Economic Summary

Week of April 17, 2020

This report will be part of an ongoing summary of recent and relevant economic commentary and data to assist municipal officials. While it should not be viewed as an exhaustive analysis of all data, we hope it will serve as a guide for your local governments during this time.

Tennessee Economy in General

The COVID-19 pandemic is constraining Tennessee's economic activity. Over the last four weeks, new unemployment claims totaled 324,501 in Tennessee and 22 million nationwide. The most losses on record. An April 15th Wall Street Journal survey of 57 economists states that a second round of layoffs has begun, and approximately 14.4 million job reductions may be added to the first wave of 22 million with an unemployment rate nearing 13% by June. This suggests that a substantial number of additional Tennesseans may become unemployed in the coming weeks. Economists caution that Tennessee unemployment rates may increase to historically high levels.

Last week, the Howard Baker Center for Public Policy and the UTK Coronavirus Outbreak Response Team (CORE) issued a report that stated Tennessee is likely already in a recession and this pending recession is likely to be deep. Differently situated communities will be impacted differently, and communities that rely on high-risk (leisure/hospitality, travel, employment services, transportation) and high contact-intensive (face-to-face interaction) industry segments will be hit the hardest.

Tennessee government leaders are planning protocols for an economic reopening. Governor Lee appointed an Economic Recovery Group to focus on a phased reboot of the state's economy. This group will issue industry specific guidance on employee and customer protection. A phased economic reopening would likely be slow and some supply chain participants would be unable to transact business if part of their supply chain did not re-open. However, it should be noted that a complete reopening could lead to a wide-spread viral infection, the largest loss of life, and another complete shut-down of the economy.

Local Government Revenues and Budgeting

Municipal budgets will be strained. In-state and national economists anticipate an upcoming recession that will be unlike any previously recorded recession. The severity will depend, in part, on your community's economic composition. Urban areas will likely be impacted the hardest, and tourism dependent economies should prepare for very significant, near-term revenue loss.

Economists caution local governments to plan budgets based on either no revenue growth or even year over year reductions for the fiscal year beginning July 1, 2020. In mid-March the state adopted a budget that assumed negative revenue growth for the remainder of the current fiscal year (ending June 30, 2020), and 0.25% growth for the upcoming fiscal year (beginning July 1, 2020). The most recent state revenue collections summary represents February revenues so the first economic effects of the virus were not apparent.

State and federal transfers may help local budgets. The upcoming FY21 state budget included $100 million in grants for cities and towns. Each city can find their allocation HERE. While state law limited the purposes of the grants, local governments should still benefit from the availability of the revenue. For more information on the state of Tennessee grant program please refer to TML's COVID website and the Governor's Department of Finance and Administration's dedicated page. In addition, according to the Tax Foundation the federal government's CARES Act included $2.6 billion for the state and local governments of Tennessee. Approximately $2.4 billion of this will go to Tennessee state government for programming, and some portion of this revenue could eventually go to local governments. On April 16, Governor Lee created the Stimulus Financial Accountability Group to ensure proper distribution of this funding. The first meeting will be remotely conducted on April 22nd. The first round of funding was limited to states and the largest cities and counties, so the National League of Cities, the National Association of Counties, and the U.S. Conference of Mayors jointly requested an allocation of at least $250 billion to go to all cities and towns regardless of size. Finally, MTAS's recent state shared revenue projections suggest lower year over year per capita allocations, but as of this time the estimates do not have post-viral spread data. Cities and towns should cautiously estimate state shared revenues until more data becomes available.

Cities and towns rely on the property tax, local option sales tax, business tax, hotel-motel tax, beer tax, and fuel taxes as local sources to fund operations. Going forward, this summary will evaluate these local sources in more depth; however, little relevant data exists today. Below is a quick review of budgeting and tax revenues by source:

Budgeting - currently, we know that the two largest sources of local government revenues will be influenced by a time-lag issue that may both help and harm budget planning. Sales tax receipts are delayed multiple months due to the accrual method (as of 4/17/2020, February is the most current month for collections). So, the sales tax revenue impact of social distancing and stay-at-home orders will not be noticed in collections reports for at least two months. This delay could require cities and towns to pass budgets projecting an entire fiscal year without any relevant sales tax data. In many instances, the local property tax has been collected for the current year and thus will not be due again until early 2021. This delay may help local government budgets as some economists anticipate economic recovery will be underway by the time property taxes are due again. However, to the extent a local government has not collected property tax or has delinquencies then they should plan budgets based on pessimistic scenarios.

Property Tax - the property tax is generally the most stable source of local revenue. Currently, there is not enough data to suggest wide-spread foreclosures or tax delinquencies similar to the 2008 Great Recession; however, the unemployment projections, potential for business failures, layoffs, furloughs and other employment scenarios could result in real liquidity problems for a far greater share of households and businesses than normal. This may impact future collections and property sales. In addition, local governments might find it prudent to anticipate higher than normal property tax delinquencies in 2021.

Sales Tax - the sales tax will be impacted on multiple fronts by behavior migration. Purchasing behavior has migrated from in-person, brick and mortar sales to internet-based sales and deliveries. This will impact situs collections for governments that depend on traditional brick-and-mortar sales. In addition, types of purchases have migrated away from discretionary and entertainment. The advance estimates of retail sales from the US Census Bureau indicate that March sales of food and beverage were up 28%, while clothing fell more than 50% and auto sales dropped more than 25%. It should be noted that business to business transactions account for nearly 1/3rd of sales tax revenues. The supply chain disruptions from the virus and subsequent actions to reduce the spread will likely impact all segments of the supply chain and reduce purchasing behavior. This reduction will occur in phases as businesses that supply other businesses gradually reduce or cease activity. More information on business outlook and sentiment can be found in the Macro-economic section.

Business Tax – the local business tax on gross receipts will likely move similarly to the sales tax revenues. In addition the filing deadline was moved from April 15 to June 15, 2020. This will naturally delay cash flow for two months, and may also ultimately reduce total collections to the extent that a business chooses to close entirely. Local governments should estimate business tax revenues with extreme caution. More information on business outlook and sentiment can be found in the Macro-economic section.

Hotel-Motel Tax – the tourism and lodging industry has effectively halted. At this time, the most current occupancy rates are from the week of March 14. This was immediately prior to widespread infections; however, global hospitality research firm STR data for that week indicated a 24.4% reduction in occupancy down to 53%. Anecdotal evidence now suggests occupancy rates in the single digits. This would suggest anywhere between three months to a half of a year of single digit percentage collections relative to the prior year.

Motor Fuel Taxes (Gasoline & Diesel) - fuel taxes are paid at the wholesale level based on the gallons purchased and remitted to the state and local governments. As the tax is based on the gallons consumed, fuel prices only impact revenues to the extent the prices change consumption behavior. The recent reduction in prices was concurrent with the Stay-at-Home order and business closures so fuel prices may not have led to increased gallonage consumption. It should be noted that the Tennessee Department of Transportation found traffic volume has fallen nearly 50% since the beginning of April.

Macro-economic Commentary

According to the Federal Reserve Beige Book for April 2020, economic activity contracted sharply and abruptly, and employment declined steeply across all regions of the United States. As previously discussed, newly filed unemployment claims for the nation exceeded 20 million over the last four weeks. In addition, retail sales fell 8.7% in March. The largest decline on record. Wall Street Journal economists anticipate a larger retail sales decline in April since business closures did not begin until the end of March.

The impact of the virus and the subsequent actions to control the spread have led to wide and varying employment estimates for the coming year. Unemployment rates may reach extremely high percentages with some estimates exceeding 30% depending on your community's economic composition. In addition, relaxing social distancing and stay-at-home actions may lead to a second wave of infections that could lead to another employment reduction and thus additional economic loss. Recent reports suggest employment may not return to current levels until 2022.

The Philadelphia Federal Reserve conducted a special weekly business outlook survey for the week ended April 5 to measure business sentiment on COVID-19. This survey found that 61% of responding firms reported a greater than 5% reduction in new orders, 25% of non-manufacturing firms have closed, almost 60% of firms have laid-off or furloughed workers, almost three-quarters have applied for or inquired about SBA loans to cover revenue shortfalls, nearly 86% of responding firms are concerned about adequate cash flows, 81% are concerned about customers paying them, and nearly two-thirds are concerned about maintaining solvency.

According to the UT-Knoxville Howard Baker Center for Public Policy, the most severe economic disruptions will likely occur in urban areas. Economies that depend on tourism should prepare for very significant loss. In addition, the Brookings Institute suggests that governments reliant on more elastic sources of revenue (sales) and/or the aforementioned high-risk industries will be more heavily impacted. Finally, economists disagree on recovery prospects. Some economists suggest a V-shape, or quick recovery; some suggest a U-shape or slower recovery; some suggest a W-shape or double-dip recovery, recession, recovery; and some even suggest a L-shape, or severe recession without a return to trend line growth. More data will provide more clarity in the coming weeks and months. The only thing that is for certain is that we have not experienced the end of the economic concerns.