

**MINUTES**  
**Regular Meeting**  
**Commission on Local Government**  
**10:00 a.m., September 28, 2015**  
**The Virginia Housing Center**  
**Henrico Room 3**  
**4224 Cox Road**  
**Glen Allen, Virginia**

**Members Present**

Bruce C. Goodson, Chairman  
Victoria L. Hull, Vice-Chairman  
John G. Kines, Jr.  
John T. Stirrup, Jr.  
Diane M. Linderman

**Members Absent**

**Staff Present**

Elizabeth Rafferty, Policy and Legislative Director  
Zack Robbins, Local Government Policy Administrator  
J. David Conmy, Senior Policy Analyst

**Call to Order**

Commission Chairman Bruce Goodson called the meeting to order at 10:03 a.m. on September 28, 2015, in Henrico Room 3 at the Virginia Housing Center in Glen Allen, Virginia.

**I. Administration**

**a. Approval of Minutes of the Regular Meeting on July 20, 2015**

Ms. Hull made a motion to approve the minutes, as presented. Such motion was seconded by Ms. Linderman, and the Commission unanimously approved the minutes.

**b. Public Comment Period**

The Chairman opened the floor to receive comments from the public and noted that there would be opportunity for public comment for the other agenda topics, including the Consolidation Incentives

Study, after staffs' presentations. No person appeared to testify before the Commission during the public comment period.

**c. Presentation of Financial Statement**

Referencing an internally produced financial statement that encompassed expenditures through the end of August 2015, Mr. Robbins stated that fiscal year-to-date expenditures were 20.3% of the total allocated amount. He noted that this amount was slightly higher than it should be – as only two months of the fiscal year (16.6%) is included, but added that the figure includes five payroll cycles in a two-month period.

**d. Policy Administrator's Report**

Mr. Robbins reviewed several news articles of interest with the Commission, including:

- Westmoreland County and the Town of Colonial Beach have been in preliminary discussions about consolidating their school divisions. He noted that Colonial Beach is only one of two towns in the Commonwealth that runs its own school division.
- Discussions regarding the merger of court systems for the City of Staunton and Augusta County continue as Augusta County deferred a November referendum vote on moving the county seat out of the city to allow the two parties to continue court consolidation negotiations.
- The Town of Smithfield and Isle of Wight County are arguing over the county's plan to extend a water line connection to subdivisions just outside of the Town limits. The move would impair the Town's planned annexation of the area and reduced the Town's utility system revenue by 20%.
- The Town of Herndon's boundary adjustment with Loudoun County, which was reviewed by the Commission, took effect in August.
- The Town of Front Royal has appropriated funds for a consultant to investigate ongoing issues with a water line extension along the 522 corridor just outside of the town limits in Warren County in light of a previous revenue sharing agreement that was invalidated by the courts.
- The Town of Mount Jackson annexed a large industrial property that was in Shenandoah County.

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- The City of Buena Vista missed its second consecutive debt payment for its municipal golf course. The City asserts that it has no obligation to make those payments because the debt was insured in the event the City was unable to pay the debt.

## II. Consolidation Incentives Study

Mr. Robbins provided the Commission with an update to the Consolidation Incentives Study including a background behind the study and existing consolidation incentives, a history of previous local government consolidation and reversion efforts, a summary of staff's work done to complete the study, an update to the formula and other staff recommendations, and an overview of the remaining tasks needed to complete the report. Copies of a draft version of the report and Mr. Robbins' presentation are attached to these minutes.

A summary of staff's recommendations include:

1. Avoid creating additional barriers to the reversion or consolidation process.
2. Provide matching funds for localities to study the feasibility of consolidation or reversion.
3. Reduce duration of incentives five years.
4. Redesign the school division consolidation formula.
5. Provide incentives for joint contracting of school services as a first step toward full consolidation.

On the topic of the redesigned school division consolidation formula, Mr. Robbins indicated that the formula had been revised from what was presented to the Commission during their previous meeting in September. He stressed that the General Assembly directed the Commission to encourage amicable consolidations that improve local fiscal sustainability and when possible realize state or local savings and local service improvements. Consequently, Mr. Robbins indicated the alternative formula was geared to assist localities experiencing above average fiscal stress and that have limited, shrinking tax bases.

Mr. Robbins then proceeded to introduce the new, recommended incentive formula and compare it to the other formula considered during the July meeting. The new formula would yield a percent bonus added to the basic school aid for the smaller division based on the local composite index (LCI) scores of

the divisions involved. The percent bonus would be determined by calculating the distance of the LCI from the statewide average in addition to the difference between the factors for the two divisions. The bonus would then be applied to the smaller school division's average daily membership (ADM) but would be capped at no more than 2,500 students. Mr. Robbins indicated that contractual consolidations would follow the same formula except the duration would last for three years with an additional two years reserved if the localities chose to fully consolidate.

Mr. Robbins also indicated that the Commission could choose to either use LCI or supplant it with the Commission's fiscal stress index as the basis for the formula. There was discussion on the differences, advantages, and disadvantages between the two options.

Mr. Goodson opened the floor for public comment on the proposed formula. Ms. Jane Woods, representing the City of Fairfax, thanked the Commission and staff for their work and emphasized the benefits and importance of contractual arrangements between school divisions and stressed that local officials are better informed on what would work best for their divisions as opposed to more statewide officials.

Ms. Hull inquired about staff's meeting with the money committees on the proposed incentives. Mr. Robbins responded that the original proposed formula was considered too complex by the committees. They also noted that the incentive directed incentives to combine smaller divisions but not to a combination of larger, wealthier divisions with smaller divisions. He indicated that he also presented an alternative formula similar to what he just presented that used fiscal stress instead of LCI as the basis. The revised formula was given more positive consideration during that meeting.

Mr. Robbins shared a series of charts and tables with the Commission members that displayed the incentive results for a variety of potential consolidations throughout the Commonwealth, especially for those localities experiencing high levels of fiscal stress and most likely to choose consolidation or reversion. He compared the results to the original formula and demonstrated how the new formula limited the state's exposure. He also showed the incentive results per student and per share of State aid.

The Commission reviewed each recommendation individually; and, by consensus, reached the following 5 recommendations (as listed previously) for the proposed consolidation incentive:

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1. Agree with avoiding creating additional barriers to the reversion or consolidation process.
2. Agree with providing matching funds – up to \$50,000 – for localities to study the feasibility of consolidation or reversion.
3. Agree with reducing the duration of incentives five years.
4. Agree with the redesigned school division formula, as presented, but revise as follows:
  - a. Recommend fiscal stress as the preferred formula basis for calculating the consolidation incentive, except for the two town school divisions and their parent counties. In those instances, the LCI would be used instead as the basis for the incentive formula.
5. Agree with providing incentives for joint contracting of school services as a first step toward full consolidation.
  - a. Communities that consolidate by contract will be eligible for three years of incentives with an additional two years available if they eventually fully consolidate.
  - b. Consider providing two-year portion of incentive for school divisions that are already contractually consolidated that choose to fully consolidate.
  - c. Include a 10-year sunset provision on the two-year portion of the incentive for full consolidation.

### **III. 2015 Catalog of State and Federal Mandates on Local Government**

Mr. Conmy explained that every year the Commission is statutorily required to publish the Catalog of State and Federal Mandates on Local Governments. He then presented a summary of some of the key additions and changes to this year's catalog, which are summarized in the Commission's agenda package. He stated that this year's catalog included 10 new mandates, for a total of 677 mandates in the 2015 edition.

Mr. Kines made a motion to approve the 2015 Catalog. Such motion was seconded by Ms. Linderman and the Commission unanimously approved the Catalog.

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**IV. 2015 Cash Proffer Survey and Report**

Mr. Conmy indicated that the survey instruments were mailed out to all localities that are eligible to collect cash proffers in July, and 80% of the responses have been received. In order to reach a 100% response rate, staff will be contacting the non-responsive localities after the due date, which is September 30<sup>th</sup>.

**V. Task Force for Local Mandate Review**

Mr. Robbins provided an updated on the Task Force for Local Government Mandate Review. The Task Force adopted their interim report to the Governor on August 27<sup>th</sup>. The Virginia Association of Counties and Virginia Municipal League assisted the Task Force and staff with developing recommendations for the report. Mr. Robbins indicated the intent was to release the report early this year in order to have an impact on the Governor's introduced budget. The report identified 11 recommendations, including:

1. Preserving local taxing authority
2. Eliminating the state capture of local fines and forfeitures
3. Return responsibility of Line of Duty Act to the Commonwealth and ensure the efficiencies identified in JLARC's 2014 report are fully implemented
4. Reinstate the first day introduction requirement for legislation with a local fiscal impact
5. Ensure the full cost of re-benchmarking for the Standards of Quality are included in the Governor's budget and fully fund the Virginia Pre-School Initiative
6. Enhance coordination between the State's workforce system and local school divisions
7. Fully fund the State's assistance to local police departments (HB 599)
8. Support local government's ability to adopt policies regarding body worn cameras and provide fiscal and technical assistance, where possible
9. Provide adequate technical assistance from and funding to the Department of Environmental Quality for its stormwater program and to the Stormwater Local Assistance Fund
10. Refrain from placing any mandates on local government utility operators

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11. Fund the State's share of jail per diems at the pre-recession level, reinstate the original definition of a "state-responsible" inmate, fully fund behavioral health services and drug and mental health courts, and identify ways for federal dollars to pay for medical costs of inmates.

Mr. Robbins indicated that a copy of the report would be emailed to the Commissioners after the meeting.

**VI. Commending Resolution for Mr. Lanza**

Next, the Commission considered Mr. Lanza's commending resolution that was distributed to the members prior to the meeting. Mr. Kines moved for approval of the draft resolution, and such motion was seconded by Ms. Hull and was unanimously adopted.

**VII. Other**

Mr. Goodson inquired if there were any other comments or topics for the Commission.

There was general discussion of staffing and workload for the Commission in light of recent and upcoming staff departures. Ms. Elizabeth Rafferty provided an update on the status of filling staff positions, including that of the Local Government Policy Manager. Mr. Kines indicated that traditionally the Chairman for the Commission on Local Government was part of the interview panel for that position. Ms. Rafferty also provided information on the background of a recent agency restructuring that merged the Commission staff with the Policy and Legislative Office within the Department of Housing and Community Development.

**VIII. Schedule of Regular Meetings**

Mr. Goodson noted the Commission's next meeting would be held on Tuesday November 17<sup>th</sup> at 10:00 a.m. in Glen Allen.

During this portion of the Commission meeting, Mr. Kines left at 12:14 p.m.

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The tentative 2016 Schedule of Regular Meetings was reviewed by the Commission, and it was suggested that the Commission consider meeting on the second Tuesday of every other month instead of the second Monday for the next calendar year. Accordingly, by consensus of the Commission members present, the 2016 Commission on Local Government meeting schedule is as follows:

- a. Tuesday, January 12, 2016
- b. Tuesday, March 8, 2016
- c. Tuesday, May 10, 2016
- d. Tuesday, July 12, 2016
- e. Tuesday, September 13, 2016
- f. Tuesday, November 8, 2016

**IX. Adjournment**

There being no further business, the Commission adjourned at 12:21 p.m.

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Bruce C. Goodson  
Chairman

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J. David Conmy  
Senior Policy Analyst



## Background

The City of Bedford reverted to town status in 2013, therefore Bedford County became responsible for providing essential basic local government services in the former city territory, and the state funding formula in place at that time to encourage consolidations and reversions resulted in about \$6 million in school aid incentive payments to Bedford County for a period of fifteen years. Unfortunately, that formula did not direct greater incentive payments to encourage consolidations of the localities with the least amount of fiscal resources. Instead, it created excessive incentives for larger suburban counties to consolidate with smaller cities with average tax bases. In fact, consolidations of the state's poorest localities would have resulted in incentive payments under \$200,000 per year, while consolidations in urban areas would have resulted in incentive payments exceeding \$25 million annually.

Following the Bedford reversion, the General Assembly directed JLARC to study the issue:

*JLARC is hereby directed, with assistance from the Commission on Local Government, to analyze and make recommendations going forward regarding the most effective balance between the costs of incentives for government and school consolidations with the expected resulting savings and operational benefits, and how best to structure such state incentives to achieve both clarity for localities as well as justification that incentives are adequate, but not more than necessary. JLARC shall complete its study and submit a final report no later than October 1, 2014.*

JLARC subsequently issued its report in September 2014, including the following recommendations:

- 1. The General Assembly may wish to consider setting forth in the Code of Virginia the state's goal to provide special funding to facilitate amicable consolidations that improve local fiscal sustainability, and when possible realize state or local savings and local service improvements.*
- 2. The General Assembly may wish to consider providing grants through the Appropriation Act to localities to assess whether consolidation is feasible, and the likelihood of improving fiscal sustainability and local services, and achieving state or local savings.*
- 3. The General Assembly may wish to amend § 22.1-25 of the Code of Virginia and item 139, A.4.c.1 of the Appropriation Act to remove references to additional state funding for future consolidations based on the local composite index.*
- 4. The Commission on Local Government should develop a new process to determine the amount of additional state funds for local consolidation. The amount of additional funding for local consolidation should be based primarily on the projected cost of consolidation. The length of time additional funding is provided should be based primarily on the complexity and length of time necessary for the consolidation. The process should be developed in coordination with the Department of Education and state Board of Education.*
- 5. The General Assembly may wish to amend the Code of Virginia to direct the Commission on Local Government to prepare and submit proposals through the governor's budget for additional*

*state funding for localities that wish to consolidate. The amount of additional funding requested should be based primarily on the projected cost of the specific consolidation being proposed.*

The 2015 General Assembly amended the 2014-2016 Appropriation Act to eliminate incentives that had been previously offered to consolidating school divisions. At the same time, the legislature directed the Commission to complete this study as follows:

*It is the Commonwealth's goal to encourage amicable consolidations that improve local fiscal sustainability and, when possible, realize state or local savings and local service improvements. Therefore, the Commission on Local Government shall develop a process to determine an appropriate calculation for additional state funds for future local consolidations. The Commission's recommendations shall be submitted to the Governor and Chairmen of the House Appropriations and Senate Finance Committees no later than December 1, 2015. The amount of additional funding for local consolidation should be based primarily on the projected cost of consolidation. The length of time additional funding is provided should be based primarily on the complexity and length of time necessary for the consolidation. The process should be developed in coordination with the Department of Education and State Board of Education with input from other stakeholders.*

### **Existing Conditions**

The Commonwealth provides a process for an existing independent city to revert to town status, and for two or more localities (of any type), or two or more school divisions, to consolidate. The State also has historically provided financial incentives and other types of incentives to encourage such actions.

*School-Aid Incentives.* Until this year, the General Assembly permitted two school divisions that consolidate to utilize the lower composite index of local ability-to-pay to determine the State's share of funding responsibility for the consolidated school division's entire membership. In situations where there was a large disparity between composite index scores and when the larger school division had a higher composite index, this could result in a significant increase in state financial assistance for fifteen years.

*Hold-Harmless Funding.* Hold-harmless funding, which ensures that state funding streams will not be reduced due to a reversion or consolidation, is provided for fifteen years for city to town reversions, and twenty years for full consolidations. State agencies which disburse aid to localities are required to continue calculating aid for such localities as though the consolidation had not occurred for that period of time.

*Other State Assistance.* Some other provisions in state law provide for continued state police assistance and VDOT street maintenance when counties become part of a consolidated city, and continued library aid following a reversion.

*Consolidation Process.* Consolidations may be initiated by the local governing bodies involved, or by citizen petition following lengthy negotiations to create an agreement to set out details about how the

consolidation of finances, workforces, and services are to occur. Ultimately, they must all go to referendum before approval.

School divisions may also consolidate - separate from the local government reversion or consolidation process - which requires the school divisions to seek approval from the Board of Education. In recent times, none have occurred, with the exception of those that resulted from reversions.

*Reversion Process.* In 1988, the General Assembly created a process providing any city with a population less than 50,000 the right to revert to town status, regardless of whether the surrounding county was willing to concur. This process relieves those cities of the responsibility of providing public education, courts, social services, and several other state-mandated services. These services would then become the responsibility of the county which the city reverted to. This occurred one year after the General Assembly enacted the State's moratorium on city annexation, which limited these cities' ability to enjoy the financial impacts of growth, at the same time as these cities were grappling with shrinking tax bases.

Similar to consolidation, the city and county involved are encouraged to amicably negotiate a detailed reversion agreement; however, if this is not possible, the courts can step in and stipulate how the reversion will occur.

#### **Review of Recent Consolidation and Reversion Efforts**

The existing processes for two localities to consolidate or for a city to revert to town status currently have significant barriers and take several years from start to finish. All nine consolidation proposals that were placed on the ballot in the last 40 years have failed. Since the reversion process was created in 1988, only three cities have opted to revert to town status, even though the process was setup to eliminate some of the hurdles of consolidation: no referendum is required, and counties have little ability to block reversion proposals. Several more cities have considered reverting to town status, but their council's have abandoned such plans. It should be noted that the termination of consolidation or reversion proposals is always a local decision, whether it be by the voters or the governing body.

All proposals to alter the form of local government take several years of study, negotiation, and hearings. The South Boston reversion, which began with discussions in 1988, did not become effective until July 1, 1995 – 7 years later - because Halifax County appealed the case to the Virginia Supreme Court. The City of Bedford began negotiating with Bedford County in 2008, and the reversion agreement was amicably executed five years later on July 1, 2013.

With respect to the three successful reversions that have occurred, in all three instances, a significant barrier to other reversions had already been lifted: cooperation among school divisions. In the South Boston reversion, Halifax County already shared a single superintendent, and jointly operated the middle and high school. In the Clifton Forge reversion, a school division was already jointly operated with Alleghany County. In Bedford, the city paid Bedford County to provide public education services to its students.

## **Stakeholder Input**

The Commission staff convened a panel of stakeholders, including representatives from the Virginia Association of Counties, the Virginia Municipal League, as well as attorneys and consultants who have represented cities and counties in past reversion and consolidation studies.

The group generally agreed that:

- No incentives should last longer than five years. Currently, they last from 15 to 20 years.
- Incentives should be provided for school divisions to enter into new joint operational contracts.
- There is a clear distinction between a consolidation incentive and a consolidation reimbursement. Incentives lure localities to consider consolidating that otherwise would not have considered doing so. Reimbursements do not entice localities to consider consolidating.
- Reimbursing localities for the “cost of consolidation” based on the “complexity of consolidation” would be difficult, because these costs and complexities are mostly driven by local political decisions about the consolidation or reversion, not by existing local conditions.
- The State should provide funding assistance for feasibility studies to localities considering reversion or consolidation. This is a cost that is somewhat consistent in each consolidation or reversion proposal. An estimate provided at the meeting was that a minimum of \$100,000 is needed for a basic feasibility study.
- The Governor and General Assembly should not be involved in making funding decisions about incentives to individual consolidation and reversion proposals. This places these state-level decision makers in the center of a local controversy.
- It is valuable to have an estimate of the amount of additional state funding at the beginning of the negotiations that must occur between the two localities.

## **Reasons to Consolidate or Revert to Town Status**

Small localities have three primary reasons to seek to consolidate. First, consolidating or reverting to town status would enable the locality to reduce the amount of tax effort required to support its basic level of governmental services. Second, consolidating resources would allow for increased efficiencies and improved economies of scale. Finally, consolidation would allow these localities to provide an expanded level of services to its citizens.

For larger localities, there is not much reason to cooperate with smaller neighboring localities. These jurisdictions generally already operate efficiently, providing an acceptable level of service, with reasonable tax rates. Entering into consolidations with nearby fiscally stressed localities is frequently seen as a burden.

The Commonwealth also has an interest in encouraging improved fiscal conditions for its local governments. First, there is an unrealized cost to the Commonwealth if it were required to take over the finances of an insolvent local government, as has happened in other states. Second, the State is responsible for a larger share of the cost of public education in its less-wealthy school divisions, and should seek to ensure that those funds are spent on high quality, efficient educational programming.

Unfortunately, very small school divisions are unable to provide the same broad course offerings available to larger divisions.

### **Recommendations**

#### **1. Avoid creating additional barriers to the reversion or consolidation processes.**

Proposals to provide incentives that would involve applying to the Governor or General Assembly for incentive funding should be avoided for several reasons:

- The existing process for reversion or consolidation easily takes more than five years. If localities were required to apply for incentives before proceeding with their reversion or consolidation, the process would take even longer, as application cycles would have to align with the State's budget cycle.
- Decisions made as part of the existing reversion and consolidation processes currently are solely made by local officials and voters, except for findings of law that are handled by the courts. Even among local decision makers – proposals to consolidate or revert frequently fail. If decisions about funding for reversion or consolidations are required to be brought before the Governor or General Assembly, it would add an additional decision point where the process could terminate, and make a local issue into a statewide issue.
- All parties to consolidations and reversions are not in favor of proceeding with the process, which would add uncertainty to any grant application process. Citizens can petition their governing bodies to consolidate with a neighboring locality, and the elected officials can object. Similarly, when reversions have been proposed in the past, counties have objected to cooperating with the affected city.

#### **2. Provide matching funds for localities to study the feasibility of consolidation or reversion.**

One of JLARC's recommendations in its 2014 study on consolidation was to provide grants through the Appropriation Act to assist localities in assessing whether consolidation is feasible and to determine the likelihood of improving fiscal sustainability and local services, and achieving state or local savings. We support this concept, as localities experiencing fiscal duress currently must bear the total cost of studying the pros and cons of consolidation and reversion. Generally, this grant should be administered as follows:

- A special fund should be created so that these grants would be available to localities as needed when considering reversion or consolidation. Maintaining a separate fund would prevent the General Assembly or Governor from being involved in allocating funds to any specific consolidation issue. Such fund could be administered by the Commission on Local Government.
- The State would provide a grant of up to \$50,000, while localities would contribute up to \$50,000 in matching funds toward a feasibility study for any proposal to consolidate localities or school divisions, or revert to town status.

- Localities should be encouraged to cooperate in funding such proposals; however, if one locality is unwilling to consider supporting such a study, the funds should still be awarded to the locality desiring to study the proposal, especially if they are experiencing above-average fiscal stress.

### **3. Reduce duration of incentives to five years.**

The two primary financial incentives that the Commonwealth historically provided for reversion and consolidation – hold harmless funding, and adjusted local composite index values for school aid – were initially provided for a duration of only five years, until amended in 2000 and 2002 to fifteen or twenty years, depending on the situation. Also, when studying the incentives provided by other states, this duration is far above the norm. Accordingly, we recommend returning the duration of these incentives to five years.

### **4. Redesign the school division consolidation incentive formula.**

Although it would be ideal for consolidation incentive funds to correlate with the cost of consolidation or to state savings, most of the cost of consolidation that is identified through feasibility studies are issues that are driven by local political decisions. For instance, a proposal to consolidate could realize savings quickly by laying off employees that are no longer needed, but due to political pressure on local officials, savings are deferred by realizing savings through employee attrition. Similar problems occur when determining how to equalize different pay scales between two consolidating localities.

In addition, there are immeasurable costs if two localities fail to consolidate when there is a fiscal crisis. The State has never had to bail out a locality from fiscal disaster. It is also unclear how debt that is defaulted upon by one locality would affect municipal bond ratings for other Virginia localities, or the Commonwealth's bond rating.

Until 2015, the bulk of financial incentives provided for consolidation and reversion consisted of additional state aid for K-12 funding offered by providing a more favorable local composite index to the consolidated school division.

Tying incentives to school funding seems sensible, as education expenditures made up 47% of total local government spending in FY 2014, by far exceeding any other category. State aid to localities for public education also accounted for 33% of the State's FY 2014 General Fund spending. Any incentive provided; however, must be reasonable, and prevent large payouts such as occurred with the Bedford reversion.

The State's funding formula for basic aid to school divisions generally sets a recognized per-pupil cost based upon the Standards of Quality, with the total cost shared between the school division and the State. In localities with a lower local composite index, in other words – a limited tax base –the state pays a greater share of the per-pupil cost of public education, while in wealthier areas, the locality is responsible for a greater share. Buena Vista currently has the lowest local composite index, with a score of 0.1756, meaning the City is responsible for 17.56% of the state recognized per-pupil cost, with the

state paying the remaining 82.44%. The index is capped so no locality has a score higher than 0.8000, therefore the state will always pay 20% of the recognized per-pupil cost to those divisions. Nine school divisions currently have a score of 0.8000. To ensure that the state funds that are used for public education are spent efficiently, incentives should be directed toward consolidations of smaller school divisions with low wealth, to ensure that the Commonwealth's contributions are spent effectively. This would also encourage localities surrounding those low wealth jurisdictions to negotiate an agreement to consolidate school divisions.

The Commission recommends these incentives should be calculated as follows:

1. In order to qualify for the school division consolidation incentive, at least one of two consolidating school divisions must have a Local Composite Index score that is below the state average of all school divisions. (FY 2015 average = 0.3968)
2. Once qualified:
  - a. For the affected localities, add together the number of LCI points below average.
  - b. Determine the difference between the two affected localities' LCI scores.
  - c. Add the results of step 2a and 2b above for the final incentive factor.
3. Next, determine the cash amount of the incentive.
  - a. Determine which locality has the lower Average Daily Membership (ADM).
  - b. For the locality with the lower ADM, determine the State Share of Basic Aid.
  - c. Multiply the Final Incentive Factor from Step 2c by the State Share of Basic Aid. The maximum ADM that this factor can be applied to is 2,500 ADM.
4. The data used to determine this incentive would be the data for the fiscal year prior to the consolidation, and this amount would be provided annually for the duration of the incentive period.

The outcomes of various combinations of localities are shown in [Appendix A](#), compared to the incentive that was offered prior to 2015. A graphic depiction of the calculation of the 'Final Incentive Factor' is included in [Appendix B](#).

**5. Provide incentives for joint contracting of school services as a first step toward full consolidation.**

The same incentives that were discussed previously for school division consolidation for a five-year period should also be extended to joint contracts for school services among two school divisions for a three year period. Should two such school divisions later determine it would be appropriate to fully consolidate, they would then qualify for an additional two year incentive.

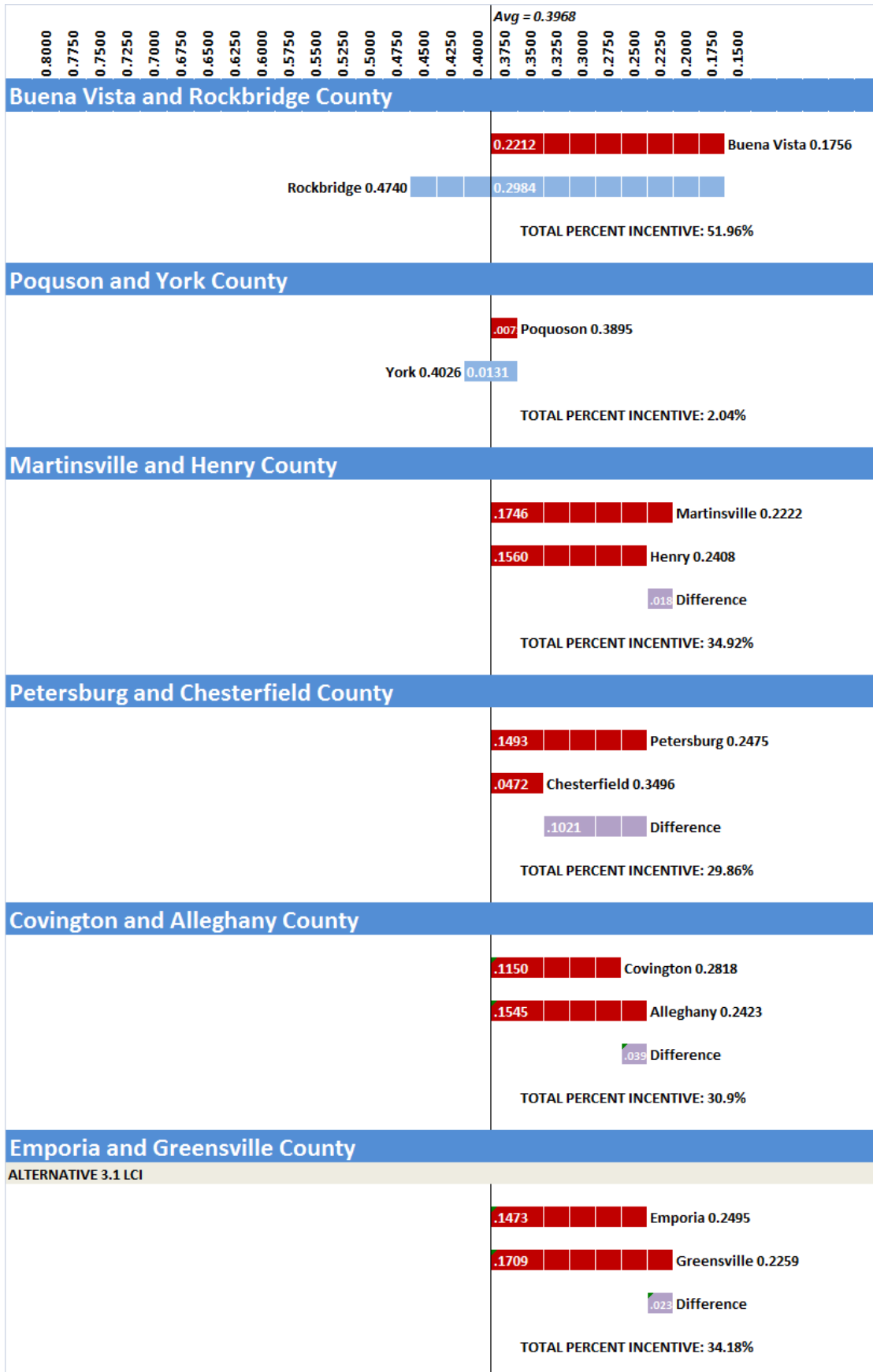
As noted previously, in recent times, only three reversions have succeeded, and those were circumstances where there already were already joint contracts between the county and city to provide school services. Based on recent consolidation and reversion efforts, the fear of a loss of local identity – which is closely tied to the schools that serve the area – has been a political barrier from consolidation, even when localities involved are facing severe financial challenges. Entering into a joint contract with another school division to provide educational services retains two distinct school boards and


superintendents, while consolidating the rest of the school division’s functions. This arrangement allows school boards to retain control though the contract – for instance, to ensure that a small city does not lose its high school as the result of consolidation. At the same time, it allows small school divisions to enjoy the efficiencies and broader course offerings that are enjoyed by a larger school division.

DRAFT



Locality 1	LCI	ADM	Locality 2	LCI	ADM	Former Incentive	Proposed Incentive	Former Incentive/ADM	Alt 3.1/ADM	Former Incentive as % of State Basic Aid Payment to smaller division	Proposed Incentive as % of State Basic Aid Payment to smaller division		
Buena Vista	0.1756	1000.35	Rockbridge	0.474	2545.6	\$ 3,879,783	\$ 1,928,563	\$ 3,878	\$ 1,928	105%	52%	Incentives to consolidations of smaller ADM/low LCI localities are consistent on a per student basis	
Martinsville	0.2222	2164.7	Henry	0.2408	7047.9	\$ 564,771	\$ 2,555,466	\$ 261	\$ 1,181	8%	35%		
Emporia	0.2495	1045.8	Greensville	0.2259	1359.1	\$ 114,280	\$ 1,242,213	\$ 109	\$ 1,188	3%	34%		
Hopewell	0.2298	4004.6	Prince George	0.243	6277.6	\$ 394,600	\$ 2,702,271	\$ 99	\$ 675	3%	21%		
Covington	0.2818	928.9	Alleghany	0.2423	2258.75	\$ 164,762	\$ 925,724	\$ 177	\$ 997	5%	31%		
Petersburg	0.2475	3912.7	Dinwiddie	0.2882	4374.15	\$ 815,123	\$ 2,324,484	\$ 208	\$ 594	7%	19%		
West Point	0.2581	780.3	King William	0.3196	2182	\$ 653,947	\$ 761,117	\$ 838	\$ 975	24%	28%		
Radford	0.2675	1602.65	Pulaski	0.3113	4284.8	\$ 839,829	\$ 1,313,285	\$ 524	\$ 819	17%	26%		
Galax	0.2738	1311.9	Carroll	0.2696	3704.75	\$ 24,489	\$ 1,077,267	\$ 19	\$ 821	1%	25%		
Franklin city	0.2978	1102.1	Southampton	0.2878	2607.3	\$ 46,598	\$ 713,356	\$ 42	\$ 647	1%	22%		
Lee	0.1886	3129.1	Scott	0.194	3589.95	\$ 95,070	\$ 4,113,103	\$ 30	\$ 1,314	1%	33%		
Smyth	0.2252	4498.3	Washington	0.3813	7058.76	\$ 4,682,180	\$ 2,956,256	\$ 1,041	\$ 657	30%	19%		
Colonial Beach	0.352	517.1	Westmoreland	0.4633	1594.4	\$ 1,022,598	\$ 255,125	\$ 1,978	\$ 493	63%	16%		
Bristol	0.3085	2181.2	Washington	0.3813	7058.76	\$ 2,183,618	\$ 1,106,962	\$ 1,001	\$ 508	35%	18%		
Norton	0.3102	816.25	Wise	0.2538	5791.65	\$ 205,158	\$ 717,655	\$ 251	\$ 879	8%	29%		
Highland	0.8	183	Bath	0.8	568.3	\$ -	\$ -	\$ -	\$ -	0%	0%		No funds: Above Avg. LCIs
Fairfax city	0.8	3156.7	Fairfax	0.6807	178005	\$ 1,824,968	\$ -	\$ 578	\$ -	60%	0%		
Chesterfield	0.3496	59088.8	Petersburg	0.2475	3912.7	\$ 26,407,796	\$ 2,324,484	\$ 447	\$ 39	16%	1%		Previous excessive incentives eliminated
Manassas Park	0.2683	3236.1	Prince William	0.3822	83683.45	\$ 44,502,550	\$ 2,218,825	\$ 13,752	\$ 686	398%	20%		
Portsmouth	0.2678	14174.6	Chesapeake city	0.361	38644	\$ 15,945,730	\$ 1,973,296	\$ 1,125	\$ 139	37%	5%		






## Local Government and School Division Consolidation Incentives

September 28, 2015


Virginia Department of Housing and Community Development



## Background

- Bedford city's reversion to town status resulted in approx \$6 million in incentive school aid payments from state to Bedford County for 15 years.
- 2014 General Assembly directed JLARC to study the issue.
  - Study to consider balance between cost of incentives and expected savings and operational benefits.
  - Study to consider how to structure incentives to achieve clarity for localities and justification that incentives are adequate, but not excessive.

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## Background

- 2015 Appropriation Act study mandate for Commission:
  - “It is the Commonwealth’s goal to encourage amicable consolidations that improve local fiscal sustainability and, when possible realize state or local savings and local service improvements.”
  - “...the Commission on Local Government shall develop a process to determine an appropriate calculation for additional state funds for future local consolidations”
  - “The amount of additional funding for local consolidation should be based primarily on the projected cost of consolidation. The length of time additional funding is provided should be based primarily on the complexity and length of time necessary for the consolidation.”

(Item 107)


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## Existing Conditions

- Two major incentives have been provided for localities/school divisions to consolidate:
  - Localities held-harmless due to consolidations for state aid for 15-20 years.
  - School aid formula to apply the lower LCI to the entire new school division for 15 years.
- Smaller incentives provided include VDOT, State Police, and Library Aid assistance.


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## Recent Reversions

- In last 20 years, only 3 school division consolidations have occurred.
  - All resulted from reversions. (South Boston, Clifton Forge, Bedford)
  - All had existing joint contracts with county school board under Va. Code § 22.1-27.
- Incentives were awarded to all three for reversion, though bulk of operational changes were elimination of city school board & superintendent.
- Incentive funding has been generally used to assist with capital needs.

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## Stakeholder Input

- Most consistent cost of consolidation is consultant fees.
  - Est. cost of quality study – at least \$100,000.
  - Other consolidation costs vary widely due to local political decisions – (i.e. decisions on salary equalization, capital needs, etc.)
- Concurred that a 15/20 year incentive duration is excessive.
  - Five year duration should be sufficient.
- Knowing the amount of the incentive at the negotiation stage is critical for successful negotiations.

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### Reasons to Incentivize Consolidations/Reversions

Why Consolidate School Divisions?

- For small localities:
  - Reduce tax effort required to support school division.
  - Improved economies of scale.
  - Expanded array of course offerings.
- For larger localities:
  - Little reason to cooperate with small localities.
- For the Commonwealth:
  - Preventing the unrealized cost of local government insolvency.
  - Ensuring state funding to lower capacity school divisions is spent on high quality, efficient programming.


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### Recommendation 1. Avoid Additional Barriers to Process

- Incentives requiring an application to the Governor or General Assembly for funding should be avoided because:
  - Process already takes 5+ years.
  - Could potentially add years to align with the State's budget process.
  - Could make a local political issue into a statewide political issue
  - Situations where one locality (typically, a county) opposes reversion or consolidation with another locality (typically, a city)


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### Recommendation 2. Provide Matching Funds for Studies

- Create a special fund, possibly administered by Commission on Local Government.
- \$50,000 match from Commonwealth.
- Encourage cooperation in funding these studies; however, understand that only one locality may be interested in pursuing.


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### Recommendation 3. Reduce Duration of Incentives to 5 years

- Prior to 2000, incentive/hold harmless funding was only offered for five years.
- Was extended to 15/20 years depending on circumstances in 2000 & 2002, presumably to address local political issues for specific proposals.
- Five years is similar to what other states offer.

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### Recommendation 4. Redesign the School Consolidation Incentive Formula

- Tying incentives to the 'cost of consolidation' is not realistic.
  - Most costs of consolidations are driven by local decisions – i.e. how much pain should be endured to realize savings quickly.
  - Unrealized cost of *not* consolidating – possibility of insolvency.
- A formula-based incentive that can be projected helps proposals move beyond the negotiation stage.

*We will need Commission direction on how to proceed!  
Will explain formula alternatives later in presentation.*


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### Recommendation 5. Provide incentives for joint operating contracts among school divisions

- Encourage new joint operating contracts among school divisions.
  - Provide 3 years of incentives, if full consolidation occurs later, an additional 2 years of incentive would be awarded.
- Allows school boards to retain control of smaller jurisdiction, while enjoying improved economies of scale and broader offering of programs.
  - Alleviates concerns about sending children to distant county schools.
  - While improved economy of scale/better programs possible – limited revenue resources would remain an issue for small school divisions.
- Recognizes that prior reversions only occurred where joint school operating contracts existed.


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### Summary of Recommendations

	Previous Incentives	Proposed Incentives
<b>Feasibility Study Assistance</b>	None.	Provide matching funds up to total \$100,000, to be administered by CLG.
<b>Hold Harmless Funding</b>	15-20 years.	5 years.
<b>School Division Consolidation Incentive Funding</b>	15 years, applying the lower LCI of the two consolidating divisions to the entire new division.	5 years using formula recommended by CLG.
<b>Incentives for Joint School Division Contracts</b>	None.	3 years, then an additional 2 years if full consolidation later adopted.


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### Which divisions do we want to encourage to consolidate?

- General Assembly directed us to encourage amicable consolidations that improve local fiscal sustainability and when possible realize state or local savings and local service improvements.


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### Which divisions do we want to encourage to consolidate?

- Least fiscal sustainable localities: Those that have highest fiscal stress scores.
- These localities have lowest per capita income, most limited tax bases (high revenue capacity), and greatest tax rates (high revenue effort).
- Of top 10 localities on Fiscal Stress Index:
  - 4 have fewer than 1,500 students
  - 3 have 1,501-2,500 students
  - 2 have 2,500-5,000 students
  - 1 has greater than 5,000 students


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### Which divisions do we want to encourage to consolidate?

- Where possible to realize state or local savings and local service improvements.
- Top 10 most expensive per student SOQ cost divisions:
  - All are geographically large, sparsely populated school divisions.
  - None experience extraordinary fiscal stress.
  - High transportation and other support costs.
  - Consolidation would most likely increase costs.

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### Which divisions do we want to encourage to consolidate?

- Localities with limited, shrinking tax bases:
  - Small independent cities with surrounding counties
  - Two town-operated school divisions
- Consistent with State city reversion policy

**NOT**

- Sparsely developed rural areas
- Combinations of localities where the State's share of public education cost is low.

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### Possible Formulas for School Division Consolidation

Alternative 1

- Base LCI Incentive & ADM Incentives determined using differences between each.
- Accelerator factor applied, diverts greater incentives to create smaller, less wealthy school divisions.

Alternatives 2, 2.1, 3, and 3.1

- Incentive is a percent bonus added to the basic school aid for the smaller division.
- Percent of bonus is dependent upon fiscal stress or local composite scores of divisions involved.
- Considers distance of division from statewide average fiscal stress or LCI scores, and differences between two divisions.

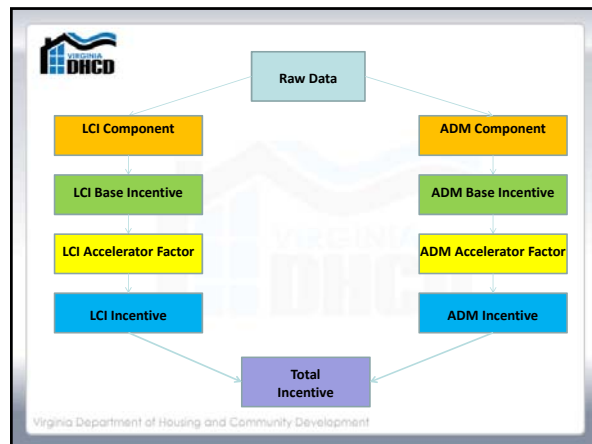
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### Possible Formulas for School Division Consolidation

**Alternative 1**

- Two components: LCI Incentive & ADM Incentive
- A base figure is determined for each component using
  - LCI base figure is the difference in state aid for the smaller ADM division using the difference in LCIs between the two divisions, up to a difference of .0500 LCI.
  - ADM base figure is the difference in state aid for the smaller ADM division using the difference in ADMs between the two divisions, up to a difference of 1500 ADM.
- An **accelerator factor** is applied to each base figure to determine the total incentive.
  - Accelerator factor considers the deviation of the proposed division's LCI and ADM from the State's mean LCI and ADM.

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### Fiscal Stress Index vs. Local Composite Index

**Fiscal Stress Index**

- Better measure of local fiscal condition:
  - Considers all revenue resources available to locality. (Revenue Capacity)
  - Considers how much revenue effort is exerted by the locality. (Revenue Effort)
  - Median Household Income
- Calculated only for cities and counties
- Not mandated by state law, methodology not set out

**Local Composite Index**

- Not a complete picture of fiscal condition:
  - Only considers: True Value of Real Property, Taxable Sales, Adjusted Gross Income
- Calculated for all local school divisions.
- 40 years as the accepted measure for distributing local aid for public education.

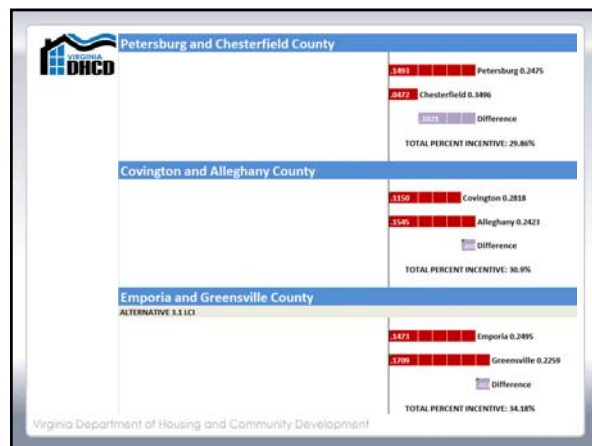
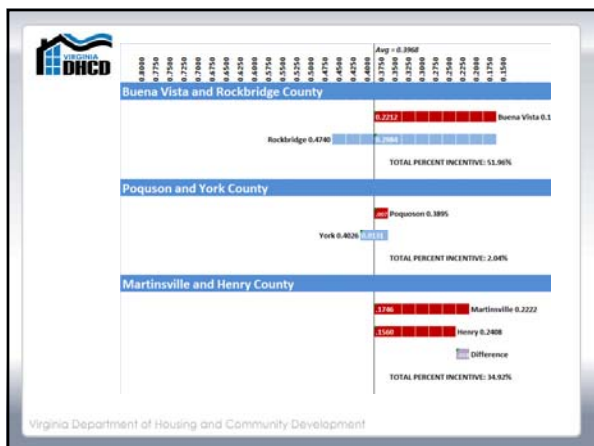
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### Possible Formulas for School Division Consolidation

**Alternative 3.1**

- Percent bonus added to Basic School Aid.
  - Bonus applied to the jurisdiction with the smaller student body (ADM).
  - Bonus is capped – can be applied to no more than 2,500 ADM.
- To qualify, at least one city or county must have a below avg. LCI (.3968 or lower)
- Percent bonus is the sum of:
  - # of LCI points below average for each jurisdiction.
  - # of points between the two jurisdictions, regardless of whether one has an above average LCI.

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### Outcomes: Alt. 1

Locality 1	Locality 2	Alt 1 Total Proposed Incentive	Alt 1/ADM	Alt 1 as % of SOQ	Alt 1 as % of State Payment
Highland	Bath	\$ 1,138,733.25	\$ 6,617	30%	402%
Colonial Beach	Westmoreland	\$ 2,320,400.00	\$ 4,500	77%	143%
Craig	Giles	\$ 2,081,953.52	\$ 4,792	26%	243%
Leesville	Rockbridge	\$ 2,153,097.89	\$ 3,309	62%	132%
Charles City	New Kent	\$ 2,736,038.05	\$ 4,693	62%	143%
West Point	King William	\$ 2,368,328.13	\$ 3,693	53%	146%
Sorry	Sussex	\$ 236,493.81	\$ 294	5%	29%
Norton	Wise	\$ 2,023,917.87	\$ 2,430	48%	111%
Blair	Wythe	\$ 2,584,658.65	\$ 1,138	33%	96%
King Queen	Caroline	\$ 2,363,357.92	\$ 2,432	64%	172%
Buena Vista	Rockbridge	\$ 2,413,707.40	\$ 2,413	64%	163%
Lee	Scott	\$ 593,703.36	\$ 199	3%	5%
Martinsville	Henry	\$ 2,395,170.01	\$ 300	13%	29%
Smith	Spotswood	\$ 2,568,296.41	\$ 371	10%	17%
Emporia	Greeneville	\$ 221,470.26	\$ 492	13%	30%
Hopewell	Prince George	\$ 1,381,004.62	\$ 475	3%	15%
Covington	Allegheny	\$ 2,094,915.85	\$ 2,217	40%	104%
Petersburg	Prince George	\$ 1,900,056.38	\$ 436	9%	14%
Norfolk	Dinwiddie	\$ 2,333,763.28	\$ 3,047	18%	30%
Edinburg	Russell	\$ 1,708,135.03	\$ 787	13%	22%


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### Outcomes: Alt 3.1

Locality 1	Locality 2	Alt 3.1 LCI Diff	Alt 3.1/ADM	Alt 3.1 as % of SOQ	Alt 3.1 as % of State Payment
Emporia	Greeneville	\$1,242,213	\$ 1,188	21%	34%
Covington	Allegheny	\$925,724	\$ 997	18%	31%
Petersburg	Prince George	\$2,394,543	\$ 612	12%	20%
Radford	Pulaski	\$1,113,285	\$ 819	15%	26%
Buena Vista	Rockbridge	\$1,928,563	\$ 1,928	35%	52%
Lynchburg	Campbell	\$1,845,064	\$ 224	4%	8%
Bristol	Washington	\$1,106,962	\$ 508	10%	18%
Martinsville	Henry	\$2,555,466	\$ 1,181	23%	35%
Galax	Carroll	\$1,077,267	\$ 821	16%	25%
Hopewell	Prince George	\$2,702,271	\$ 675	13%	21%
Franklin city	Southampton	\$713,356	\$ 647	12%	22%
Norton	Wise	\$717,655	\$ 879	17%	29%
Scott	Lee	\$4,113,301	\$ 1,146	20%	29%

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### Overview of Outcomes

**Alternative 1**  
 Incentivizes creating new divisions with lower LCIs and lower ADMs. Combining large/wealthy with small/poor locality does not result in noteworthy incentive.

**Alternative 3.1**  
 Directs greatest incentives toward jurisdictions that are most dependent on State funds – greatest return on State investment. Also provides increased incentives for a wealthy and a poor jurisdiction to consolidate. (High vs Low LCI)  
 No incentive unless at least one locality has below average LCI score.

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### Questions?

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