Economic Summary; Volume V

Week of May 15, 2020

Tennessee Economy in General

Every Tennessee county reopened in some form this week. Nashville's Phase 1 reopening began May 11, and the balance of the state gained a full week of experience operating under the Tennessee Pledge. As stated in the prior summary, the major ongoing question will continue to be consumer confidence and appetite for personal risk.

The re-opening was overshadowed by the state's release of April revenue collections (representing March activity). State revenues dramatically missed expectations. The state attributed the miss to COVID actions and behaviors as well as extended tax filing deadlines for business related taxes. For the month of April, actual revenues missed budgeted revenues by nearly 38%. This miss was driven by a collective 65% under-collection in F&E, Business, and Hall Income taxes as well as Sales and Use missing budget by more than $61 million, or 7%. Year to date, State General Fund revenues fell $164 million under budget, once again, driven largely by the extended filing deadlines. The state's predominant revenue source (Sales and Use) was $182 million above budget through nine months.

The May revenue report, which will not be released for nearly four weeks, will likely reveal the true depths of the economic downturn. This report will cover the four April weeks of extremely limited economic activity and massive unemployment claims. A glance at the taxes by sales classification highlight the purchasing behavioral impact of COVID and the stay-at-home orders, and this data may reveal short-term revenue expectations. As Table 1 shows, eating & drinking places, hotel & lodging, and big-ticket item purchases contributed greatly to the sale and use tax under-collection, and many of these classifications have not returned to comparatively normal business patterns.

Table 1: Select Sales and Use Tax Collections by Classification

Tax Classification	Amount	Percentage
Eating places	$(24.9m)	-29.1%
Motor vehicle dealers	$(16.1m)	-19.6%
Hotel & lodging	$(14.2m)	-52.7%
Apparel & accessory stores	$(10.8m)	-45.2%
Amusement services	$(5m)	-45%

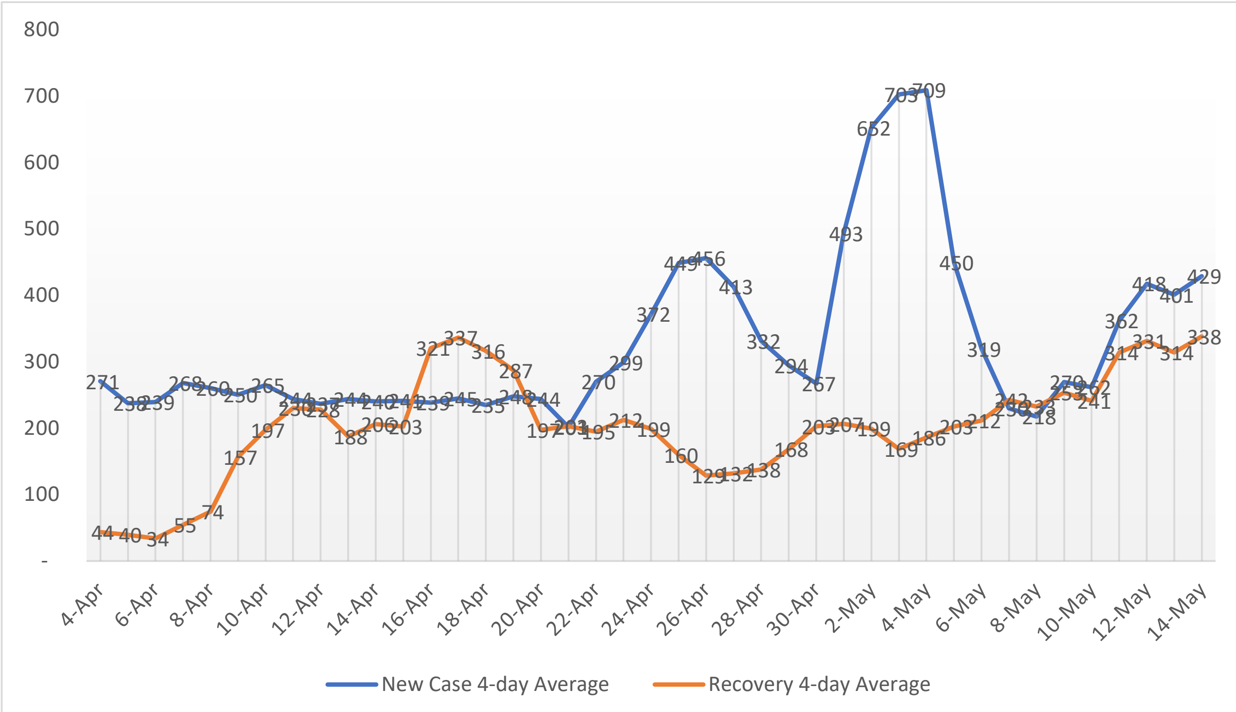
The immediate COVID-related job recissions appear to be slowing. The Tennessee Department of Labor and Workforce Development Weekly New Unemployment Claims release reported another reduction in new claims. As Table 2 shows, for the week of May 9, new unemployment claims increased by 29,308 which is the lowest since the stay-at-home orders began. Over the last eight weeks, new unemployment claims totaled 503,888. Continuing Claims increased to the highest level during the pandemic. As of May 9th, 307,327 claims were paid totaling $66.2m State and $228.4m Federal representing nearly $960 per claim (~$278 State and ~$682 Federal). In addition, on Monday the Department issued guidance that an individual must return to work regardless of health concerns if employment is available or else potentially lose unemployment benefits.

Table 2: New Unemployment Claims by Week

Week Number	Week Ending Date	Number of New Claims Filed	Continued Claims
11	21-Mar-20	39,096	16,098
12	28-Mar-20	94,492	34,570
13	4-Apr-20	116,141	112,438
14	11-Apr-20	74,772	199,910
15	18-Apr-20	68,968	267,053
16	25-Apr-20	43,792	324,543
17	2-May-20	37,319	321,571
18	9-May-20	29,308	325,095
		503,888	

Finally, from a healthcare perspective, COVID-19 cases grew again this week. According to statistics from the Tennessee Department of Health and COVID-19 Unified Command, the state confirmed 2,604 new cases and 2,098 recoveries during the 7-day period ending May 14. Over a 14-day period, the state confirmed 5,965 new cases and 3,543 recoveries, which were both 14-day rolling total increases over the week prior. Chart 1 shows the 4-day moving averages of new cases and recoveries since April 4th. Averaging smooths anomaly events. As Chart 1 shows, on average, new cases exceeded recoveries over the previous week.

Chart 1: 4-Day Average New Case and Recovery Data



Local Government Revenues and Budgeting

As previously mentioned, the state released the April revenue report this week. The report provided local governments the initial revenue impacts of the business shutdowns and stay-at-home orders. While the report suggested deeper difficulties in May, local government revenue sources collected by the state were mixed. Local option sales tax did not fall nearly as much as the state sales tax, and the local business tax drop was attributed to the filing extensions.

Current year collections will be aided by eight months of revenue growth that exceeded expectations. Prior to April, the state sales and use tax grew at more than 6% year-to-date and is still 4.5% year over year after the April report. Business and fuel tax revenues also exceeded expectations prior to April. The state's amended budget reduced current year growth from 3.75% to 2.5% and may be tested by the May revenue report which will represent a full month of COVID-related business closures and stay-at-home orders. Finally, despite April's bleak revenue report, local option sales tax collections are still growing at nearly 6% year over year and other revenue sources are currently up as well.

Local Option Sales Taxes

For the month, April 2020 aggregate local option sales tax fell by slightly under 1% when compared to April 2019, but year-to-date collections have grown by nearly 6%. As mentioned in prior summaries, while the state and local option sales tax applies to the same purchases, the sales "tax base" differs. This difference can be attributed to 1) the single article cap, which overweighs the importance of more expensive item purchases to state government compared to local governments, and 2) differential state rates on certain items such as food, which can impact the state budget but not locals if purchasing patterns migrate between rates. These two differences may help explain why state sales tax revenues fell much more than local option sales tax revenues.

Table 3 illustrates how a migration from auto purchases to food store purchases will reduce state revenues while not impacting local government revenues. If you compare auto purchases to food purchases, despite an estimated $78 million additional aggregate spending on these items state sales tax revenues fell by nearly $3.8 million. Meanwhile, even assuming each motor vehicle sale fell under the $1,600 single article cap local option sales tax revenues would have increased by more than $2 million. Of course, not all grocery store purchases will be at the 4% food item rate which would decrease the Total Difference; however, this example helps illustrate that for every $100 spent on 7% tax rate items, $175 would need to be spent on 4% tax rate items simply to receive the same amount of sales tax revenue.

Table 3: Comparison of Specific Sales and Use Tax by Classification Items

(1)	(2)	(3)	(4)	(5)	(6)
	Tax Collections	State Rate	Estimated Sales	LOST Rate	Estimated LOST
Motor Vehicle Dealers, New + Used	(16,149,536)	7%	(230,707,657)	2.75%	(6,344,461)
Grocery Stores	12,363,564	4%	309,089,100	2.75%	8,499,950
Total Difference	**(3,785,972)**		**78,381,443**		**2,155,490**

Finally, local governments should be cautious of the potential for revenue migration between municipalities/tax jurisdictions. The total collections associated with catalog and mail order sales, which includes online sales, increased by nearly $8.4 million or 62% for the month. Under destination sourcing, online sales tax revenues will accrue to the point of delivery (jurisdiction in which deliver occurs). To the extent that a portion of these online purchases would have otherwise been made in a brick-and-mortar store by a non-city resident were it not for COVID-19, then municipalities with physical storefronts will lose sales tax revenue.

Local governments should proceed very cautiously with FY21 local option sales tax (LOST) estimates due to purchase class migration and the potential for higher-than-normal internet/catalog sales moving revenues between tax jurisdictions, but total LOST revenues may not fall as much as the state during FY21.

Hotel-Motel Taxes

As Table 1 showed, state collections attributed to hotel and lodging sales fell by almost $14.2 million, or more than 50%, for the month of April (March activity). Thus, local governments lost local option sales tax revenues; however, many local governments levy a hotel-motel lodging tax on lodging stays. According to a 2015 TACIR report, while state law allows for different rates most jurisdictions levy a 5% rate on lodging stays. Therefore, local governments not only lost sales tax revenues but also likely lost almost 50% of lodging tax revenues. Table 4 estimates the total loss for local governments exceeded $15 million based on the state's sales tax loss and the 5% hotel-motel rate.

Table 4: Total Revenue Loss on Lodging Stays, March 2020

	Sales Tax Collections	Sales Rate	Estimated Sales	Hotel-Motel Rate	Estimated Hotel-Motel	Total Difference
State Collections	(14,188,313)	7%	(202,690,186)	0.00%	-	(14,188,313)
Local Collections	(5,573,980)	2.75%	(202,690,186)	5.00%	(10,134,509)	(15,708,489)

These estimates represent approximately two weeks of business closures and stay-at-home orders. April will likely be much worse. In addition, anecdotal evidence and public statements suggest that lodging may not recover quickly. Local governments should anticipate little to no lodging revenues for the next quarter and dramatically lower-than-normal lodging revenues in subsequent quarters.

Liquor-by-the-Drink Tax

The liquor-by-the-drink (LBD) or mixed drink tax is an elective revenue source for local governments with 75% of revenues dedicated to education. The first half stays with the state and funds a portion of the Basic Education Program (BEP) Formula. The second half is returned to the situs of tax levy with half of that amount dedicated to local education funding, and the final amount for general government.

Bar and restaurant closures impacted local governments and education. April mixed drink tax collections were 60% under budget. The state estimated $75m this year for local governments so a one-month 60% reduction is equal to a 5% loss, or $3.75m. Local school systems lost one-half of this amount, or $1.875m, and the local government lost the balance. April collections will likely be much worse since bars and restaurants were closed for the entire month. The LBD tax is a situs-based tax so some municipalities (and thus either city or county school systems) will experience dramatic revenue shortfalls while other municipalities may not lose much revenue. Each municipality should lean on their local bar and restaurant understanding to determine potential revenue disruption.

Business & Income Taxes

April's business activity taxes fell dramatically year over year. Department of Finance and Administration Commissioner Butch Eley noted that the extended filing deadline for Business, Hall, and F&E taxes caused the under-collection. In general, local governments do not share in the F&E tax; however, local governments levy the business tax and receive a portion of what remains of the Hall Income tax.

The business tax replaced the Hall Income tax in aggregate importance to municipal budgets in recent years and is now potentially a top five revenue source for municipalities. The business tax is a gross receipts tax so as business revenues grow municipal revenues grow. Under state law, the business tax is due the 15th day of the fourth month following the end of a business's fiscal year. For example, if a business operated on a calendar-fiscal year then they would complete their fiscal year on December 31 and their business tax would be due by April 15. Many businesses operate on a calendar-fiscal year so April was generally the largest collection month.

In mid-March, the state extended the business tax filing deadline to June 15. This extension delayed revenue collections for two months and the lack of current data impacted local government ability to budget business tax revenues for the fiscal year beginning July 1, 2020. As restrictions relax and businesses can re-open, municipalities should monitor their local businesses and account for potential permanent closures as they prepare business tax revenue estimates.

Macro-economic Commentary

This week, the **U.S. House** leadership introduced the HEROES Act. If passed, it would provide $375 billion in direct local aid to be split 50/50 between cities and counties regardless of population. Under the provisions of the bill as introduced, 70% of the municipal allocation will go to entitlement cities (>50k people) and the remaining 30% will be given to states to be distributed to non-entitlement cities. The prospects in the **United States Senate** appear uncertain at best. In addition, the state has not decided how it will distribute the majority of the $2.4 billion from the CARES Act that is available for local governments, but additional guidance may be forthcoming.

The COVID disruption pushed the April consumer price index down by its largest amount since the 2008 Great Recession. In addition, month-over-month “core” prices fell by the largest amount on record. While the basket of goods proportioning that CPI is based upon is not reflective of last month’s consumer activity so price increases or reductions in one industry may over-weigh the total, deflation became a concern because recent inflation levels were low. The prospect of deflation may severely hamper the economy. Deflation occurs when prices fall. Initially, deflation sounds good for consumers; however, deflation is not as good for businesses because it reduces revenues. Revenue reductions impact the ability to make ongoing payments, particularly on debt service which is generally not as flexible as other payments such as to vendors or employees. According to the St. Louis Federal Reserve, corporate debt is at historically high levels. Price reductions may reduce revenues and impact the ability for businesses to make their debt service payments. This may lead to corporate defaults or additional bankruptcies.

Nationally, job losses continued at extraordinarily high levels this week. The U.S Department of Labor reported another 3 million new weekly claims for the week ended May 9. The advance insured unemployment rate was 15.7% with the four-week average insured unemployment claims increasing by 2.7 million to 19.76 million. The new claims were lower than prior weeks; however, with nearly 37 million jobs lost over the last eight weeks nearly one-quarter of people employed in February have lost their jobs.