Quarterly Revenue Report
Q1 FY 2018-2019 (July – September)

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ABOUT THIS DOCUMENT

The League’s quarterly Revenue Reports provide a state-level update on tax revenues collected by the state that are returned to local governments throughout the year. These include a portion of local option sales and use taxes, utility sales taxes (on electricity, piped natural gas, telecommunications, and local video programming), beer and wine excise tax, and solid waste disposal tax. These taxes are distributed to municipalities throughout the year according to formulas outlined in state law. For more information on the different types of state-collected local taxes and distribution formulas, see the League’s “State-Collected Local Taxes: Basis of Distribution” memo.

WHAT’S NEW THIS QUARTER?

The following NC Department of Revenue (DOR) data was released since the League’s last Revenue Report in September:

<table>
<thead>
<tr>
<th>Distribution Data</th>
<th>From Sales Period</th>
<th>Distribution Received</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales &amp; Use Tax¹</td>
<td>July, August, &amp; September, 2018</td>
<td>Oct., Nov., &amp; Dec. 2018</td>
</tr>
<tr>
<td>Utility Sales Tax</td>
<td>July, August, &amp; September, 2018</td>
<td>December 2018</td>
</tr>
<tr>
<td>Solid Waste Tax</td>
<td>July, August, &amp; September, 2018</td>
<td>November 2018</td>
</tr>
</tbody>
</table>

Based on this data, the following table summarizes our analysis of statewide trends for the first quarter of local governments’ 2018-2019 fiscal year:

<table>
<thead>
<tr>
<th>QUARTER 1 REVENUE SUMMARY</th>
<th>Total Distributed</th>
<th>% Change from Q1 Last Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Article 39 Sales &amp; Use Tax</td>
<td>$374,977,047</td>
<td>+2.4</td>
</tr>
<tr>
<td>Sales &amp; Use Tax Refunds</td>
<td>$92,611,656</td>
<td>+59.7</td>
</tr>
<tr>
<td>Natural Gas Sales Tax</td>
<td>$2,217,908</td>
<td>+21.0</td>
</tr>
<tr>
<td>Electricity Sales Tax</td>
<td>$93,318,700</td>
<td>+3.9</td>
</tr>
<tr>
<td>Telecommunication Services Sales Tax</td>
<td>$11,134,352</td>
<td>-4.5</td>
</tr>
<tr>
<td>Video Programming Sales Tax</td>
<td>$18,323,016</td>
<td>-4.4</td>
</tr>
<tr>
<td>Solid Waste Tax</td>
<td>$2,069,215</td>
<td>+3.8</td>
</tr>
</tbody>
</table>

¹ Distributions received are generally representative of sales three months prior, and were collected by DOR two months prior. Based on state accounting guidelines, the League assumes that revenues are accrued for 90 days. Please refer to memo #1015, “Recognition of Sales Tax and Other Revenues at Year-End,” issued by the LGC on March 31, 2004, for further details and guidance.
LOCAL GOVERNMENT SALES & USE TAXES

Of the taxes distributed to local governments by DOR, sales and use taxes make up the largest amount of revenue received. Local sales taxes are divided into different Articles, though not all are levied by every county. This report focuses only on Article 39 sales tax distributions. Article 39 tax is charged in every locale and distributed to counties based on where the Article 39 sale occurred. Because of this, Article 39 sales tax revenue trends perhaps best reflect the general trends in local government sales tax revenue.

Compared to last year, first quarter Article 39 sales and use tax distributions totaled $374,977,047 and were 2.35 percent higher than the same quarter last year. August collections (July sales), were 1.34 percent lower than the same month last year, while September collections (August sales), and October collections (September sales) were 6.25 and 2.22 percent higher.

Overall, 37 counties experienced a sales tax distribution increase equal to or greater than 6 percent, with 77 counties overall seeing growth. On the other hand, 23 counties experienced a decrease in sales tax revenue for the first quarter compared to last year. The map below shows which counties experienced positive and negative Article 39 sales tax trends during the first quarter of FY18-19.

Q1 Positive vs. Negative Article 39 % Change
The chart below shows year-over-year comparisons of monthly Article 39 sales tax distributions. The solid line represents the percent change from the same month in the previous fiscal year. The columns represent the totals each month.

This quarter’s overall increase was slowed by a 59.7 percent increase in sales tax refunds, compared to the same quarter last year. The total amount of sales tax refunded during the first quarter was $92,611,656. The column chart below shows the year-over-year comparison of monthly sales tax refunds. The solid line represents the percent change from the same month in the previous fiscal year. The columns represent the totals each month. The pie charts on the next page also show that sales tax refunds made up nearly 10 percent of collections during quarter one this year, compared to 6.5 percent during the same quarter last year. However, for some counties, sales tax refunds an even larger portion of their net collections. For example Durham, Harnett, and Scotland County saw refunds that equaled 50, 42, and 24 percent of net sales tax collections this quarter, respectively.
Taxable sales in North Carolina fluctuate widely throughout the year but have been steadily increasing since 2010. At the end of FY 18-19 Quarter 1, the 12-month moving average of taxable sales was $12.36 billion – 57 percent higher than its lowest point in February 2010 ($7.85 billion). However, the rate of increase continues to slow.

Taxable sales have grown in all business type categories. The largest proportion of taxable sales occur in the General Merchandise, Unclassified, and Food business types. See Attachment A for more detail on what business types are included in these categories.
UTILITY SALES TAXES

Quarterly, the Department of Revenue distributes sales tax from four separate utilities – electricity, natural gas, telecommunication services, and video programming. During last fiscal year (2017-18), the proportion of local government utility tax revenue from each source was the following:

Quarter 1 FY18-19 utility sales taxes were distributed to local governments on December 17, 2018. The following graph shows the percent change from last year to this year for each quarter’s utility sales tax distributions.
Below is a more detailed summary of each distribution by utility type.

**Electricity**²: Local governments received $93,318,700 in electricity sales tax revenue for the first quarter of Fiscal Year 2018-19. This is a 3.9 percent increase from the same quarter last year. Electricity tax revenue is dependent on the price of electricity and consumer demand. Prices are less volatile, as they are regulated by the NC Utility Commission. Consumption is highly dependent on weather. Heating and cooling degree days (an indicator of heating and cooling electricity demand), is typically a good predictive measure of trends in electricity tax revenue. Unfortunately, data for the first quarter is currently unavailable due to the ongoing federal government shutdown.³ For more discussion on electricity sales tax trends, see the League’s recent “Factors Affecting Electricity Sales Tax Revenue” memo.

**Natural gas**⁴: Local governments received $2,217,908 in natural gas sales tax revenue for the first quarter of Fiscal Year 2018-19. This is a 21.0 percent increase from the same quarter last year. Like electricity, natural gas tax revenue is largely dependent on weather-related consumption and prices.

**Telecommunication services**: Local governments received $11,134,352 in telecommunication sales tax revenue for the first quarter of Fiscal Year 2018-19. This is a 4.5 percent decrease from the same quarter in the previous year. Taxes on telecommunication services continue to be negatively impacted by a growing reliance on cell phones in place of land line phone connections.

**Video programming**: Local governments received $18,323,016 in video programming sales tax revenue for the first quarter of Fiscal Year 2018-19. This is a 4.4 percent decrease from the same quarter in the previous year.

² During the 2014-15 Fiscal Year, the electricity franchise tax was eliminated, and local governments began receiving a percentage of tax on electricity sales instead. Electricity tax revenues remain increased as a result of the change, but remain below their 2015-2016 Fiscal Year peak.

³ https://www7.ncdc.noaa.gov/CDO/CDDivisionalSelect.jsp

⁴ Like the electricity tax revenue, local governments now receive a percentage of tax revenue from the sale of natural gas, rather than the previous franchise tax.
SOLID WASTE DISPOSAL TAX

Revenue from solid waste comes from a $2 per-ton solid waste disposal tax charged 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. Department of Revenue distributes this revenue to local governments quarterly. Quarter 1 FY18-19 solid waste taxes were distributed to local governments on November 15, 2018, and totaled $2,069,215. This first quarter distribution was 3.8 percent higher than the first quarter distribution in Fiscal Year 2017-18. Despite the unexpected year-over-year decline during the final quarter of Fiscal Year 17-18, the first quarter this fiscal year continues the upward trend in solid waste tax revenue. In North Carolina, the health of the construction industry plays a large part. Housing starts were up 14 percent this October compared to the same month last year.\(^5\)

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\(^5\) [https://www.richmondfed.org/~media/richmondfedorg/research/regional_economy/reports/snapshot/pdf/snapshot_nc.pdf](https://www.richmondfed.org/~media/richmondfedorg/research/regional_economy/reports/snapshot/pdf/snapshot_nc.pdf)
ECONOMIC UPDATE

North Carolina’s economy continues to be strong, though there is increasing speculation for when the next downturn will hit. Dr. Michael Walden’s NC Economic Outlook report recaps the economic trends observed in 2018, including faster state GDP growth than in 2017, a drop in all three measures of unemployment, and rural counties experiencing the fastest rate of job growth. In 2018 North Carolina was ahead of the nation in job growth, the number of discouraged and underemployed workers, and average wage rate (though NC’s was flat while the nation’s declined).6

Walden’s December 2018 Index of North Carolina Leading Economic Indicators shows a modest 0.8% November increase, following a large drop in September and October due to Hurricane Florence. The increase was mainly due to an improvement in hurricane-related jobless claims. There was little movement in other components of the index, which may suggest slower growth in 2019.7 Walden’s Economic Outlook report predicts slightly slower (2.5%) state GDP growth, and approximately 15,000 less net new jobs in 2019.8 Dr. John Connaughton’s December 2018 forecast predicts a similar 2.9 percent increase in Gross State Product (GSP) in 2019 over the 2018 level, with output increases in fourteen of fifteen economic sectors. Sectors with the strongest predicted output growth are construction, other services, information, and transportation, warehousing and utilities (TWU). Unlike Walden, Connaughton predicts 20,000 more net new jobs in 2019.9

The Carolinas Survey of Business Activity for December 2018 reported slowing growth for firms in the Carolinas, though with spending growth and optimism for business conditions in the coming months. Firms reported a drop in employment in December, and continue to experience a shortage of workers with needed skills. Prices paid and prices received both grew in December, with prices paid continuing to grow faster.10

If growth continues, this coming June will mark the longest period of sustained economic growth in the nation’s history. Understandably, the private sector is increasingly wary. Duke University’s CFO Global Business Outlook Survey found that nearly half of US CFOs believe the economy will enter a recession by the end of 2019, and 82 percent expect one by the end of 2020. This economic pessimism is consistent globally, with 97 percent of African, 86 percent of Canadian, and 67 percent of European CFO’s anticipating 2019 year-end recessions in their countries.11

Ultimately, how the economy performs in 2019 is dependent on many unpredictable factors nationally and internationally. Debt and oil prices are less of a concern for the next recession. Mike Walden points out that unlike before the Great Recession, debt is now a lower share of household income and business net worth. Similarly, unlike during the two recessions of the 1970’s caused by high energy prices, the US is now a net exporter of oil and will likely benefit from an increase in oil prices predicted for the beginning of 2019. However other pieces of the economy to monitor that could trigger the next recession include international

9 https://belkcollege.uncc.edu/sites/belkcollege.uncc.edu/files/media/Dec%202018%20Forecast%20Presentation.pdf
trade disputes, the stock market, and Federal Reserve policies. In December, the Federal Reserve again raised the benchmark interest rate for the fifth consecutive quarter, despite political pressure. This signals continued Fed confidence in the health of the economy. However, anticipated slower growth in 2019 also led the Fed to reduce their intended number of 2019 rate increases from three to two.

Another recent and unexpected factor that risks pushing the U.S. economy into contraction is the ongoing federal government shutdown, which is now the longest in U.S. history. Based on calculations by the White House Council of Economic Advisors, the four-week shutdown has so far reduced economic growth by half a percentage point. Reduced spending and investment by employees and contractors who are not being paid continues to reduce economic growth by 0.13 percentage points each week.

RESOURCES
- Local government revenue distribution data can be found on the N.C. Department of Revenue website.
- Information on economic indicators used in this report can be found in the following locations:
  - Federal Reserve Bank of Richmond
  - Wells Fargo
  - Dr. Michael Walden of N.C. State University
  - Dr. John Connaughton of UNC-Charlotte

ATTACHMENT A – Top Three Business Groups for Taxable Sales in NC

**Unclassified Group - 4.75%**

701 Beauty and barber shops and supply dealers
702 Bookstores, school supply stores
703 Newspstands
704 Coal, wood, fuel oil, and bottled gas dealers
705 Feed stores, millers, hatcheries
706 Florists and nurseries
707 Airplane dealers
708 Hotels, motels, cottage rentals, etc.
709 Office machine and supply dealers
710 Funeral homes
711 Others
712 Photographers, artists, photofinishers
713 Printers, publishers, blueprinters, engravers, etc.
714 Laundries, dry cleaners, etc.
715 Hospitals, physicians, veterinarians, etc.
716 Boat and marine supply dealers
717 Pet, hobby and craft shops
718 Chemical, janitorial supplies and paper products dealers
719 Machine shops; locksmiths, etc.

**General Merchandise Group - 4.75%**

501 Department stores
502 Drugstores; drug and medical supply houses
503 Dry goods stores; fabric and yarn shops
504 Farm implement and supply stores
505 Discount stores; general stores
506 Hardware stores
507 Jewelry stores; watch and clock repair shops
508 Leather and leather goods stores
509 Industrial machinery and supply dealers
510 Secondhand goods stores; flea markets
511 Sporting goods stores; toy shops
512 Variety stores; 5 & 10 specialty stores
513 Others
514 Paint, wallpaper, and glass stores
515 Pawn shops; army surplus stores, etc.
516 Road building equipment and supply dealers
517 Gift and novelty shops; coin dealers

**Food Group - 4.75%**

301 Bakeries
302 Candy and confectionery stores
303 Dairies and dairy bars
304 Grocery stores, meat markets, etc.
305 Vending machine operators; drink stands
306 Restaurants, cafeterias, grills, snack bars, etc.
307 Others
308 Taverns, nightclubs, etc.