

RECENTLY-ENACTED CHANGES TO THE LOCAL DISTRIBUTION FUNDS

July 16, 2007

The recently-enacted state operating budget bill for the fiscal year 2008-2009 biennium (Am. Sub. H.B. 119, 127th General Assembly) makes landmark changes to the state's three local distribution funds: the Local Government Fund (LGF), the Local Government Revenue Assistance Fund (LGRAF), and the Library and Local Government Support Fund (LLGSF). This document discusses those changes.

H.B. 119 HIGHLIGHTS

- **Extends freeze through CY 2007.** Pursuant to uncodified section 757.03, the “freeze” on distributions is extended through Calendar Year 2007. Therefore, the Calendar Year 2007 distributions from the LGF, LGRAF and LLGSF shall equal the distributions that were made in Calendar Year 2006.¹
- **Provides new funding mechanism.** Beginning in Calendar Year 2008, the LGF and the LLGSF will receive a designated percentage of *total* state General Revenue Fund tax revenues. Under prior statutory law, the LGF and LLGSF received a share of specifically designated state tax revenue sources, not *total* state GRF tax revenues. Each month, the LGF shall receive 3.68 percent of prior-month tax revenues, and the LLGSF will receive 2.22 percent of prior-month tax revenues. Note that reactivating “percentage of revenue” funding will result in considerably different cash flow patterns than those experienced during the freeze; thus, there could be substantial monthly distribution variances between Calendar Year 2007 and Calendar Year 2008. (For further discussion of this issue, refer to the Explanation section below.)
- **Consolidates LGRAF into the LGF.** Beginning in January 2008, the LGRAF is eliminated and no further monies will be distributed to the county undivided LGRAF. Monies that would have otherwise been distributed from the LGRAF will instead be distributed from the LGF.
- **No monthly distributions will be “skipped”.** We have been informed of a misunderstanding regarding a potential “skipped” distribution in December 2007. We can emphatically state that **there will be NO skipped local fund distributions occurring in December 2007 or any other month.** To clarify, December 2007 will be the last month in which distributions will be made based on the “freeze”; January 2008 will be the first month in which distributions will be made using the new funding method and using the statutory LGF and LLGSF distribution formulas.
- **The fund names remain the same.** Unlike earlier versions of H.B. 119, the enacted bill makes no changes in the names of the local distribution funds. Thus, the terms “Local Government Fund” and “Library and Local Government Support Fund” are retained.

¹ Distributions of dealer in intangibles tax revenues are not affected by these provisions. That is, H.B. 119 makes no changes to the dealer in intangibles tax, including method by which it is distributed among the county undivided local government funds. Thus, distributions from this tax source will remain based on the amount of tax paid by dealers in intangibles, by county location.

- **Makes no change to the LLGSF distribution formula.** The statutory method for distributing LLGSF monies among the 88 counties will be reactivated beginning in January 2008. That is, H.B. 119 simply restores the distribution formula already existing in state law and which has not been used since July 2001 as a result of the “freeze” on distributions.²
- **Alters the LGF distribution formula.** The formula used by the state for distributing the Local Government Fund (i.e., to the 88 counties for subsequent distribution to subdivisions, and directly to the over 500 municipalities with a municipal income tax) has been changed. An explanation of these changes is provided below.
- **CY 2008 estimates will be issued in July 2007.** In July 2007, the Department of Taxation will issue estimates of the Calendar Year 2008 LGF and LLGSF distributions to the county auditors. The LLGSF estimates will be issued by July 20 and the LGF estimates will be issued by July 25.

EXPLANATION OF MAJOR CHANGES

The changes to the local distribution funds contained in H.B. 119 are truly significant. Although the slower than normal revenue growth expected for the upcoming two-year budget cycle may obscure its significance, the legislation will nonetheless have an important long term impacts. Notable features of H.B. 119 are discussed below.

Change in Funding Method

Since July 2001, the local distribution funds have been subject to a “freeze”.³ However, beginning in January 2008 the freeze will be lifted and the funds will receive a designated percentage of state tax revenues.⁴ Furthermore, the restored “percentage-of-revenue” funding method has been taken to its logical conclusion: rather than receiving a percentage of revenues from certain designated tax sources, the local funds will receive a percentage of ALL General Revenue Fund (GRF) tax sources. This will provide greater stability for the local funds because they will be supported by a wider, and thus inherently steadier, funding foundation (this especially true for the LLGSF, which was based on a percentage of only state income tax receipts). For the first time, the local distribution funds will be in lockstep with the state’s GRF tax revenues.⁵

Because of the continued implementation of the tax reform changes contained in the state operating budget bill enacted two years ago (Am. Sub. H.B. 66, 126th General Assembly), state GRF tax revenues are expected to grow at an extremely modest pace (by a less than one percent annual rate) during the upcoming FY 2008 and FY 2009 biennium. With few exceptions, state programs will experience little or no growth during the upcoming biennium. Because of the expected tight fiscal conditions, the LGF and

² For information on the LLGSF distribution formula, see the Library and Local Government Support Fund section of the 2006 Ohio Department of Taxation *Annual Report*.

³ To clarify, distributions were not frozen at their pre-freeze levels during this time period. Because of lagging state tax revenue performance, reconciliation adjustments were imposed in CY 2002 and CY 2003, resulting in reduced distributions in those years relative to CY 2001. (Because of declining state revenues, the distribution decreases would have occurred even if the “freeze” had not gone into effect.) Furthermore, in CY 2003 there was an outright \$30 million cut in combined LGF, LGRAF and LLGSF distributions; this reduction was one element in a package of legislated budget cuts. Since CY 2004, distributions have been frozen at their CY 2003 levels.

⁴ An uncodified provision contained in H.B. 119 requires a one-time transfer of monies from the LGF to the new Local Government Services Consolidated Grant Fund. This provision makes a \$1 million reduction to the January 2008 to the “nontownship and nonvillage” distributions in each county. Technical corrections related to this transfer requirement are anticipated later this calendar year so a complete and accurate description of this provision is not feasible at this time.

⁵ Note that the local distribution fund resources will not be in lockstep with *total* GRF revenues because the GRF receives monies from various non-tax sources (such as liquor profits and fees).

LLGSF funding percentages were set at a level intended to produce modest growth in Calendar Year 2008.⁶ The funding percentages were set at 3.68% for the LGF, and 2.22% for the LLGSF. These percentages will become effective in January 2008.

Change in LGF Distribution Formula

Another dramatic change relates to the LGF distribution formula. Neither the LGF nor the LGRAF distribution formulas have been in effect since the “freeze” began in July 2001. Underlying factors that influence county-to-county LGF formula outcomes (notably, the relative size of municipal property valuation) have changed considerably across the counties over the last six years. This means that simply reactivating the existing LGF formula in Calendar Year 2008 would have resulted in considerable distributional dislocations across the counties: relative to Calendar Year 2007, a few county undivided local government funds would have experienced windfall increases, others would have experienced more moderate increases, and the remainder would have experienced declines of varying degrees. To prevent such dislocations and to do so in a fiscally viable manner (given the state’s financially constrained circumstances), H.B. 119 consolidates the LGRAF into the LGF, and sets forth the following method for distributing monies from the resulting “expanded” LGF:

1. During each year, each county will receive at least what it received in combined LGF and LGRAF distributions during Calendar Year 2007 (subject to available resources - see footnote 6); and,
2. Of any monies remaining once the distributions described above have been made, distributions will be made to the 88 county undivided local government funds based on each county’s proportionate share of population (using the U.S. Census Bureau county population estimates generated during the prior calendar year).⁷

Finally, please note that during each year the over 500 municipalities that receive a direct distribution of monies from the state LGF will continue to receive a distribution equal to the amount received in Calendar Year 2007. However, there will be no growth in such distributions. Any remaining amounts in the LGF will be distributed to the 88 county undivided local government funds using the formula explained above for ultimate disbursement to the subdivisions.

New Monthly Cash Flow

One result of transitioning from “freeze” funding to “percentage of revenue” funding will be notable month-to-month changes in the magnitude of local fund distributions. For example, ever since the imposition of the freeze in fiscal year 2002, February distributions have been particularly significant, owing largely to “embedded” transfers that were originally made to the local funds from the Income Tax Reduction Fund in early 2001. For this reason, we expect that February 2008 distributions will be somewhat smaller than February 2007 distributions. In fact, we estimate that year-to-date 2008 distributions will not catch up to year-to-date 2007 distributions until June 2008 (or perhaps even July 2008). To summarize, during CY 2008, distributions in some months will exceed those made during CY 2007 while distributions in other months will fall below CY 2007 levels.

Distribution of County Undivided LGF Monies to the Local Subdivisions

As discussed above, the LGRAF will cease to exist beginning in January 2008 as a result of its consolidation into the LGF. Most counties use their own specific “alternative” formula for allocating monies by the budget commission to the county’s subdivisions. Of those counties using “alternative” formulas, a few of them use one particular allocation formula for the undivided LGF and a different allocation formula for the undivided LGRAF (in contrast, most counties use the same formula for the

⁶ It should be noted that there are no guaranteed funding levels for the local distribution funds in Calendar Year 2008. If revenues do not meet estimates, local fund distributions could conceivably fall below their Calendar Year 2007 levels.

⁷ This portion of the new LGF distribution formula is identical to the LGRAF distribution formula that had been in effect since that fund’s inception in 1989.

LGF and the LGRAF). Beginning in Calendar Year 2008, monies will no longer be allocated to the subdivisions using the county's undivided LGRAF allocation formula.⁸ Unless a new formula is adopted according to the process allowed under RC 5747.53, the county's existing undivided LGF allocation formula will be used for distributing future undivided LGF monies.

RECAP OF THE CY 2007 AND CY 2008 DISTRIBUTIONS

1. The Calendar Year 2007 distributions from the LGF, LGRAF and LLGSF will match the Calendar Year 2006 distributions (with the exception of dealer in intangibles tax distributions; see footnote 1).
2. In July 2007, the Department of Taxation will issue Calendar Year 2008 LGF and LLGSF distribution estimates to the county auditors. Pursuant to the statutory LLGSF estimation process, subsequent Calendar Year 2008 LLGSF distribution certifications will be issued in 2007 and 2008 (i.e., updated CY 2008 estimates will be issued in December 2007 and in June 2008, and the final CY 2008 certifications will be issued in December 2008).
3. Beginning in January 2008, there will be no further LGRAF distributions. There will be a commensurate increase in LGF distributions, however.
4. The freeze will be lifted starting in January 2008 and "percentage of revenue" funding will be restored. On a month-to-month basis, there will be considerable variations between Calendar Year 2008 distributions and Calendar Year 2007 distributions. This is the expected and necessary result of transitioning from freeze funding to percentage-of-revenue funding.

FURTHER INFORMATION

Questions or comments on the local distribution funds may be directed to the following email address: lgf@tax.state.oh.us.

⁸ Only if the statutory process in RC 5747.53 is followed could the county's existing undivided LGRAF allocation formula be adopted as a replacement to the existing undivided LGF allocation formula.