

# The Financial Impacts of COVID-19 on Indiana's Local Governments



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COVID-19 has had an immediate, wide-ranging and potentially devastating impact on essentially every aspect of all of our lives, and we all have heard and understand the impacts to our daily lives and personal economy. However, as we anticipate and prepare for a lifting of the various stay-at-home orders and the gradual opening of the economy, we should not lose sight of the impacts that have been and will be put upon the units of government that we with interact with the most – local governments.

The counties, cities and towns, townships, and various other special districts that we rely upon for the most essential services (public safety, transportation, sanitation and utility services) have often performed in plain sight without much fanfare (notwithstanding the occasional rate increase or missed trash pick-up). These services provided at the local level are funded through a combination of federal, state and local sources – all of which have been impacted as a result of this global pandemic.

My purpose here is to look at the financial constraints that these local governing bodies are just beginning to experience, will soon experience, or need to plan for as we work our way through this crisis as it pertains to the reduced availability of revenues to provide essential services.

## **Immediate Impacts**

Generally, the three most impacted revenue sources that will be immediately affected would include utility revenues, property tax collections and local road funding.

1. **Local Utilities** – One of the first financial constraints to befall our communities was in Governor Holcomb's first series of executive orders. Executive Order No. 20-05 (dated March 19, 2020), in part, barred utilities from disconnecting utility customers due to lack of payment. This is not new to many gas and electric utilities that annually have a disconnection of service ban during the coldest months of the year. However, the

governor's order also barred utilities from assessing a penalty for non-payment for a period of 60 days.

No one is attempting to make the argument that the 3-5 percent penalty for a late payment is going to break the bank of the local utility; nor, that large segments of the population need every bit of financial relief they can get during this event. Yet, a blanket removal of a deterrent (the penalty) might unintentionally increase uncollectable accounts in the near term and could produce a deeper hole for individuals to work their way out of as conditions improve.

Utility Funds are often a source of funds for short-term needs of the civil governments, and the delay in customer payments could have an impact on the availability of this potential funding source for short-term financing needs.

2. **Property Tax Collections** – In Governor Holcomb's Executive Order No. 20-05 (dated March 19, 2020), was a waiver of the late payment on non-escrowed, property tax payments, which are due on or before May 11, 2020 for a period of 60 days. Much like the utility penalty waiver, an unintended consequence might be the delay of property tax collections. Property tax collections in Indiana are due each May and November and are then subsequently distributed to local taxing entities in June and December. Tax collections received after the May and November dates are typically held and distributed in the next settlement. Accordingly, a 60-day payment deferral by a property owner could result in a six-month funding delay for local governments. Approximately 50-60 percent of the annual revenues to local governments are generated from local property tax collections.
3. **Local Road Funding** – Local road fund comes from two primary distributions from the State – the Motor Vehicle Highway (MVH) Fund and the Local Road and Street (LRS) Fund. These funds are generated from a combination of motor fuel taxes collected at the pump (gasoline, diesel and special fuels) and various vehicle registration fees. It has been estimated that the stay-at-home order has reduced daily traffic counts by 30-60 percent according to Purdue University's Local Technical Assistance Program (LTAP) in conjunction with the Indiana Department of Transportation. A reduced traffic count can be tied to lower fuel sales and, accordingly, less fuel tax revenues. There is essentially a 60-day lag between the sales at the pump to dollars distributed to local communities. So, the reduced travel during the second half of March will be reflected in the distribution of revenues to local entities in May. The full impact (based on April's inactivity) will be seen in the June distributions. Again, with the two-month lag, the return to normalcy will be seen 60 days later in increasing collections.

4. **Other Tax Revenues** – Additionally, some communities have become reliant upon other tax revenues that are specifically tied to various activities within their communities. They would include but not be limited to:
  - a. Food and beverage taxes
  - b. Innkeepers (hotel/motel) taxes
  - c. Local gaming admission taxes
  - d. General admissions (ticket) taxes

## Impacts Forthcoming

**Local Income Taxes** – The other considerable source of local funding are local income taxes. These taxes fund a variety of services including, but not limited to, general services, property tax relief, economic development and public safety.

The good news here is that income tax distributions are based on the prior year's collections. So, the monthly distributions being made currently are based upon 2019 collections and should not be impacted for the remainder of this year. However, this fall, as local governing bodies are working on their 2021 budgets, the State of Indiana will provide the certified local tax collections to be distributed in 2021. Given the current economic conditions it can safely be said that local income tax distributions coming to local communities in 2021 will be lower than the present levels.

The State of Indiana is aware of these circumstances and the impacts that local communities are facing. The State is fortunate that it has accumulated a healthy surplus of approximately \$2.2 billion. However, the State will face revenue losses of its own from lost sales, income, fuel and gaming taxes, as well as delayed income tax payments from extension of return and payment deadline from April 15, 2020, to July 15, 2020.

**Sort-Term Cash Flow Program** – The Indiana Bond Bank is working on a short-term cash flow program, which will assist local communities with needs caused by the delay in upcoming property tax collections. On April 17, 2020, the Bond Bank's Board of Directors authorized up to \$500 million of short-term notes through its Mid-Year Advance Funding Program. This is a loan program and will have an interest cost. Most communities have not budgeted for interest payments as the need was not anticipated as this year's budget was being prepared last fall.

Plans are in the works for additional federal relief that is targeted for state and larger local governmental entities. The bill that is presently being developed could provide approximately \$500 billion to assist with cash flow needs during the next 24-36 months. The program would be open to states, counties (with populations of at least 500,000) and cities (with populations of at least 250,000).

Like the Payroll Protection Program (PPP), one could imagine that the initial round of funding could be quickly absorbed and subsequent funding rounds may be required.

## **Items for Communities to Address**

So, with all of this in mind, local government officials should be assessing their current circumstances and be developing and/or re-evaluating their action/recovery plans. While each community would need to deal with the particular facts and circumstances before them, some of the more common items that every community should address might include the items outlined below.

First, do not assume that everything will be okay and that the State and/or federal government will step in to make everything right. If assistance dollars do find their way into the community – that’s great, but it would be better to assume, for now, that no outside assistance is coming anytime soon, if at all.

Next, understand your present financial position and cash flows for the next 18-24 months. Prepare your cash flows using the most conservative assumptions (in other words, underestimate your potential revenues) given the constraints on the horizon and overestimate your expenditures. These expenditures should be based on a re-evaluated scope of services to be provided.

**Debt Payments** – Identify and make certain that you can make your scheduled debt service payments in a full and timely fashion. A word of warning concerning these debt payments: Many communities have established some form of a funded Debt Service Reserve Fund. The purpose of that is to have available dollars to make full and timely payment of the scheduled principal and interest payments. Essentially, this is an “in case of emergency – break the glass” remedy. While this option may be appealing at this point in time, to the greatest extent possible, this option should be avoided. There are certain current and future financial and disclosure ramifications that can come from the use of a debt service reserve fund. A community should consult with their financial advisor and legal counsel before drawing down an established debt service reserve fund.

**Capital Expenditure Deferrals** – The community should consider whether or not there are capital and or maintenance items that can be postponed or eliminated without a detrimental impact on providing essential operations.

**Re-Evaluation of Essential Services** – Communities may need to consider what services are non-essential and can be curtailed, avoided, postponed or deferred for the time being.

**Sources of Temporary Cash for Short-Term Needs** – Look internally first. Identify any underutilized funds that could be used for temporary loans to funds with more pressing needs. Keep in mind that those temporary loans are, in fact, temporary and need to be repaid by December 31. Once internal sources are exhausted, outside sources should be investigated.

Again, the Indiana Bond Bank is well suited to assist local governments with getting short-term cash needs keeping in mind that the loan amount is based on uncollected property taxes within the current year. So, program limitations may not fully meet your anticipated needs.

Finally, communication is essential during these times. Local entities should be communicating both internally and externally to ensure that everyone is on the same page concerning what is anticipated, what is being considered and what should be expected as we work through these difficult times. Governing bodies need to be aware of constrained revenues, employees should be made aware of budget restrictions and taxpayers need to be aware of impacts on modified service levels that may be necessary.

## **K-12 Public Schools**

The one local governmental segment that was not addressed yet are local K-12 schools. Schools receive most of their funding from State Tuition Support Payments. Property taxes are used to pay debt service, transportation and some non-classroom related matters.

Schools have long been watching cash flows and expenditures because of their new normal of State funding. Over 60 percent of the State's expenditures are tied to K-12 education. Given the State's budget issues and pending new priorities, the odds of additional new funding in the next budget cycle could be remote.

However, this pandemic has shown some of vast discrepancies amongst Indiana's school districts. The lack of 1:1 computing coupled with the lack of adequate and reliable broadband access throughout the state is placing an ever-increasing spotlight on the need to address these critical infrastructure issues sooner rather than later. This need is not only being raised with education in mind, but is shared with a broader set of constituencies. The lack of this basic infrastructure (current technology and internet access) has impacted almost every educational, medical, business and governmental segment of our communities. Again, but for the lack of an available funding source.

## **Final Thoughts**

Like with so many issues that have faced our local communities over time, those people who either have prepared or are preparing will be better suited to effectively work through a crisis.

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