
<th>Projected Change from FY19-20 to FY20-21</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales and Use Tax</td>
<td>See Section 4 on Page 8 for Range of Scenarios</td>
<td>See Section 4 on Page 8 for Range of Scenarios</td>
</tr>
<tr>
<td>Electricity Sales Tax</td>
<td>+1.7%</td>
<td>+1.0%</td>
</tr>
<tr>
<td>Local Video Programming Tax</td>
<td>+1.0%</td>
<td>-1.7%</td>
</tr>
<tr>
<td>Telecommunications Sales Tax</td>
<td>-7.5%</td>
<td>-9.2%</td>
</tr>
<tr>
<td>Piped Natural Gas Sales Tax</td>
<td>-10%</td>
<td>-1.5%</td>
</tr>
<tr>
<td>Solid Waste Disposal Tax</td>
<td>-3.2%</td>
<td>+1.0%</td>
</tr>
<tr>
<td>Alcoholic Beverages Tax</td>
<td>0.5%</td>
<td>0.0%</td>
</tr>
</tbody>
</table>

2.1 PROJECTION TIME FRAME

The Local Government Commission (LGC) encourages the use of a 90-day accrual period to meet GASB 33 measurement focus requirements (See “Memo #1015 ‘Recognition of Sales Tax and Other Revenues at Year-End’”). Because the revenues governments receive in September are derived from sales through June, we consider them to be from the previous fiscal year, corresponding to when the transaction took place. This report considers the following data to be included in a “fiscal year” of revenue:

- DOR monthly distribution data for collection months August through July
- DOR quarterly distribution data beginning with the collection quarter ending in September, and stopping with the collection quarter ending in June.
For an example of how sales month, collection month and distribution month align, see DOR’s [Sales Tax Distribution and Closeout Schedule](#). For the full distribution schedule, see DOR’s [Local Government Distribution Schedule](#).

### 2.2 Cautionary Note

*Please read through the entire memo for important caveats and context related to each of the League’s projections for the revenue sources above.*

Estimates included in this document should be used only as a rough guide in preparing your Fiscal Year 2020-21 proposed budget. Estimates should be modified as necessary to fit your local situation, its actual trends, and your own assumptions about the effects of economic and political factors. Revenue estimates are always subject to error and may fluctuate widely based on unpredictable factors such as weather conditions, policy changes, and, this year, a global pandemic. Our goal is to provide municipalities with a reasonable projection of where state-collected revenues are heading.

These estimates also assume that the General Assembly will make no changes in 2020 to the formulae that govern municipal shares of State-collected revenue. Please continue to pay close attention to the [League’s Legislative Bulletins](#) throughout the session for updates on the state of any legislation. If our revenue estimates change materially prior to July 1 due to economic circumstances or legislative action, we will advise you of the changes.

### 2.3 Questions and Contacts

Any questions related to this document should be directed to [Caitlin Saunders, Research Strategist](#), or [Chris Nida, Director of Research & Strategic Initiatives](#). For your convenience, this document also includes [North Carolina Department of Revenue contacts](#) for any other questions. Special thanks to the Public Affairs team at the North Carolina League of Municipalities, Anca Grozav, Bob Coats, and Michael Cline with the North Carolina Office of State Budget and Management, Barry Boardman with the N.C. General Assembly’s Fiscal Research Division, and Cindy Matthews Wilkes and Ernest Irving with the North Carolina Department of Revenue for their assistance in preparing this document.
3 OVERVIEW OF ECONOMIC CONDITIONS

It has taken only a matter of months for COVID-19 to grow from regional concern to a life-changing global event. Its impact has been likened to history-altering events like World War II, the Great Depression, and the so-called “Spanish” flu pandemic of 1918. Like the Battle of Yorktown in 1781, the world has been turned upside down.

The human toll of this pandemic is at the forefront of concerns. As of this writing on March 27, there had been nearly 550,000 cases diagnosed worldwide, resulting in almost 25,000 deaths. Diagnoses in the U.S. continue to rise exponentially, increasing from 30 on March 1 to more than 68,000 on March 26. North Carolina reported its first deaths from the virus the final week of March.

The rapidly changing nature of the pandemic and the economic impacts of the resulting public health challenges have left economists and businesses scrambling to predict what this means for the future. In many cases they have chosen not to do so at all. In a commentary entitled “Depressing Thoughts,” Raymond James Chief Economist Scott Brown wrote “nobody knows what the economic impact of COVID-19 will be.” Companies as diverse as Twitter, Square, Mastercard, Maximus, and Discovery suspended their fiscal outlooks for the remainder of 2020. Investment strategists have done much the same.

Nevertheless, our goal is to present to you the best information available regarding the state of the economy on a macro and a more state-specific level. And on both counts, those willing to issue predictions are decidedly not optimistic, particularly in the near term, and the scale of the pessimism has seemed to increase as the situation develops. Some of the published outlooks on U.S. GDP are summarized in the sales and use tax section below. Morgan Stanley and Goldman Sachs forecast annualized second quarter GDP reductions of 30 and 24 percent, respectively. Manufacturing indices from the Philadelphia and New York branches of the Federal Reserve fell to 8- and 11-year lows, respectively. The Anderson Forecast at UCLA released a forecast on March 12 and then revised it 4 days later to announce that the U.S. had entered a recession. Titles for Wells Fargo’s weekly economic commentaries went from “2020 is off to a good start” on Jan. 17 to “Coronavirus won’t move the Fed” on Feb. 21 to “Shock and awful” on March 20.

The intent of pointing out these rapid shifts is not to criticize but instead to reflect the pace at which things are currently changing, and to caution that the current situation will likely continue to evolve in the days and weeks ahead. The Federal Reserve took aggressive action this month in response to the circumstances, including a rate cut to near zero and unlimited quantitative easing. Fed chairman Jerome Powell took the rare step of giving a live TV interview to the “TODAY” show on March 26, admitting that the country may be in a recession, but said that the economy is starting from a strong position and “the virus is going to dictate the timetable.” As of this writing, it appeared that Congress would pass and the President would sign a $2 trillion response package that included direct payments to individuals, additional unemployment benefits, funds for hard-hit businesses, and money for hospitals and state and
local governments. After the Senate passed that package, the U.S. Labor Department reported that nearly 3.3 million Americans had filed for unemployment the week ending March 21, shattering previous record numbers dating back to 1967. Members of the N.C. General Assembly began convening remote meetings to discuss potential state response that same week, but as of March 27 they were not scheduled to return to Raleigh to vote on any action until April 28.

As of late March, there was little direct data to reflect the changes in the N.C. economy in recent weeks. Indicators from early in the year were generally positive but rendered almost irrelevant by the rapid spread of COVID-19. The most immediately available data was unemployment claims. As of mid-March, the state had processed more than 166,000 such claims, almost as many as were processed for the entire calendar year of 2019. The Governor has since closed all schools through May 15 and ordered the mandatory shutdown of establishments such as barber shops and salons, which will likely lead to even more claims. City and county governments across North Carolina have begun issuing “stay at home” orders urging their citizens only to leave the house when absolutely necessary. N.C. State economist Michael Walden initially predicted N.C. job losses in the tens of thousands, and then a week later revised his estimated job loss for the state to at least 250,000.

None of this speaks directly to the consumer factors that drive many of the revenues detailed later in this memo, specifically sales tax. At the state level, that data will not be available for some number of months. Nationally, the trends were not encouraging. Federal action to put more money in the pockets of workers may help, but March results from the University of Michigan’s Survey of Consumers indicated declining optimism. Survey director Richard Curtin wrote that “an economic recession has already begun, and it is likely to reduce consumer spending for a period that is two to three times as long as the virus crisis.” An updated forecast of hotel business for 2020 predicted a 37 percent decline in revenue per available room, including a 60 percent dip in the 2nd quarter of the year. A leading tourism official in N.C. predicted that the tourism industry could see losses of $50 billion as a result of the pandemic. Spending on items like groceries and health supplies may remain strong, but if the thought was that some of the projected decline in retail sales at brick and mortar establishments would be buoyed by online sales, that has not borne out. Data from China during their period of greatest restrictions on citizens indicated that retail sales had fallen more than 20 percent year over year.

The housing market and construction industry is one key driver that we frequently look to for N.C. sales tax indicators. As of January housing starts in N.C. were up more than 21 percent over the same month in the previous year. But by March 19, national groups were predicting overall declines in both housing starts and single-family home sales. State-level data was not yet available.

The state of the economy – be it globally, nationally, or at the state level – is obviously very much uncertain with a number of moving parts. We will continue to keep you updated as circumstances change and more data becomes available. As much as anything, the immediate future of the economy and how quickly any recovery occurs will be tied to the nature of COVID-19 and any public health measures that are or are not taken to curtail the spread of the virus. Please stay safe and we will update you on the economic climate as it evolves.
4  STATE-SHARED TAX REVENUE PROJECTIONS

4.1  SALES AND USE TAX

4.1.1  Overview of NC Sales Tax Distribution
Sales and use taxes make up the largest amount of tax revenue that the state distributes to local
governments in North Carolina. In fact, for the median North Carolina municipality, 28% of municipal
revenue is sales tax. Local sales taxes are authorized as different “Articles” in statute. Not all Articles are
levied by every county. For an overview of every sales tax article and how it is distributed, see our Basis
of Distribution Memo.

In addition to the state’s distribution calculations, distribution methods can vary by county as well. Every
April, counties can change the method of distributing local option sales tax revenues within the county,
either from per capita to proportion of ad valorem tax levies, or the other way around. The method chosen
by the county board of commissioners determines the division of money within a county area among
county and municipal governments for the next year. Population or tax levy changes might make some
counties take a close look at the current distribution method to see if it is still advantageous to them.
Cities and towns need to prepare for possible county changes in distribution methods during April 2020.
A change in the distribution method made by a county in April 2020 will become effective for the
distribution made in July 2020. As a result, it will affect both your FY19-20 and FY20-21 sales tax
revenues.

4.1.2  Economic Unknowns
This year, projections for sales tax are very uncertain. At the time of this report, national and state
economic forecasts are being revised daily in response to increasingly stringent social distancing
measures put in place by states and local governments to slow the COVID-19 pandemic. The magnitude
of the effect that this will have on taxable sales remains to be seen.

There is growing consensus among economists that:

• There will be sharp economic decline in the U.S. at least from April through June.
• Due to a wave of unemployment caused by business closures, the period of social distancing will
likely be followed by at least one more quarter of negative growth, meeting the popular
definition of a recession.
• The economy will then likely gradually recover into early 2021.

However, many questions and unknowns remain:

• How long will governments keep social distancing and “shelter-in-place” orders in effect? The
  longer they last, the more likely it becomes that the steepest period of economic decline could
go beyond June.
• How long would a subsequent recession last? Will consumer spending quickly rebound once social distancing is eased? Or will unemployment caused by business closures cause consumers to hold back on spending for even longer?

• If social distancing measures are effective, the population will more slowly approach the 90% threshold for “herd immunity.” If there is a second coronavirus wave during the next flu season, and before a vaccine is ready, will similar measures be revisited during local governments’ FY20-21?

• What will the Federal government’s economic stimulus package(s) include, and will it ease the effects of social distancing measures?

• Will the steps the Federal Reserve is taking ease any potential recession?

A sampling of economic forecasts for calendar year Q2 (April through June) are summarized in the following table:

<table>
<thead>
<tr>
<th>Source</th>
<th>GDP Projection April-June 2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goldman Sachs</td>
<td>-24%</td>
</tr>
<tr>
<td>JP Morgan</td>
<td>-14%</td>
</tr>
<tr>
<td>Pantheon Macroeconomics</td>
<td>-10%</td>
</tr>
<tr>
<td>Morgan Stanley</td>
<td>-30%</td>
</tr>
<tr>
<td>St. Louis Fed</td>
<td>-50%</td>
</tr>
<tr>
<td>Bank of America</td>
<td>-12%</td>
</tr>
<tr>
<td>Oxford Economics</td>
<td>-12%</td>
</tr>
<tr>
<td><strong>AVERAGE</strong></td>
<td><strong>-21%</strong></td>
</tr>
</tbody>
</table>

It is important to point out that these projections are annualized, meaning the forecasts are for how much the GDP would shrink if the 2nd quarter contraction took place for an entire year. For example, a 5% decline in a single quarter would be reported as a 22% annual rate of decline, and a 10% contraction in a single quarter would be reported as a -52% annual decrease.

A projection from Pantheon Macroeconomics that foresees a 20 percent decrease in non-essential spending (sports, retail, hospitality, vacation travel, etc.) from April through June further bolsters these dramatic GDP estimates. Also in support of these projections, data out of China for January through February showed a -21% decline in retail sales. To put this in a somewhat alarming context, during the worst quarter of the Great Recession the US economy only shrank by 8.4%.

However, consumer sales patterns during a pandemic vary widely by products and services. Previous pandemics for SARS and MERS highlight three demand patterns in retail sales worth noting. After an outbreak, sales of daily necessities such as food and baby items rapidly stabilize, following an initial spike during the crisis due to panic. The pattern observed with items related to health protection and home cleaning is an early spike caused by “pantry loading,” followed by very low demand following an outbreak. Finally, discretionary purchases, such as apparel and personal care services, tend to dip during an outbreak but then spike and stabilize when that demand is ultimately released.
Working in favor of local sales tax in N.C. is that it does apply to grocery food. Therefore, to the extent that restaurant spending is shifted to at-home food preparation, that shift would be captured by local sales tax. In addition, N.C. clarified its online sales tax law last year so that, as of Feb. 1, most online transactions should be subject to local sales tax. Nevertheless, with the size of the projected economic contraction, it seems unlikely that either of these two factors would entirely offset reduced consumer spending.
4.1.3 Establishing a Baseline

This year, we use historic overall taxable sales in North Carolina as well as Article 39 & 40 local government distributions to identify the current trends in sales tax state-wide. For the past five fiscal years, Article 39 sales tax distributions have seen positive growth each year. Figure 1, below, shows that although the growth rate declined in FY15-16 and FY16-17, it ticked back up to 6.53 percent in FY19-20. The total of the first two quarters of this fiscal year’s Article 39 distributions (approximately $846 million) is already 8.08 percent higher than the same period last year.

**Figure 1**

Annual Article 39 Sales Tax Distribution (Y-O-Y Change)

Figure 2 below compares each month’s distribution in recent fiscal years. Each month of Fiscal Year 2019-2020 so far has seen Article 39 sales tax growth compared to last year. DOR’s November collections were up 12.17 percent. December and January collections were up slightly less, at 2.07 percent and 1.82 percent, respectively.

**Figure 2**
Despite overall statewide growth, regional variations in growth rates were seen across the state. Through the first half of FY19-20, combined Article 39 and 40 revenue was positive in 96 of 100 North Carolina counties. In 42 of these counties, the increase exceeded the state’s year-to-date growth of 8.08 percent. The map in Figure 4 below shows the FY19-20 year-to-date trends in combined Article 39 and 40 sales tax distributions, by county. Counties in red are experiencing a decrease, counties in light green are experiencing an increase, and counties in dark green are experiencing an increase greater than the state average. This map illustrates how local trends can vary dramatically from the statewide trends observed.

**Figure 3**

**Each County’s % Change in Article 39&40 Distributions FY19-20 Year-to-Date**

Aside from economic conditions, one major factor affecting local variation in sales tax distributions is the amount of refunds processed during a particular time period. Table 1 below shows the total refunds each month so far this fiscal year, compared to refunds in the same month last fiscal year. The unpredictable timing of when tax-exempt entities file for refunds results in high volatility in the amount of sales tax taken out of total distributions each month. Overall, they are down about 17% percent compared to this time last year.
This fiscal year to date, sales tax refunds were 6.28 percent of gross collections, compared to about 8 percent of gross collections at this point last year (See Figure 4).

4.1.4 Sales Tax Projection
Prior to the global Coronavirus outbreak, all of these positive trends in sales tax distributions this fiscal year-to-date pointed to continued sales tax growth of about 5.6 percent for the remainder of this fiscal year, and maybe slightly less, yet still positive, next fiscal year.

What could be a worst-case scenario? While the current economic decline stems from a completely different set of circumstances than the Great Recession, we took a look back at historical taxable sales data from that period, in combination with a sampling of economists’ GDP forecasts, to shed any light we can on what might be expected. The worst decline in total taxable sales during the Great Recession occurred from FY07-08 to FY08-09. At that time, the 2008-2009 fiscal year ended with taxable sales 9.38 percent less than 2007-2008 (See Figure 5). The average growth in the ten years since has been 3.79 percent.

### Table 1
**Refunds Each Month FY19-20 Year-to-Date**

<table>
<thead>
<tr>
<th>Date</th>
<th>Refunds_TY</th>
<th>Refunds_LY</th>
<th>Refunds % Change YOY</th>
</tr>
</thead>
<tbody>
<tr>
<td>August 2019</td>
<td>$16,477,858.36</td>
<td>$36,619,923.00</td>
<td>-55.00%</td>
</tr>
<tr>
<td>September 2019</td>
<td>$17,188,939.61</td>
<td>$27,469,332.41</td>
<td>-37.42%</td>
</tr>
<tr>
<td>October 2019</td>
<td>$28,808,911.41</td>
<td>$28,522,400.52</td>
<td>4.51%</td>
</tr>
<tr>
<td>November 2019</td>
<td>$9,673,837.31</td>
<td>$32,791,095.41</td>
<td>-70.50%</td>
</tr>
<tr>
<td>December 2019</td>
<td>$14,298,365.17</td>
<td>$5,740,796.23</td>
<td>149.07%</td>
</tr>
<tr>
<td>January 2020</td>
<td>$43,182,256.66</td>
<td>$26,721,918.88</td>
<td>61.60%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$130,630,168.52</strong></td>
<td><strong>$157,865,466.45</strong></td>
<td><strong>-17.25%</strong></td>
</tr>
</tbody>
</table>
As discussed earlier in this report, a 20% sales decline from April through June seems to be in the realm of possibility at this point in time.

Below are our current best estimates for several scenarios. They range from a projection of moderate impact that sees a 5% decline in sales for the next calendar year quarter followed by a flattening of growth and a rebound in the 2nd half of FY20-21, to a most conservative scenario that envisions a 20% decline in sales for the upcoming quarter followed by a total year-over-year decline in FY20-21. Please use these scenarios as a guide to what we view as possible outcomes while using your own knowledge of your local economy and local trends to project your community’s specific sales tax impact. We intend to update these projections throughout the year as additional real data and updated economic forecasts become available.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Most Conservative</td>
<td>-20%</td>
<td>-9%</td>
<td>-3%</td>
<td>No Growth</td>
</tr>
<tr>
<td>Severe</td>
<td>-10%</td>
<td>-9%</td>
<td>No Growth</td>
<td>No Growth</td>
</tr>
<tr>
<td>Moderate</td>
<td>-5%</td>
<td>No Growth</td>
<td>No Growth</td>
<td>3% Growth</td>
</tr>
</tbody>
</table>

Based on the scenarios for sales tax growth and decline detailed in the table above, full year impacts of those various scenarios would project as follows.

<table>
<thead>
<tr>
<th>Scenario</th>
<th>FY19-20 Year-End Growth</th>
<th>FY19-20 Local Government Distribution Change ($)</th>
<th>FY20-21 Year-End Growth</th>
<th>FY20-21 Local Government Distribution Change ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Most Conservative</td>
<td>-0.5%</td>
<td>-$17.2 million</td>
<td>-3.2%</td>
<td>-$115.6 million</td>
</tr>
<tr>
<td>Severe</td>
<td>2.2%</td>
<td>$81.1 million</td>
<td>-2.3%</td>
<td>-$86.1 million</td>
</tr>
<tr>
<td>Moderate</td>
<td>3.6%</td>
<td>$130.2 million</td>
<td>1.5%</td>
<td>$54.4 million</td>
</tr>
</tbody>
</table>
4.2  Utility Sales Taxes

For the purpose of electricity, telecommunications, natural gas, and video programming quarterly distributions, we assume that the fiscal year accrual begins with the distribution received by local governments in December. (This is synonymous with the distribution covering DOR’s “collection quarter” ending in September.) See the League’s Basis for Distribution Memo for the recent history of how this revenue is distributed.

Utility tax growth during the Great Recession did not necessarily match the decline and recovery trends of the rest of the economy. Instead, underlying factors such as policy changes, energy prices, weather, and changing technologies cause growth in these revenues to swing dramatically in any given year. During this year’s unprecedented pandemic circumstances, the future impact on utility consumption is even more unclear. For the purposes of this year’s projection, we are assuming no change to the pre-Coronavirus trajectory of utility sales taxes, yet like sales tax forecasts, we will provide ongoing updates as more data becomes available.

4.2.1 Electricity Sales Tax

The total amount of electricity sales tax distributed each year has gone both up and down since FY14-15, but saw a 4.93 percent increase in FY18-19 and is up 1.85 percent this fiscal year to date (See Figure 6). The electricity sales tax total for the first six months of this fiscal year was $177,374,779, up nearly three percent in the first quarter and one percent in quarter two, compared to the same quarters last year.

**Figure 6**

Price and consumption both play a role in year-over-year growth. The all-sector average electricity price for the first two quarters of FY19-20 was 9.615 cents per kilowatt-hour, which is a 2 percent increase over
the average price from the same period last year, and likely a contributing factor in revenue growth so far this year.

As far as electricity consumption, weather is one of the largest contributing factors. As shown in Figure 7, the electricity tax distributions always peak in the first quarter, which corresponds with warm summer months. Cooling degree days, an indicator of cooling-related electricity demand, also peak during the same time period each year (See Figure 8) and are one good indicator for consumption. For the first quarter of FY19-20, cooling degree days were 3.6 percent lower than the same quarter in 2018, according to data from the National Centers for Environmental Information (See Figure 8). Therefore, although price is up, consumption is likely down, hence the small growth seen so far this year.

**Figure 7**

![Sales Tax on Electricity by FY.FQ](image)

**Figure 8**

![Cooling Degree Days and Heating Degree Days by FY.FQ](image)
**A Note on Temperature Data:** We assume that electricity bill payment occurs one month prior to utilities remitting the tax to DOR (the collection month). We also assume that electricity consumption occurs one month prior to the bill payment. Therefore, the temperature data used in our analysis is offset by two months. For example, temperatures in May, June, and July would affect the distribution for DOR’s July, August, and September collection quarter.

Looking forward, the [Energy Information Administration (EIA)](https://www.eia.gov) projects electricity prices will decrease roughly 0.75 percent in the South Atlantic region between mid-calendar year 2019 through the start of 2021. [EIA projections also show](https://www.eia.gov) that electricity sales are expected to decrease for all sectors, from mid-calendar year 2019 through the start of 2021.

Electricity tax distributions so far this year are slightly higher than last year. Based on historical data, and with a slight projected price and consumption decrease for the remainder of this fiscal year, we project that statewide electricity sales tax revenue for FY19-20 will end up 1.7% higher than FY18-19.

Similarly, the coming fiscal year’s revenues will depend on weather (and consumption in general) and electricity prices. While long-term industry predictions indicate increased energy efficiency leading to a decrease in consumption, North Carolina’s population (and its electricity customer base) continues to increase. We continue to expect slight growth in this revenue source, and project that electricity sales tax revenue will increase by 1.0 percent in FY19-20.

Please remember that, unlike in the past, local fluctuations in electricity consumption or population will not affect your distribution. Any excess revenues over those generated statewide in FY13-14 are distributed based on your city’s percentage of total property taxes levied. As such, changes in your property tax rate or base could affect the ad valorem distribution of any excess revenues, but the change would have to be extremely significant to materially affect the statewide calculation.
4.2.2 Piped Natural Gas Sales Tax

Piped natural gas tax distributions tend to fluctuate more dramatically than electricity sales tax distributions. In the past three years alone, growth has varied from -4.8 percent all the way up to 27.8 percent. This fiscal year so far, piped natural gas tax distributions are down 10 percent. (See Figure 9)

**Figure 9**

Combined, the first two quarterly distributions of FY19-20 totaled $4,985,375.79. While the September 2019 distribution was up 11.8 percent, the December distribution was down 24.7 percent. Despite the overall dip for the first two quarters this year, the bulk of annual natural gas tax distributions don’t arrive until June, covering DOR collections during the quarter ending in March (See Figure 10). On average, the first two quarters of the fiscal year represent only about 30 percent of the annual total distribution for piped natural gas tax.

**Figure 10**

Sales Tax on Piped Natural Gas by FY/Q.
Like electricity taxes, price and consumption (largely driven by weather) are the main factors affecting piped natural gas tax distributions. The Q3 peaks in natural gas tax distributions match closely with Q3 peaks in the number of heating degree days (Refer back to Figure 8). As described earlier in the electricity tax section, temperatures in November, December and January will affect the natural gas consumption seen in the next distribution (covering tax collected during the third quarter ending in March). This year, the heating degree days for the months affecting the next distribution are down 8 percent (see Figure 8).

Due to the significant decrease in the number of heating degree days for the upcoming and largest distribution, and the decrease seen so far already this year, we project a 10 percent decrease in the total statewide FY19-20 distribution of natural gas sales tax revenues to municipalities.

High volatility in distribution amounts over the past few years, coupled with a strong correlation with unpredictable weather patterns, make forecasting the next fiscal year highly uncertain. Based on trends since the distribution change went into effect in 2014, we project a 1.5 percent decrease in natural gas sales tax revenues in FY19-20.

Similar to electricity, because any future adjustments to this distribution will be made based on statewide property tax levies, it will not be affected by any changes in current users of natural gas in your town or on any population gains or losses you experience.
4.2.3 Telecommunications Sales Tax

Annual totals for telecommunication sales tax distributions have declined every year since Fiscal Year 2008-09, though to varying degrees. The total distribution for the most recent fiscal year (2018-19) was 8.5 percent lower than the prior fiscal year (2017-18) (See Figure 11). The September 2019 quarterly distribution was down 12.5 percent from the same quarter last year, and the December 2019 quarterly distribution was down 11.8 percent from the same quarter last year. The total amount distributed for these first two quarters was $18,990,198.48. This amount is down 12.2 percent compared to the same period the previous year (See Figure 11).

**FIGURE 11**

Annual Telecommunication Services Sales Tax Distribution (Y-O-Y Change)

Much of the decline is related to customers abandoning landline telephone service for mobile telephone service. Mobile penetration and engagement continue to increase among virtually all age levels. The CDC’s National Health Interview Survey showed that more than one-half of American homes have only wireless telephones, and more than 76 percent of adults aged 25-34 live in wireless-only households.

Given the historical data and this continuing trend, we expect that annual statewide telecommunications revenues for FY19-20 will decrease by 7.5 percent. We expect these revenues to decline further next year. We predict telecommunications taxes will decline by 9.2 percent in FY19-20.

For cities and towns incorporated before July 1, 2001, the distribution of this revenue is based on each municipality’s past share of the old telephone franchise tax, so there should be no local economic adjustments to the statewide growth estimate. These cities and towns will also be unaffected by any population changes.

For towns incorporated on or after July 1, 2001, the distribution is based on population, so some local variation from the statewide percentage is possible and differences between the 2018 and 2019 Certified Population estimates will affect distributions.
4.2.4 Local Video Programming Tax
Annual total video programming distributions have seen both growth and decline year-over-year in the last five fiscal years, though the overall trend is downward (See Figure 12). The overall decline is primarily attributable to cable TV customers “cutting the cord” in favor of streaming services. For FY18-19, there was a 5.2 percent decrease in video programming tax distributions. The September 2019 distribution was up 2.2 percent, and the December quarterly distribution was down 5.1 percent. These first two quarterly distributions of FY19-20 totaled $36,049,264.13 – slightly down a combined 1.4 percent from FY18-19 (See Figure 12).

**Figure 12**

Last September, the Federal Communications Commission issued the Section 621 Cable Franchise Order, effectively creating a cap on the franchise fees and in-kind services local governments could receive from cable companies. There was some concern that this would negatively impact video programming distributions to municipalities in North Carolina. However, the current interpretation by the N.C. Department of Revenue is that this order does not apply to North Carolina, where our system of applying sales tax to video programming does not meet the definition of “franchise fees.”

After last year’s significant decline, and this year’s small decline thus far, we expect that the statewide annual distributions will end up with 1 percent growth at the end of FY19-20.

Based on performance in recent years, we project that future revenues will continue to decline, though at a slightly slower rate. We expect that video programming revenues will decrease by 1.7 percent in FY20-21.

While this distribution is not based directly on population, population change is a factor in the annual distribution formula. As a result, growth or decline in population between the 2018 and 2019 Certified
Population Estimates will affect these revenues, although not in the exact percentage as the increase or decline in population.

Cities with qualifying Public, Educational, and Governmental (PEG) channels are entitled to supplemental PEG channel support funds for up to three channels. These funds must be provided to the organization that operates the channel. The amount per channel for FY19-20 is approximately $27,211. Factors that affect PEG funding include the total number of PEG channels and any returns of PEG channel money. We do not expect these factors to change materially in FY20-21.

To receive supplemental PEG channel funds, you must certify your PEG channels to the Department of Revenue each year by July 15. The 2020 certification forms will be available on the Department of Revenue website here: https://www.ncdor.gov/documents/tr-peg-cable-peg-channel-certification.

### 4.3 SOLID WASTE DISPOSAL TAX

The State levies a $2 per-ton “tipping tax” on municipal solid waste and construction and demolition debris that is deposited in a landfill in the state or transferred at a transfer station for disposal outside the state. Cities and counties receive 18.75 percent of the tax, and revenues are distributed on a per capita basis. Three of the past five years have seen over 5 percent growth in this distribution. So far this year, the September and December quarterly distributions rose by 5.7 and 4.6 percent. These first two quarterly distributions of FY19-20 totaled $4,368,631.64 which is a 5.2 percent increase over the same period last year (See Figure 13).

**FIGURE 13**
The health of the construction sector tends to be a contributing factor to solid waste revenue, and as mentioned earlier in the Economic Overview section of this report, housing starts in North Carolina were up 21 percent in January over the year prior. However, this is likely to slow due to the current Coronavirus pandemic.

Last year saw tremendous growth. The current, more moderate, 5.2 percent growth, combined with economic decline projected for the remainder of the year, leads to the conclusion that this year will experience a decline. **We expect total distributions for FY19-20 to decrease 3.2 percent from total distributions in 18-19.** Taking into account historical data as well as economic recovery forecasts for the upcoming fiscal year following this year’s decline, **we project that solid waste tax distributions for FY20-21 will increase 1.0 percent over FY18-19.**

Because this revenue is distributed on a per capita basis, a particularly large annexation taking effect between July 1, 2019 and June 30, 2020, could justify projecting additional revenue growth for your municipality.

### 4.4 Alcoholic Beverages Tax

The alcoholic beverage tax is an excise tax paid by the producers of alcohol based on their sales of alcohol in North Carolina. A portion of taxes collected are distributed by the Department of Revenue to municipalities based on population. With the fiscal year running from April through March, cities can expect to receive the beer and wine sales tax distribution within 60 days of March 31.

At the time of this report, the 2020 alcoholic beverage tax distribution has yet to be released. Each fiscal year the total distribution has varied and seen both growth and decline, though with a general upward trend. The most recent fiscal year distribution (2018-19) totaled $39,594,186, which was an increase of 1.89 percent compared to the previous year.
Growth in this distribution is dependent on the proportion of beer and wine sold in North Carolina, which are taxed in different amounts. An excise tax of 61.71¢ per gallon is levied on the sale of beer. An excise tax of 26.34¢ per liter is levied on the sale of unfortified wine, and an excise tax of 29.34¢ per liter is levied on the sale of fortified wine.

The Department of Revenue anticipates that the distribution is trending only slightly higher than last year’s distribution. For this fiscal year’s upcoming distribution, an approximate 0.5% increase, subject to change pending any last collections or refunds for the year. Despite impending economic decline next year, alcohol sales tend to be resistant to economic downturns. Assuming no further legislative change, we would expect the 2020 distribution to again see little to no growth. Because these distributions are based on population, it is important to incorporate factors like annexations or de-annexations during the fiscal year into your municipality’s projection.
4.5 **Powell Bill**

Transportation revenues are facing volatility like many other revenue sources. As business closures and social distancing measures reduce the amount of commuting on the roads, oil prices are falling across the globe. Economic uncertainty for consumers and recommendations against travel work to also limit the amount of driving being done at the current time.

All that being said, the Powell Bill funds that are distributed to municipalities for transportation expenditures are not directly dependent on those funds. Whereas previously the amount of Powell Bill funds distributed were tied directly to motor fuels tax collections, at present the amount appropriated from state funds to municipalities is an annual decision made by the General Assembly. Last fall legislators opted to keep the FY2019-20 Powell Bill appropriation flat at $147.5 million, while increasing the appropriation in FY2020-21 by $7.375 million, for a total appropriation of $154.875 million.

The increase in appropriation did come with one additional condition. The $7.375 million increase in Powell Bill funds is only available to cities with a population of 200,000 or less, meaning that Charlotte, Raleigh, Greensboro, Winston-Salem, Durham, and Fayetteville, are not eligible for any of the new money. They will share in the existing appropriation of $147.5 million, but the $7.375 million increase will effectively be treated as a separate pot of money for all of the cities that participate in the Powell Bill program, minus the six largest in the state. Population and mileage factors will be determined separately for the additional appropriation, based on population and mileage totals for municipalities excluding the six listed above.

The formula for distributing the existing appropriation to eligible cities has not changed. Of the total annual distribution of Powell Bill funds, 75 percent is allocated among eligible cities based on population. Assuming municipal population increases at approximately the same rate as it has over the last five years, we would project the per capita allocation for the FY20-21 Powell Bill distribution to be $19.11. To estimate your expected population-based distribution, multiply this amount by your expected 2019 population. Your Certified 2018 Population Estimates (July 1, 2018 Estimates with July 1, 2019 Municipal Boundaries) can be found at the bottom of the Office of State Budget and Management’s Municipal Population Estimates page: [https://www.osbm.nc.gov/demog/municipal-estimates](https://www.osbm.nc.gov/demog/municipal-estimates). You should adjust your 2018 Certified Population to account for any annexations going into effect between July 1, 2019 and June 30, 2020. The remaining 25 percent of the Powell Bill distribution is allocated based on the number of city-maintained street system miles in each municipality. The projected value of the mileage-based allocation for the FY20-21 Powell Bill distribution is $1,580.13 per street mile. After calculating your estimated city-maintained street mileage as of July 1, 2020, multiply that figure by the per-mile rate to calculate your city’s total street mile allocation.
5 REMEMBER: REPORT YOUR BOUNDARY CHANGES!

Many state-collected revenue distributions depend on accurate municipal boundary information, either to calculate populations or to determine utility sales within the municipality. It is the responsibility of individual municipalities to notify all appropriate organizations as soon as possible of any changes in their boundaries. The list of organizations you are required to provide with a revised boundary map and a copy of your annexation ordinance includes: 1) the Register of Deeds, Tax Assessor, Board of Elections, and GIS department for any county in which your municipality is located; 2) the Secretary of State; and 3) all gas and electric companies that have customers in your city or town. Failing to provide this information in a timely manner could result in lost revenue for your municipality. Do not send copies of your annexation maps to the Department of Revenue, as this is no longer required.

In addition, your municipality should respond to the Annexation Survey included as part of the State Demographer’s annual North Carolina Demographic Survey (NCDS), which can be found online at https://ncds.osbm.nc.gov/. In addition to information about annexations, the survey includes questions on group quarters and residential building activity. A letter will be mailed to all municipalities in the first part of May to confirm the current municipal point of contact for completing the annual survey. An e-mail will then be sent to the designated point of contact for each municipality by June 28th directing them to the online survey. The Certified Population Estimates – used for revenue distributions – estimate the 2019 population living in areas annexed on or before July 1, 2020. The State Demographer cannot include these populations if the annexations have not been reported through the survey.

Please remember, you will receive two boundary and annexation surveys, one from the State (June 28 – described above) and one from the federal government (in January); both must be completed by your municipality, unless you have a “consolidated BAS agreement” with your county. Completing just one survey will not provide the information for the other. More information on the federal BAS can be found at https://www.census.gov/programs-surveys/bas.html.
6 Department of Revenue Contact List

Listed below are the appropriate contacts at the Department of Revenue for questions regarding municipal concerns.

- Questions about the amount of revenue included in a distribution – Cindy Matthews Wilkes, Distribution Unit, (919) 814-1118.

- Questions about the status of a municipality’s sales tax refund – Cindy Matthews Wilkes, Distribution Unit, (919) 814-1118.

- Questions about the allocation of sales tax refunds to a municipality – Cindy Matthews Wilkes, Distribution Unit, (919) 814-1118.

- Interpretation of sales tax laws – Ginny Upchurch, Director, Sales and Use Tax Division, (919) 814-1085.

- Requests for a list of claimants that received a sales tax refund in a county in which the city is located – Cindy Matthews Wilkes, Distribution Unit, (919) 814-1118.

- Requests for a list of businesses that paid sales tax and may be engaged in a business subject to a food and beverages tax, room occupancy tax, vehicle rental tax, or heavy equipment rental – Cindy Matthews Wilkes, Distribution Unit, (919) 814-1118.

- Requests for statistical data related to local taxes – George Hermane, Information Unit, (919) 814-1129.

- Requests for statistical data related to State-collected taxes – Schorr Johnson, Director of Public Affairs/PIO, (919) 814-1010.

- To change the email address at which you receive notification of distributions – Kathy Robinson, Financial Services Division, (919) 754-2525. If you have failed to receive an email notification of your distributions, do not contact DOR, but instead call the Office of the State Controller at (919) 707-0795.