

## **COVID-19 poses threats to Iowa state and local services**

### *Additional state fiscal relief from Congress critical to key services*

By Peter Fisher

The combined effect of the looming recession and the health emergency triggered by the COVID-19 pandemic will have a devastating effect on state and local budgets. Recognizing this, Congress has passed three major pieces of legislation aimed at mitigating the effects of the crisis, both on individuals and on state and local governments. Those measures are intended in part to reduce the severity of the economic downturn by expanding safety net programs, thereby stabilizing incomes and consumer spending to a degree. Federal legislation is also aimed at assisting businesses and assisting governments in responding to the crisis. Here we take a first look at what we might expect for state and local governments in Iowa, both in terms of the fiscal impact of the crisis and the forthcoming federal assistance.

One thing is clear: The federal assistance provided thus far is limited to helping states meet additional spending necessitated by the health crisis. This does little to offset the coming severe declines in state and local tax revenue. Much more assistance is needed if states are to avoid drastic cuts in funding for education, health care, public safety and other crucial public services as they struggle to balance budgets in the face of increasing need and plummeting revenues. Moreover, the impending recession could be both deep and long; the fiscal aid thus far is tied to the health emergency, or is slated to end within the year. It needs to be extended for the duration of the economic crisis.

*Federal assistance provided thus far is limited to helping states meet needs caused by the health crisis. Much more is needed if states are to avoid drastic cuts in education and other crucial public services.*

### **State Revenue and Spending**

When the Revenue Estimating Conference (REC) last met, on March 12, 2020, they estimated that the state's general fund would end the current fiscal year, on June 30, with a surplus of \$539 million. Since then, of course, the economy has been in a tailspin. Unemployment claims have been at record highs three weeks in a row and businesses across the state are closed or are suffering drastic reductions in sales. Sales and income tax revenues are sure to take a dive. In addition, closed casinos mean less gaming revenue, and corporate income taxes, which are quite volatile, are likely to fall substantially as well.

Moody's analytics, as noted in a state Fiscal Update on March 31, was forecasting declines in state revenues of 10 percent on average as a result of the economic downturn.<sup>1</sup> This is also the most recent estimate by the Center on Budget and Policy Priorities, which notes it could be higher because of the uniqueness of the current slowdown; Maryland is forecasting a 15 percent revenue decline, and Ohio is anticipating a 20 percent budget cut.<sup>2</sup> The projected unemployment rate

through next year is substantially higher than during the Great Recession, and budget problems are likely to continue beyond the upcoming fiscal year.

If we use the conservative estimate for the time being, a 10 percent drop in fourth-quarter revenues (April through June of this year) would amount to roughly \$200 million, which would reduce the ending surplus to \$339 million, without taking into account additional expenditures. Iowa also has \$784 million in reserve funds — \$588 million in the cash reserve fund and \$196 million in the Economic Emergency Fund (EEF).<sup>3</sup> The Iowa Legislature, in their emergency bill (SF 2408) passed as they adjourned in March, granted the governor authority to spend up to 10 percent of the EEF and authorized the Legislative Council to approve amounts beyond that, up to the full amount in the EEF. It is too early to tell whether the ending surplus combined with the EEF will be sufficient to offset revenue shortfalls in the fourth quarter. If it is not, legislative action would be required to draw on the Cash Reserve Fund.

The governor, under the authority granted in SF 2408, has transferred \$17 million from the EEF to fund a new Small Business Relief Program. Demand for those funds has exceeded that amount several times over. The state has also spent, or expects to spend, \$59 million on personal protective equipment and other purposes related to the COVID19 emergency. To cover those expenses, the state has been awarded \$44 million in federal disaster relief funds, 75 percent of the total.<sup>4</sup> The state has requested that the federal government pick up the remaining 25 percent as well. Additional state expenditures related to the COVID19 emergency could be covered by the \$45 billion for a Disaster Relief Fund that was part of the CARES Act.

The REC forecast for the next fiscal year, ending June 30, 2021, was \$8,236.7 million in general fund revenue. Sticking with Moody's speculation that revenues will fall by 10 percent, that means a shortfall in state general fund revenue of \$824 million for next fiscal year. The state will also have additional spending needs necessitated by the state response to COVID-19 and increased demand on safety net programs. This additional spending, however, may be covered by the federal CARES Act. Under that legislation, a Coronavirus Relief Fund (CRF) was created to funnel \$139 billion to the states for expenditures related to the COVID-19 public health emergency. Iowa's share will be \$1.25 billion.

The CRF money must go for COVID-19 related expenditures not accounted for in the state budget most recently passed, which would be for the current fiscal year, and only for such expenditures through December 30, 2020.<sup>5</sup> Congress has made it explicit that these funds are not for regular general fund programs seeing a shortfall in revenue due to the economic crisis.<sup>6</sup> This differentiates the CARES Act from the state fiscal relief during the Great Recession, which was intended to allow states to maintain services at current levels.

Most analysts agree that federal fiscal assistance to states provided in the CARES Act will prove woefully inadequate. As noted above, the funds are for emergency related purposes beyond what the state budget normally covers. But the substantial drop in state revenues expected for next fiscal year means that all general state funding — K-12 school aid, support of regents institutions and community colleges, public safety, infrastructure, and general operations of state agencies — will have to be slashed below current budget levels unless federal funds replace lost revenue.

Such broader fiscal support may be forthcoming in a fourth piece of federal legislation dealing with the COVID-19 emergency. A number of analysts, as well as the National Governors Association and a coalition of 188 nonprofit organizations, have argued that state and local governments will need another \$500 billion.<sup>7</sup>

Some additional federal funding streams are tied to particular categories of state expenditures. The Families First Coronavirus Response Act, enacted on March 18, provides \$35 billion in additional Medicaid funds through an increase in the federal match (FMAP) by 6.2 percent. The Legislative Services Agency estimates that Iowa will receive about \$62 million in additional federal Medicaid funds for each quarter in which the national emergency caused by COVID-19 remains in effect.<sup>8</sup>

The CARES Act contains additional smaller revenue streams:

- \$3.5 billion in additional funding for childcare through the Child Care and Development Block Grant program.
- \$1.5 billion to states under the Community Development Block Grant program, with another \$3.5 billion provided directly to localities.
- \$4.3 billion to public health agencies to prevent, prepare for, and respond to COVID-19.
- \$25 billion for public transit systems.

### ***Local Governments and Education***

Local governments are affected by the health and economic crisis as well, of course, though the mainstay of city and county budgets in Iowa remains the property tax, which accounts for 86 percent of local government tax revenue and which is less susceptible to economic business cycles.<sup>9</sup> Schools depend on property taxes as well, but about 60 percent of their funding comes from the state. The principal effect on property taxes will be an increase in delinquencies; localities have also extended deadlines for payment of property taxes, so even with everyone eventually paying tax due there will be some cash flow issues arising. Further down the road, a severe recession will undercut housing markets, resulting in falling residential property values and hence a decline in the property tax base for all local governments. Localities will vary in the extent to which they can respond to falling valuations with higher tax rates; many cities are already at the tax rate limit.

Local option sales taxes account for 13 percent tax revenue for municipalities in Iowa, 6 percent for counties. Sales taxes in 2017 generated about \$341 million for cities and counties in Iowa. A 10 percent drop in sales tax revenue could reduce revenues by \$34 million. School districts will also feel the effects of a reduction in state income tax revenues next fiscal year and a delay in payments this year, though the income tax surcharge accounted for just 4 percent of school district tax revenue.<sup>10</sup>

The CARES Act also provides \$30.75 billion for an Education Stabilization Fund. Iowa is projected to receive a total of \$237 million broken into three components:<sup>11</sup>

- \$82.5 million for K-12 schools, provided to the states and then passed along to school districts.
- \$128.5 million for higher education distributed directly to public and private colleges and universities. Regents institutions will receive \$45.5 million, community colleges \$36.2 million; at least half of those amounts must be used for emergency aid grants to students.<sup>12</sup>
- \$26 million for emergency education relief grants distributed by the Governor to schools, colleges, and universities hit particularly hard by the health emergency.

School districts also received \$484 million in SAVE funds in 2019 — the statewide penny on the sales tax that is distributed to school districts for capital projects and physical plant maintenance.

Districts generally do not pledge more than 70 or 75 percent of annual SAVE revenue to retiring bonds issued to construct or improve facilities, so districts are unlikely to find themselves unable to cover debt service. However, some districts will have to reduce the sales tax revenue that had been substituting for property taxes in the repayment of debt, in effect increasing the property tax rate to cover the shortfall. Others will simply have to defer maintenance or postpone projects that they had planned to fund with SAVE revenue. Another option would be to go to the voters to seek an increase in the Physical Plant and Equipment Levy to make up for the lost sales taxes, unless they are already at the maximum for that levy.

School districts relied on about \$103 million in local income tax surcharge revenue in 2017 through the Instructional Support Levy. The \$82.5 million provided for K-12 schools would appear adequate to offset a large drop in income tax revenue; whether it is enough to also compensate for some delays and declines in receipt of property taxes and for lost SAVE revenues is not clear.

At this point, the effect of the COVID-19 emergency on tuition revenue and state support for private colleges, community colleges, and public universities is unclear. If post-secondary education institutions remain closed through the summer that would produce a sizable drop in tuition revenue for summer classes.

In the coming weeks we will begin to learn just how severely the economic shutdown has impacted sales and income tax revenues and what this means for the remainder of this fiscal year and, most significantly, for the fiscal year 2021 budget that the Iowa Legislature must pass by the end of August.

---

<sup>1</sup> Legislative Services Agency, Fiscal Update, March 31, 2020. "NCSL Covid-19 Webinar — Fiscal and Economic Issues."

<sup>2</sup> Center on Budget and Policy Priorities, "States Need Significantly More Fiscal Relief to Slow the Emerging Deep Recession," April 14, 2020. <https://www.cbpp.org/research/state-budget-and-tax/states-need-significantly-more-fiscal-relief-to-slow-the-emerging-deep>; <https://www.cleveland.com/coronavirus/2020/03/ohio-gov-mike-dewine-will-freeze-state-government-hiring-look-for-big-spending-cuts.html>

<sup>3</sup> Legislative Services Agency, Fiscal Update, March 13, 2020. "LSA General Fund Balance Sheet Update (March 2020)"

<sup>4</sup> Legislative Services Agency, Fiscal Update, April 9, 2020. "Covid-19 Response: Iowa Disaster Declaration, FEMA-4483-DR."

<sup>5</sup> Legislative Services Agency, Fiscal Update, March 31, 2020. "H.R. 748 Coronavirus Aid, Relief, And Economic Security Act Appropriations."

<sup>6</sup> The Cares Act states: "Coronavirus Relief Fund payments may not be used to directly account for revenue shortfalls related to the COVID-19 outbreak."

<sup>7</sup> Center on Budget and Policy Priorities, "States Need Significantly More Fiscal Relief to Slow the Emerging Deep Recession," April 14, 2020. <https://www.cbpp.org/research/state-budget-and-tax/states-need-significantly-more-fiscal-relief-to-slow-the-emerging-deep> ; A coalition of 188 nonprofit organizations sent a letter April 13: "Letter to Congress urging \$500 billion in relief funds for state, local, territorial, and tribal governments and other transformative investments," <https://www.epi.org/publication/letter-to-congress-urging-500-billion-in-relief-funds-for-states-territories-and-localities-and-other-transformative-investments/>; NGA: "National Governors Association Outlines Need for 'Additional and Immediate' Fiscal Assistance to States." <https://www.nga.org/news/press-releases/national-governors-association-outlines-need-for-additional-and-immediate-fiscal-assistance-to-states/> ;

<sup>8</sup> Legislative Services Agency, Fiscal Update, March 20, 2020, "Covid-19 Economic Stimulus Package — Medicaid."

<sup>9</sup> For cities it is 77 percent, 89 percent for counties, and 93 percent for school districts. US Census Bureau Annual Survey of State and Local Government Finances, 1977-2017 (compiled by the Urban Institute via "State and Local Finance Data: Exploring the Census of Governments." <https://state-local-finance-data.taxpolicycenter.org/pages.cfm>)

<sup>10</sup> See note 5 for the source of figures in this paragraph.

<sup>11</sup> Center on Budget and Policy Priorities: "How Much Will States Receive Through the Education Stabilization Fund in the CARES Act?" <https://www.cbpp.org/research/state-budget-and-tax/how-much-will-states-receive-through-the-education-stabilization-fund>

<sup>12</sup> Legislative Services Agency, Fiscal Update, April 10, 2020. "Higher Education Relief Funding — Final Distribution."

***Peter Fisher is research director at the Iowa Policy Project (IPP), which is part of the Iowa Fiscal Partnership along with the Child and Family Policy Center (CFPC). Both IPP and CFPC are Iowa-based, nonpartisan, nonprofit organizations that do research and analysis on public policy issues facing Iowans.***