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# The Effects of Uncertainty on Local Government Budgeting: A comparative analysis of two Kentucky counties' responses to budgetary uncertainty

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# **The Effects of Uncertainty on Local Government Budgeting**

A comparative case analysis of two Kentucky counties' responses to budgetary uncertainty

**Alyshia Powell**

## **Executive Summary**

Congress must pass twelve separate appropriations spending bills by October 1<sup>st</sup> to enact the annual federal budget. Since 1974, Congress has only passed the federal budget by the beginning of the fiscal year four times (Draper and Pitsvada 1984). Continuing resolutions are utilized to help fill the gap until Congress and the President can agree upon a budget, but they often come with delays in funding of federal programs. Because the appropriations process also funds many state and local revenue sources, any delays or cuts caused by a continuing resolution can have significant effects on their budgeting processes as well.

To determine the impact of spending decisions made at the federal level on the local budgetary process, I have prepared a comparative case analysis of two similar federal programs in two Kentucky counties. I chose to study the Impact Aid program administered through the Department of Education and the Payment in lieu of taxes (PILT) program administered through the Department of the Interior, as they both compensate local governments impacted by the presence of federal land within the county. Federal land cannot be taxed, and thus these local governments lose out on tax revenue that is essential to funding public services for their citizens.

To localize this study I analyzed the two aforementioned programs' importance to the two Kentucky counties that receive the greatest levels of funding, Hardin County and McCreary County. Studying Impact Aid in Hardin County and PILT funding in McCreary county gave the best insight into the significance of these programs and how the federal appropriations process impacts the amount and timing of this funding to the counties.

Through analysis of local budgets and interviews with key budget officials, I was able to determine how the federal budgetary process impacted Impact Aid and PILT funding in the Kentucky counties. Continuing resolutions cause uncertainty as Impact Aid is distributed in

multiple payments to the Hardin County School District, whereas PILT funding has fallen victim to sequester and cuts that often come with non-mandatory spending programs. The inconsistency in the time and the amount of the funding makes it difficult for the county to plan and budget.

Ultimately, I found that Impact Aid and PILT funding constitute a small percentage of revenue for the respective local budgets, but in combination with other federal transfers, make a large difference at the margin. Uncertainty from continuing resolutions and delays in the federal budgetary process can cause local governments to alter contingency funds, prioritize their expenditures and/or think about increasing local taxes in order to compensate for the inconsistency in transfer amounts and timing.

## **Introduction**

According to the United States Constitution, Article 1 Sections 7 and 9, Congress has the “power of the purse” giving the legislative body the responsibility to create the annual budget. Congress is tasked with passing twelve appropriation-spending bills by the beginning of the fiscal year on October 1<sup>st</sup>. Appropriations bills allocate funding to agencies, grant assistance programs, and provide funding to state and local governments. For a variety of reasons, the annual budget has only passed by the beginning of the fiscal year four times since the 1970s (Tollestrup 2014). Thus, the annual budget is likely to come in alternative forms such as an Omnibus spending bill, a Continuing Resolution (CR), or supplemental appropriations bills.

The Congressional appropriations process has significant implications down to the state, and even local level. Any uncertainty and inconsistency associated with federal funding impacts the budgetary planning of state and local governments. Studying how uncertainty impacts local government spending decisions can help those involved at the federal level understand the implications of their budgetary decisions. Understanding how different agencies, governments, and localities react to the uncertainty can also serve as a teaching mechanism for other similar agencies experiencing uncertainty that can come in many different forms.

In this paper I demonstrate the implications of budget uncertainty by studying two specific federal programs and their impact on two Kentucky counties. I first review the current research on budgetary uncertainty caused by the federal appropriations process and how local governments across the country are responding to this budgetary uncertainty. Next, I introduce two federal programs, the Department of Education’s Impact Aid program and the Department of the Interior’s Payment in lieu of taxes (PILT) program, which I study in context of the two Kentucky counties that receive the most funding from these programs. I end with a comparison

of the two cases, which leads to a policy recommendation based on the sources of uncertainty associated with the two federal programs of interest.

### **Review of Related Literature**

The federal budgetary timeline has evolved over the course of American history. Originally, the fiscal year was aligned with the calendar year, but Congress struggled to pass appropriations bills by the beginning of the fiscal year. In 1790, the second appropriations act extended the beginning of the fiscal year to July 1<sup>st</sup> and then to October 1<sup>st</sup> via the Budget and Impoundment and Control Act of 1974. Since then, there have only been four years that Congress and the President were able to pass a regular appropriations act by October 1<sup>st</sup> (Draper and Pitsvada 1984).

In order to limit uncertainty for federal funding recipients, the continuing resolution is the budgetary tool used in absence of an appropriations act that extends funding temporarily, or long term in some instances. As Tollestrup notes, “between fiscal years 1998 and 2010, Congress enacted 79 continuing resolutions which averaged 18 days in duration and ranged in length from 21 to 365 days” (2014). The agencies that receive funding had to adhere to previous year funding levels or those specifically changed by the temporary resolution.

Programs that are not considered mandatory spending bring with them great uncertainty for local governments. As a discretionary spending fund, the program has potential to be eliminated or cut back significantly (Corn 2015). State and local governments that depend on discretionary funding as revenue are responding to the potential for significant cuts in federal grants and payments by reassessing their tax structures and providing lower quality public services. Chrissie Long (2013) of Harvard’s Kennedy School of Government also notes that,

depending on how drastic federal cuts become, the credit rating of local governments could suffer, which would greatly increase their borrowing costs.

### **Federal Budgetary Process**

Funding for many federal programs is appropriated in an annual process conducted by Congress. The Congressional appropriations process provides up to thirty-nine percent of total federal spending, with the remainder of funding coming from mandatory spending and debt payments that are established by House of Representatives and Senate committees (Tollestrup 2014). At the beginning of February the President submits a budget proposal, which begins the appropriations cycle. By April, Congress will have reviewed the President's proposal and will have formulated a resolution. From April to October, the authorization measures as well as the twelve appropriations bills will go through committee and floor consideration, and if not enacted by the beginning of the fiscal year (October 1<sup>st</sup>), the process will continue into the remaining months of the calendar year, usually in the form of a continuing resolution.

### **Local Budgetary Process**

Kentucky is one of thirty-nine states that apply Dillon's Rule of Law to all local governments and municipalities (National League of Cities 2015). According to Dillon's Rule, local budgetary processes are outlined and enforced through the state government. In Kentucky, the Department for Local Government's Office of Financial Management and Administration produces a budgetary guideline for counties that includes a submission timeline as well an outline of preparation procedures. For Kentucky counties, budgets must be submitted to the fiscal court by May 1<sup>st</sup>. The fiscal court will then meet to consider and investigate proposed expenditures and send all recommended changes to the county Judge Executive by June 1<sup>st</sup>. The

budget is then to be adopted no later than July 1<sup>st</sup>, which is the beginning of the fiscal year for Kentucky and its county governments (kydlg.org 2016).

According to this schedule, the county government should know how much to budget for federal revenue by May 1<sup>st</sup>. County governments operate on a different fiscal year and thus must know how much Congress has allocated to the state and their locality in order to accurately estimate revenues. With continuing resolutions, there is a greater level of uncertainty that can impact how local governments plan and budget.

### **Federal Programs of Interest to Local Governments**

Congress appropriates funds each year to states that contain a significant amount of federal land within their borders. While the federal land can increase tourism and environmental quality, it can also have significant implications on local budgets given its tax-exempt status. State and local governments are faced with the struggle to provide quality education and public services to citizens who are exempt from contributing to the revenue stream that comes from property taxes. To compensate for this loss in revenue, the federal government has implemented several assistance programs, including the Department of Education's Impact Aid Program and the Department of the Interior's Payment in lieu of taxes program.

While the concept of these two programs is the same, they do have distinguishing characteristics. The Department of Education's Impact Aid is distributed to public school districts that educate students who reside on military bases. Because the families live on base, they do not pay the local property tax, which is generally one of the main sources of educational revenue for local school districts. The Department of the Interior's similar program, Payment in lieu of taxes (PILT), distributes payments to local governments that lose out on property tax

revenue from federal lands within their jurisdictions. Property tax revenue is generally used to provide the basic services such as safety, utilities, and infrastructure maintenance and repair.

To localize the study of these two programs, I will focus on the two Kentucky counties that receive the most Impact Aid and PILT funding. Studying the counties that receive the most funding from these programs will show how great of an impact these revenue streams can be to local governments. It will also show how delays or inconsistencies impact the decisions that the local school district and government must make. The two counties to be studied are Hardin County, which receives the most Impact Aid as home to Fort Knox, and McCreary County, located in the foothills of the Daniel Boone National Forest.

### **Case Study One: Impact Aid in Hardin County School District**

The Impact Aid Program is administered through the United States Department of Education as part of the eighth appropriations bill that funds Labor, Health and Human Services, Education and related agencies (Tollestrup 2014). The federal government has distributed Impact Aid for the past fifty years in order to make up for the influx of public school enrollment that a military base can bring to a local community without expanding its tax base. Local education agencies (LEAs) across the country currently receive over \$900 million per year in subsidies to help educate 1.2 million federally connected students, including those living on military bases (Buddin, Gill & Zimmer 2004).

### **History**

The Impact Aid program was officially established as part of the Elementary and Secondary Education Act of 1965, Title III. This law has been amended and tweaked several times since its inception in 1950 because of the changes in school finance. The funding for the

aid was increased sharply in the 1960s-1970s but was then cut in half beginning in early 1980 (Buddin, Gill & Zimmer 2001). After suffering further cuts along the way, the current funding levels resemble that of the 1980s and Impact Aid has expanded eligibility to include students of federal employees, students living in low-rent housing, and children living on Indian lands. Children who live on a military base but attend the local public school account for around thirty-six percent of the Impact Aid funding (Buddin, Gill & Zimmer 2004).

School districts that receive Impact Aid can use the funding to cover a wide variety of expenses within the boundaries of the state and local educational requirements. The funding can be used for capital expenses, teacher salaries, textbooks, equipment, and special learning programs. The funding eligibility for the Impact Aid Program depends on the amount of funding appropriated by Congress, as well as the number of eligible school districts and the number of federally connected students.

### **Allocation of Funding**

When the Impact Aid program is fully funded, the aid is allocated based on a formula that assigns weight to the different categories of students. For instance, students living on base would receive one weight, and a student who lives on base but also has a learning disability would be given a greater weight (Annis 2016). Funding would then be distributed in proportion to the number of federally connected students in the district. However, if the program is not fully funded, the Impact Aid resources are only sent to the districts with the highest weighted concentration of federally connected students.

Each September, parents of military children are asked to fill out and return a source form to their local school district so it may submit a comprehensive report to the Department of

Education who then distributes Impact Aid. School districts submit the report by January in order to become eligible for funds for the next fiscal year.

The distribution of Impact Aid payments is dependent upon the federal budgetary process. In an interview with Alfred Lott (2016), Director of the Office of Impact Aid Programs under the Department of Education, he noted that the first round of payments are processed around October 1<sup>st</sup>, but are usually prorated given that continuing resolutions have become the norm. Continuing resolutions prevent the agency from knowing exactly how much they will be allocated for that fiscal year. Once a budget is finally passed, a second round of payments is distributed to the local school districts to make up for the difference in how much they were eligible for, and how much the agency was able to distribute as a result of the continuing resolution. Finally, there may be additional payments distributed as they close out previous years' funding. If there is remaining funding left as they close previous fiscal years out, the Department of Education will distribute those funds among the 1,200 schools based on the concentrations of weight determined by the submitted reports. The agency usually closes one or two previous fiscal years within the current fiscal year. This means as many as four to five payments are likely to be distributed within a given fiscal year, and the timing is uncertain because the agency is dependent upon the passing of the federal budget.

### **Impact Aid in Hardin County School District**

I chose to study Impact Aid in the context of Hardin County, Kentucky as it is the school district receives the highest amount of this funding in the state from the Department of Education. Hardin County is home to Fort Knox, which is an Army post located south of Louisville that covers over 109,000 acres and three different counties. Hardin County Schools educate over 14,000 students in grades kindergarten through twelfth grade, including over 1,300

that are federally connected (Lewis 2016). These 1,300 students have parents who work at Fort Knox as either non-active military personnel or in a civilian capacity on base. Because of the connection to the base, these students qualify the district for Impact Aid from the Department of Education.

The amount of funding the county receives is based on self-reported data. Hardin County schools designate a day in September to send source forms home with students to fill out and return. According to an interview with Hardin County Director of Student Services, Brian Lewis, around forty to fifty percent of students return the form by the specified day in December. Mr. Lewis said that every year around 12,000 forms are sent out, and the school district only receives Impact Aid based on the average 5,000-6,000 returned forms.

On the source form, the students' parents are asked if their student or family fits several different categories. The students' whose parents live or work at Fort Knox (or any other military post) with both non-active and civilian status are assigned a "weight", but Mr. Lewis did note that students who fit these categories and have learning disabilities are weighted heavier (Lewis 2016). Students with active-military parents are required to attend schools through the Department of Defense and therefore are not assigned a weight. Impact Aid is also given to the school district for students whose parents work or live in a federal government building, including the Veterans Administration Hospital, Louisville Airport, or government subsidized housing through the Department of Housing and Urban Development. Table 1.1 below is an example of the report submitted from Hardin County School District to the Department of Education that shows a breakdown of the different classifications of students.

**Table 1.1  
Hardin County Schools  
Impact Aid  
2015-16**

<i>School</i>	<i>Military</i>	<i>Ft. Knox</i>	<i>Fed. Bldg.</i>	<i>VA Hosp.</i>	<i>Bluegrasses AD</i>	<i>Standiford Field</i>	<i>Ft. Campbell</i>	<i>Sp. Ed. Military</i>	<i>Total</i>
Central Hardin	27	57	1	1				3	89
John Hardin	39	40		3				3	85
North Hardin	48	79		2				5	134
Bluegrass	32	45		3				3	83
East Hardin	11	13	1	2		1			28
JTA	50	74		3				1	128
North MS	13	8						1	22
West Hardin	10	10						1	21
Creekside	6	11						6	23
GCB	40	26							66
Heartland	36	30		3				3	72
Howevalley	3	3							6
New Highland	30	46	1					6	83
Lakewood	8	17						2	27
Lincoln Trail	17	23		2				3	45
Meadow View	44	29		1				7	81
North Park	24	22		2				6	54
Radcliff	13	22						1	36
Rineyville	37	69		1				8	115
Vine Grove	45	53			1	2		7	108
Woodland	13	22		1					36
Brown St.									
<b>Totals</b>	546	699	3	24	1	3		66	1342

*Based on report generated by Brian Lewis, Director of Student Services for Hardin County Schools.2015.*

While Impact Aid makes up a small portion of the Hardin County School District's budget (less than five percent of general fund revenue) the federal appropriations process has affected the consistency of payments. Impact Aid is funneled into the school district's general fund, which is used for daily operations and functions. In 2015, the actual total amount of Impact Aid funding totaled just over \$194,000, while the budgeted amount was \$300,000. This \$105,000 difference may not seem significant, but when actual revenue totals in the general fund do not match the budgeted revenue, it impacts the school district's spending decisions.

With federal funding averaging around ten percent of total revenue, any inconsistency from year to year is difficult to manage. In an interview with Hardin County Schools Finance Director Jessica Annis, she noted that the fiscal year for the Hardin County School District goes from July 1<sup>st</sup> to June 30<sup>th</sup>. This presents a problem, as it has become the norm for Impact Aid to be dispersed in different months and in different amounts each fiscal year as a result of continuing resolutions at the federal level. Since 2011, the Hardin County School District has budgeted, on average, around \$250,000 in federal Impact Aid from the Department of Education each fiscal year. This number is based on the estimated funding levels of the program combined with the estimated number of forms that will be returned. In table 1.2 below, the budget amount of Impact Aid is shown alongside the actual amount that was distributed, along with the total number of payments that were made to reach the actual amount for fiscal years 2011-2016.

**Table 1.2**  
**Impact Aid to Hardin County School District**  
**FY 2011-2016**

Year	Budgeted Impact Aid	Actual Amount of Impact Aid	Difference in Actual vs. Budgeted	Total Number of Payments Distributed
<b>2011</b>	\$250,000	\$473,350	\$223,350	4
<b>2012</b>	250,000	497,440	247,440	4
<b>2013</b>	300,000	514,329	214,329	9
<b>2014</b>	300,000	262,308	(37,692)	2
<b>2015</b>	300,000	194,016	(105,984)	4
<b>2016</b>	200,000	86,470 (so far)	(113,530)	3 (so far)

*Based on report created by Jessica Annis, Finance Director of Hardin County Schools. 2016.*

The table supports a point that Annis made in the interview: staff try to estimate the amount of Impact Aid that will be budgeted but can never count on the previous year as an accurate reference. In 2011 and 2012, the school district budgeted \$250,000 and received almost double that in actual Impact Aid funding from the Department of Education. The finance staff then felt comfortable increasing budgeted amounts to \$300,000, which was a good estimate for FY 2013, but then the next two years saw negative discrepancies between the budgeted and actual amounts that altered their estimates for FY 2016. As this is only one program that makes up the total state and federal portion of general fund revenue, when there are several programs with fluctuating payments and payment schedules, the school district is faced with difficult decisions on how they will respond.

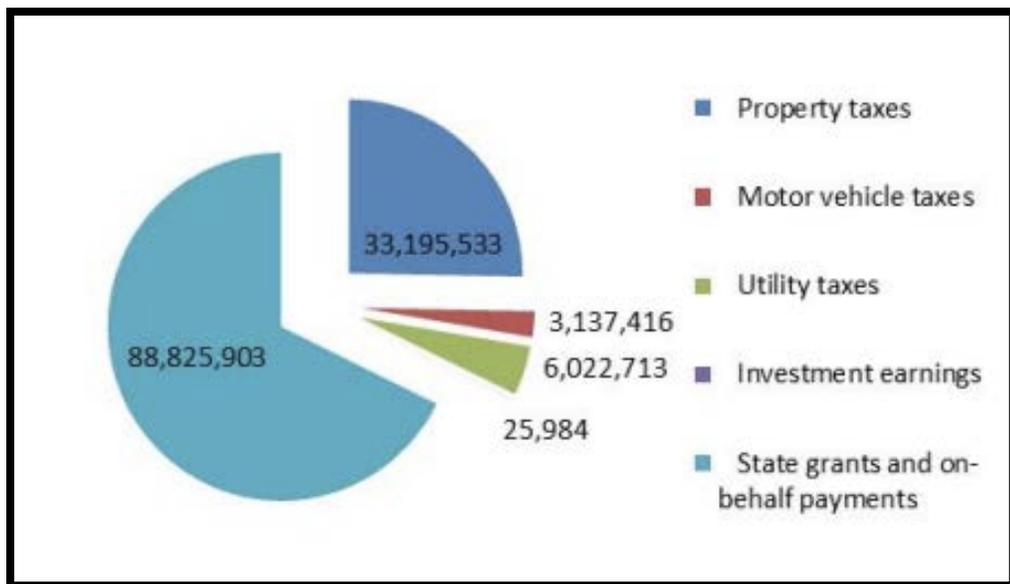
An additional concern of the Impact Aid is the number of payments that are distributed within the fiscal year in order to reach the actual total program funding the school district receives. As Table 1.1 indicates, in fiscal year 2013, over nine separate payments were distributed; totaling over \$200,000 more than budgeted. While in fiscal year 2014, there were only two payments made, totaling almost \$40,000 less than what the school district had budgeted. Because the school district cannot accurately estimate the amount and timing of the Impact Aid, Annis stated that the school district, cannot count on this funding as a reliable source of general revenue stating “ we can’t bank on receiving any funding”.

When budgeted general revenue totals are less than actual revenue totals, adjustments must be made to account for the difference in order to cover budgeted expenditures. For the Hardin County School District, in response to the uncertainty regarding federal funding in general, specifically Impact Aid, they increase their contingency fund. By state law, school districts must have a two percent contingency factored into their budget. Contingency funds are

dollars set aside to cover the uncertainty, and are used in the case of actual revenue totals that are less than budgeted totals or for expenditures that exceed budgeted totals. The contingency fund cannot be used until the end of the fiscal year, but is usually rolled over to the following year. In fiscal years 2005 and 2006, contingency was set slightly above the two percent minimum, and has increased to as much as five percent contingency in fiscal year 2014. Most recently the Hardin County School District adopted a three percent contingency for fiscal year 2015.

Ms. Annis noted that while Impact Aid has been inconsistent, the greatest level of uncertainty for the Hardin County School District comes from inconsistency at the state level. Most of this uncertainty comes from the fluctuations in on behalf payments that reimburse school districts for personnel health costs, retirement costs, and district-wide technology

**Figure 1.1**  
**Hardin County School District Revenue Breakdown**  
**FY 2015**



*From BASIC FINANCIAL STATEMENTS, SUPPLEMENTARY INFORMATION, AND INDEPENDENT AUDITOR'S REPORTS. FY ending June 30, 2015.*

Figure 1.1 above shows a breakdown of the Hardin County School District's revenue sources for FY 2015. This figure is included in the school district's annual financial report, and state grants and on behalf of payments have constituted the greatest portion of revenue for over ten years, thus any fluctuation or delays in this funding can significantly impact the school district's spending decisions (kydlg.gov 2015).

### **Case Study Two: Payment in lieu of taxes in McCreary County**

The second program of interest in this study is the Payment in lieu of taxes program. Vast swathes of the country host Department of Interior, Bureau of Land Management, and National Forest lands. These federal lands cannot be taxed, thus the PILT program is designed to support county and municipal governments that lose property tax revenue due to the presence of federal lands in their jurisdictions. Similar to Impact Aid, these payments are thought to compensate for the fact that local governments must supply public services to those who live on federal land, without proportionally expanding the county's tax base. The PILT program has been critical to local governments out west, and has been especially beneficial to those eastern Kentucky counties in the foothills of the Daniel Boone National Forest.

#### **History**

Before 2008, PILT payments were funded by annual appropriations. As a result of the Emergency Economic Stabilization Act, mandatory funding of the PILT program was authorized for years 2008-2012. Authorized funding for the program was extended in 2013 as a result of the 21<sup>st</sup> Century Act; however, there was a sequestration of around five percent of funding for the program later that year. Full funding of the PILT program was renewed as a result of the Agricultural Act of 2014. Congress approved discretionary funding in the amount of \$372

million with the Consolidated and Further Continuing Appropriations Act of 2015 for PILT funding in fiscal year 2015 (Corn 2015).

### **Eligibility**

Assuming that Congress appropriates funds to the PILT program, payments are made to local governments based on a complex formula. Five factors ultimately affect the calculation of payments to those areas: the number of eligible acres, county population, previous years payments from other federal land programs, state laws and the Consumer Price Index (Corn 2015).

### **Acres of Eligible Land**

Per Section 6904 of the PILT law, there are nine categories of eligible federal land. The categories include: lands in the National Park System, lands in the National Forest System, lands under the jurisdiction of the Bureau of Land Management, lands used for federal water development projects, lands in the National Wildlife Refuge System, Dredge Disposal areas under the US Army Corps of Engineers jurisdiction, lands located in the area surround the Purgatory River Canyon and Pinon Canyon that were acquired to expand the Fort Carson military reservation, lands with semi-active or inaction Army installations used for mobilizations and for reserve component training, and specific lands acquired by the Department of the Interior or the Department of Agriculture under the Southern Nevada Public Land Management Act (Corn 2015).

### **Population**

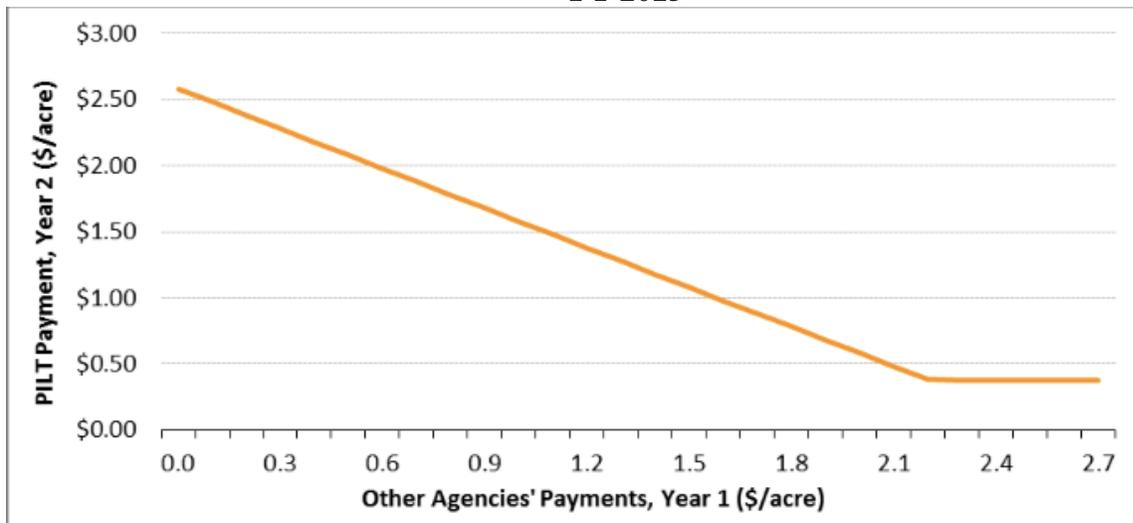
Another factor in determining how much PILT funding a county is eligible for is population. There are different levels of payment based on county population; as the population increases so too does the amount of PILT funding. Counties with lower populations receive

higher amounts of funder per-person than counties with higher populations. There is a maximum payment each year, which in turn limits the population size the Department of the Interior will recognize. This penalizes counties with larger populations (Corn 2015).

### **Prior Year Payments from Federal Agencies**

In an effort to even out payments across counties, payments from other federal agencies on behalf of the federal land are taken into account when calculating PILT funding. There are several state programs and other federal programs that help compensate localities for the loss of property tax revenue, and these are all factored into the PILT formula. All prior year payments are subtracted from the following year's PILT funding. The standard rate, as this offset is called, indicates that as payments from other sources increase, there is a proportional decrease in PILT funding. However, Congress wanted to ensure that all eligible counties received some funding, so there is a minimum rate that is distributed no matter the total of other agency payments. This is shown graphically in Figure 2.1 below.

**Figure 2.1  
PILT Payments versus Other Agency Payments  
FY 2015**



Corn, Lynne M. 2015. *PILT (Payments in Lieu of Taxes): Somewhat Simplified*. Congressional Research Service Report: 10. Washington, D.C

The flat portion of the graph shows that regardless of the amount of funding from other agencies, in fiscal year 2015, all eligible counties received at least \$.037 an acre in PILT funding

### **State Law**

Kentucky requires PILT funding to come through the state to then be distributed to counties. Other states require the funding to pass through the county government to some other entity such as the local school board. The funding distributed to the local entities are not considered in the PILT formula meaning that counties in a pass-through states do not have to deduct the funding from their previous year's payment. To regulate the funding and help ensure that pass through states are receiving correct payments, every governor is expected to submit a report to the Secretary of the Interior that shows all funding to counties. The Department of the Interior also does its own auditing to ensure that payments from other agencies are reported accurately as this impacts future funding (Corn 2015).

### **Consumer Price Index**

PILT funding levels are required to be adjusted for inflation by a 1994 addition to the law. Each year the minimum payment and the ceiling payment are adjusted to reflect the Consumer Price Index as reported by the Bureau of Labor Statistics. PILT funding is unique in that its levels of funding are adjusted annually as no other federal land program is required to account for these changes (Corn 2015). Because of this, the amount of the PILT funding will continue to rise (indicated by the flat portion of the graph in figure 2.1) each year, regardless of other agencies' payments.

### **Calculation of Payment**

The PILT formula is based on two options, either the standard option or the minimum provision. The standard option takes the lesser of either the county's eligible land multiplied by

the per-acreage funding level, or the ceiling funding level based on a county's population. The lesser amount is then subtracted by the total of the previous year's federal agency payments. The minimum provision is calculated by taking the lesser of either the county's eligible acreage multiplied by the minimum per-acre funding level or the level of payment based on the county's population. The minimum provision is used for those counties who had significant payments from other agencies in the last year. The county is eligible for whichever calculation is greater (Corn 2015).

All 2,254 eligible counties must submit a report of relevant data to the Secretary of the Interior in order for the agency to determine the exact authorization amount for the following fiscal year. As previous years have shown, PILT payments are susceptible to sequesters and cuts, so this uncertainty along with the fact an exact dollar amount of funding is not usually available right around the beginning of the next fiscal year can severely impact a local government that depends on the federal funds to provide basic services to its residents.

### **PILT Funding in McCreary County**

In analyzing the impact of PILT funding in Kentucky, I chose to study McCreary County, which receives the highest amount of PILT funding from the Department of the Interior. McCreary County is located in southeastern Kentucky and is home to the Daniel Boone National Forest and the Big South Fork National River and Recreation Area. The federal government owns over sixty percent of McCreary County, with the National Forest Service (NFS) and the Department of the Interior owning over forty percent combined (Judge Stephens 2016). There is also a federal prison in the county, Tennessee Valley Authority (TVA) projects, and Lake Cumberland, which is owned by the National Parks Service (NPS).

Over the past ten years, up to ten percent of the annual county budget came from in lieu of tax payments, which compensate for the lost tax revenue from the aforementioned federal lands. The PILT payments are found on the McCreary County budget as part of general fund revenues and are categorized as In Lieu Tax Payments. Along with the PILT payments from the Department of the Interior, the county also receives some in lieu of taxes revenue from the State Treasurer's office for TVA projects as well as PILT funds from the UFS (McCrearycounty.com 2015). Table 2.1 shows McCreary County's in-lieu-of-taxes revenue for the past ten years.

Total revenue has remained relatively steady throughout the past ten years, with 2010 as the anomaly. Tax revenue along with intergovernmental payments significantly decreased in 2010, causing total revenue to decrease to  $\frac{1}{4}$  of the previous year's total. The decrease in total revenue caused the in lieu of taxes revenue to constitute a higher percentage of the total, which explains why the percentage increased from twelve percent of total revenue in 2009 to twenty-eight percent in 2010.

In an interview with McCreary County Judge Executive Douglas Stephens, he stated that in lieu of payment revenue as a whole has remained relatively constant over the past five years. For the past five years, revenue from the TVA and USF has remained, on average, around \$65,000 and \$95,000 respectively. It is the Payments from the Department of the Interior that tend to fluctuate more, most recently experiencing a fifty-six percent increase from fiscal year 2013 to fiscal year 2014 (McCreary.gov 2015). In 2013, the program experienced a sequestration, while in 2014 it was fully funded. Judge Stephens said PILT payments are generally received in June, and the fiscal year begins July 1<sup>st</sup>. He noted that the county does wait anxiously to see if that money will be appropriated at the end of the authorizing period, as PILT funding has been up for re-authorization several times in the past ten years.

**Table 2.1**  
**McCreary County In Lieu of Taxes Revenue**  
**FY 2007-2015**

Year	In Lieu of Taxes Revenue	Total Revenue	% of Total Revenue
<b>2007</b>	\$448,985.36	\$6,342,449	7.08
<b>2008</b>	331,433	8,649,292	3.38
<b>2009</b>	1,041,492	8,255,323	12.62
<b>2010</b>	748,127	2,600,439	28.77
<b>2011</b>	720,081	6,509,940	11.66
<b>2012</b>	688,510	6,631,447	10.38
<b>2013</b>	733,943	7,534,806	9.74
<b>2014</b>	745,772	6,509,952	11.46
<b>2015</b>	641,620	7,147,875	8.98

*Created using audits from the Kentucky Department of Local Government for FY 2007-2015.*

In a small county that averages around a \$7 million budget, I asked Judge Stephens how McCreary County handles the uncertainty that can come from these federal programs being held up or cut back as a result of the Congressional appropriations process. Judge Stephens noted that declines and uncertainty surrounding federal funding are having a huge impact on the county's ability to provide public services for its citizens. He also noted that it has been difficult for the county to predict PILT funding as well, which has resulted in a prioritization of expenditures based on the funding level. As a leader over the county budgetary process, Judge Stephens said that in the future there may be need to increase taxes should PILT and other federal funding continue to dwindle. He also mentioned that he will continue to lobby Congress for this in lieu of taxes funding that impacts the county's general revenue fund.

In discussing budgetary uncertainty with Judge Stephens, he brought up a federal program that is impacting the county most, the Secure Rural Schools (SRS) funding program through the U.S. Forest Service, which is a branch of the U.S. Department of Agriculture (USDA). The Secure Rural Schools and Community Self-Determination Act of 2000 gave funding to rural counties with federal land to help with education costs and road repairs. In 2015, around \$285 million was authorized and distributed to over forty-one states. The funding from this program must be used for specific purposes. Judge Stephens said that when the county receives SRS funds, it immediately writes a check for fifty percent of the funding to the McCreary County School District and the other fifty percent goes into the road budget as federal revenue.

It is the SRS payments that lead to the greatest level of uncertainty, which makes it hard for the county to plan and budget. Judge Stephens noted that SRS payments have declined almost

every year since 2000, mainly because the act has been up for renewal several times since it originally expired in 2000. The uncertainty surrounding SRS funding is making it difficult for the county to maintain its roads; over ¼ of the county's 400 miles of roads are paved as chip and seal because the county cannot afford pavement and gravel. Judge Stephens noted that the uncertainty surrounding SRS revenue for the road fund has the county looking into the future to plan for alternative revenue sources for the road fund.

### **Comparison of Case Studies**

Important to the analysis of the two cases is a comparison of the program themselves as well as the counties' responses to the uncertainty of the programs' funding. A comparison of the programs presents the opportunity to determine best practices in how the funding is calculated and distributed. Comparison of the counties' response to uncertainty of the program funding can help counties facing uncertainty (of any kind) in the future.

### **Comparison of the Federal Programs**

The Impact Aid Program and the PILT program are alike in their intent to compensate local governments and school districts that are impacted by the presence of federal land in their area. The tax-exempt federal land leads to a loss in property tax revenue, which goes into the general fund that is used to provide public services in counties, such as education. Both serve as just one source of federal revenue for most school districts and counties, but federal funding as a whole plays a pivotal role in the financing of day-to-day operations and long-term projects as it makes up around ten percent of total revenue for both the Hardin County School District and the McCreary County government. Any change in the funding amount of these programs does create a challenge for future planning.

**Table 3.1  
Comparison of Case Studies**

	<b>Hardin County Schools</b>	<b>McCreary County</b>
<b>Federal Program of Interest</b>	Impact Aid	Payment in lieu of taxes (PILT)
<b>Program funding as a percentage of general fund revenue (average from 2005-2015)</b>	<5%	<10%
<b>Funding formula</b>	Based on the return of source forms sent home with students	Based on a combination of acres of federal land, population, previous funding, state law, CPI and Congressionally appropriated funds
<b>Timing of transfer</b>	Multiple and unpredictable payments throughout the fiscal year	One lump sum at the beginning of each June
<b>Greatest cause of uncertainty</b>	Inconsistency in timing of transfer payments, and citizen participation in return of source forms	Inconsistency in the amount of payments from year-to-year
<b>Response to uncertainty</b>	Adjustments to the contingency fund	Priority budgeting and Congressional lobbying for PILT funding

The biggest difference between the programs is the way in which the payments are calculated and distributed. Impact Aid is distributed based on appropriated funding, and school districts are responsible for collecting their own data through returned source forms from students. PILT funding, also distributed based on appropriated funding, is determined using a formula that is based on a report from every county with eligible federal lands within their boundaries. There is an element of citizen participation in the formula of Impact Aid that is not present in the PILT formula, which increases the level of uncertainty the Hardin County School District must face.

The programs are different in their history of appropriations as well as the consistency in the amount and timing of the payments. Since 2008, PILT funding has been renewed several times. In recent years, such as 2013, PILT funding was subject to sequestration that reduced funding by over five percent. PILT payments have fluctuated in amount, which has caused uncertainty for local governments; however, the timing of the payments has remained around the first week of June, right in time for the beginning of the fiscal year, July 1<sup>st</sup>. Impact Aid has not experienced such uncertainty as to whether or not it will be funded. Impact Aid payments have remained relatively consistent in amount; however, they have been distributed in multiple payments due to the regular occurrence of continuing resolutions. Not knowing when to expect the Impact Aid has caused uncertainty for the Hardin County School District.

### **Comparison of County Response to Uncertainty**

The Hardin County School District and the McCreary County government did have different responses to budgetary uncertainty associated with the federal programs of interest. The Hardin County School District utilizes the contingency fund within their budget to account for any uncertainty. They are required to have a two percent contingency, but have increased it to

around five percent in the last five years. Use of contingency funds allows for a "cushion", so to speak, in case estimated revenues and expenditures do not align with actual totals.

McCreary County dealt with the uncertainty that came not only from the fluctuating amount of PILT funding, but also the threat of the program being eliminated through the Congressional appropriations process. Judge Executive Stephens says that the county has prioritized its spending so that projects or services at the top of the list are sure to be funded, and others towards the bottom will only be funded if the resources are available. He also said that the county joins with others receiving PILT payments to lobby their Congressman to advocate for the PILT program, as it is a critical source of revenue for those counties in the foothills of the Daniel Boone National Forest.

### **Conclusion**

From studying these two federal programs in two Kentucky counties, it is evident that federal transfers make up a small percentage of the local budgets, but make a large difference at the margin. There is also an added uncertainty for Impact Aid as a result of the citizen participation in returning the source forms. At the root of all uncertainty is the amount of funding that the federal government allocates for Impact Aid and PILT programs. Any delay in this decision-making caused by a continuing resolution can impact not only the amount of the payments received by the local governments from the federal programs, but also when the payments are able to be distributed.

In conclusion, I have one policy recommendation for the Department of Education. In order to reduce uncertainty associated with Impact Aid funding, I would recommend that the Department of Education communicate with other federal agencies, such as the Department of Defense and the Department of Veterans Affairs to get a more accurate count of federally

connected students within a school district. These agencies have data and records on their employees and their families, and gathering data this way would ensure a more accurate count of federally connected students as opposed to the school districts' report of only the returned source forms. The Hardin County School District is potentially receiving only half of what they are eligible for given that only forty to fifty percent of the source forms are returned. By communicating with other agencies that already have this data, the Department of Education can bypass the reporting phase of the local school districts and more accurately distribute Impact Aid funding to eligible school districts.

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