Understanding the Local Composite Index

Prepared By:

Fiscal Analytics, Ltd.

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Introduction

- The Local Composite Index (LCI) dates to the 1970's and purports to measure a locality's ability-to-pay for K-12 education.
- The LCI computes the locality's relative state share of three revenue capacity indicators – true market value of real estate (TVRE - 50% weighting), Virginia Adjusted Gross Income (VAGI - 40%), and taxable sales (10%).
- The capacity indicators are then divided by a localities' relative state share of school ADM (66.6%) and population (33.3%).
- Finally, the calculation is multiplied by 0.45 to get the relative 45% local/55% state weighted average share of SOQ costs.
- The result is the local composite index applied to the SOQ and other state education funding programs for local cost sharing purposes.

Introduction (Continued)

- There is an adjustment to the standard calculation for localities with non-resident income is above 3 percent of VAGI: in the 2022-24 biennium LCI, 36 localities have their LCI adjusted by removing non-resident income from VAGI.
- Except for sales tax distributions and select other non-SOQ accounts (such as the recently adopted one-time $419 mil flexible funding support), the vast majority of state K-12 aid is distributed thru the LCI. Therefore, nearly $7 billion in annual state aid to localities is currently influenced by the LCI.

COMPOSITE INDEX OF LOCAL ABILITY-TO-PAY FORMULA

Average Daily Membership (ADM) Component =

$$.5\left[\frac{\frac{\text{Local True Values}}{\text{Local ADM}}}{\frac{\text{State True Values}}{\text{State ADM}}}\right] + .4\left[\frac{\frac{\text{Local Adjusted Gross Income}}{\text{Local ADM}}}{\frac{\text{State Adjusted Gross Income}}{\text{State ADM}}}\right] + .1\left[\frac{\frac{\text{Local Taxable Retail Sales}}{\text{Local ADM}}}{\frac{\text{State Taxable Retail Sales}}{\text{State ADM}}}\right]$$

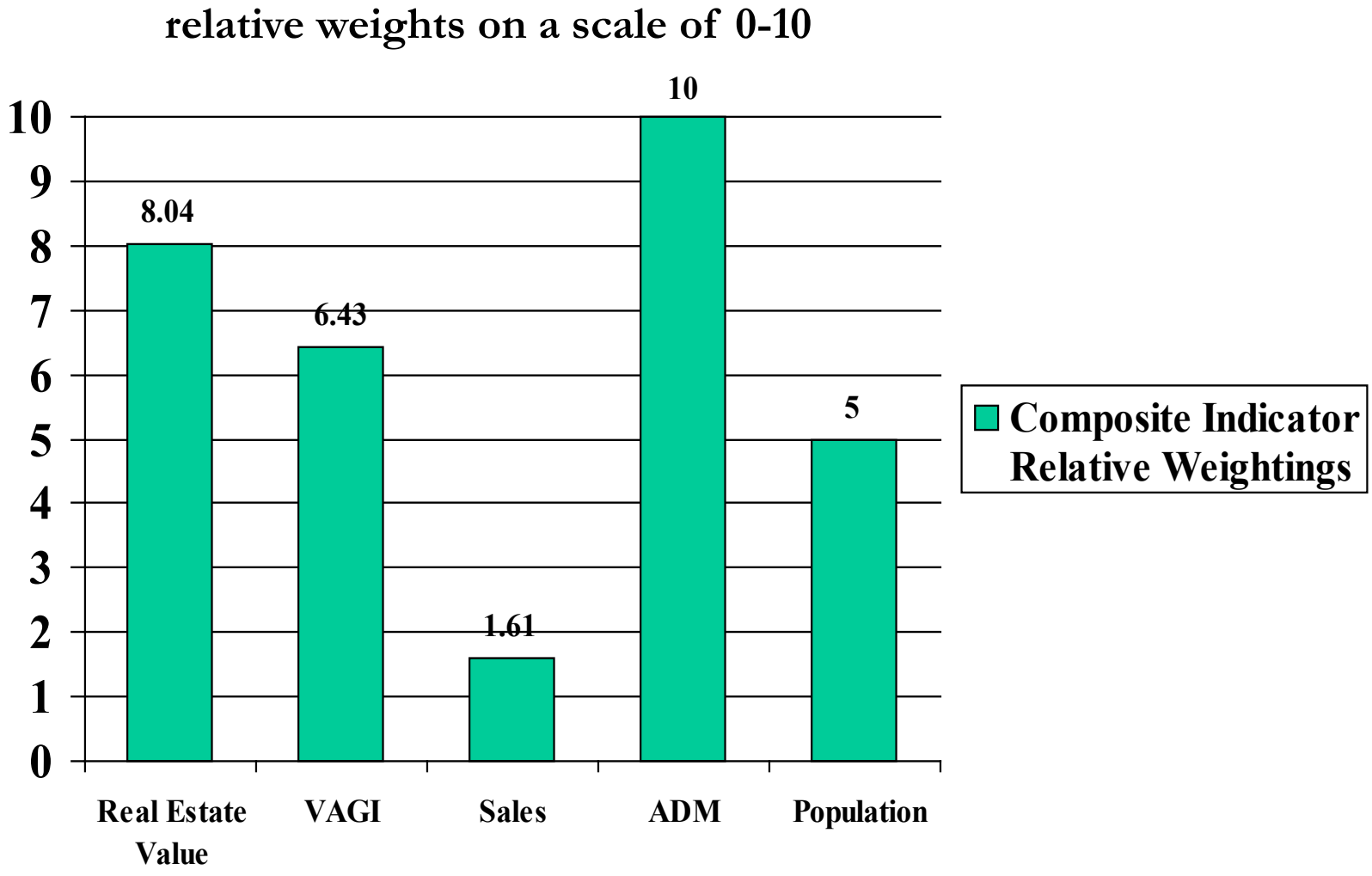
Population Component =

$$.5\left[\frac{\frac{\text{Local True Values}}{\text{Local Population}}}{\frac{\text{State True Values}}{\text{State Population}}}\right] + .4\left[\frac{\frac{\text{Local Adjusted Gross Income}}{\text{Local Population}}}{\frac{\text{State Adjusted Gross Income}}{\text{State Population}}}\right] + .1\left[\frac{\frac{\text{Local Taxable Retail Sales}}{\text{Local Population}}}{\frac{\text{State Taxable Retail Sales}}{\text{State Population}}}\right]$$

Final Composite Index =

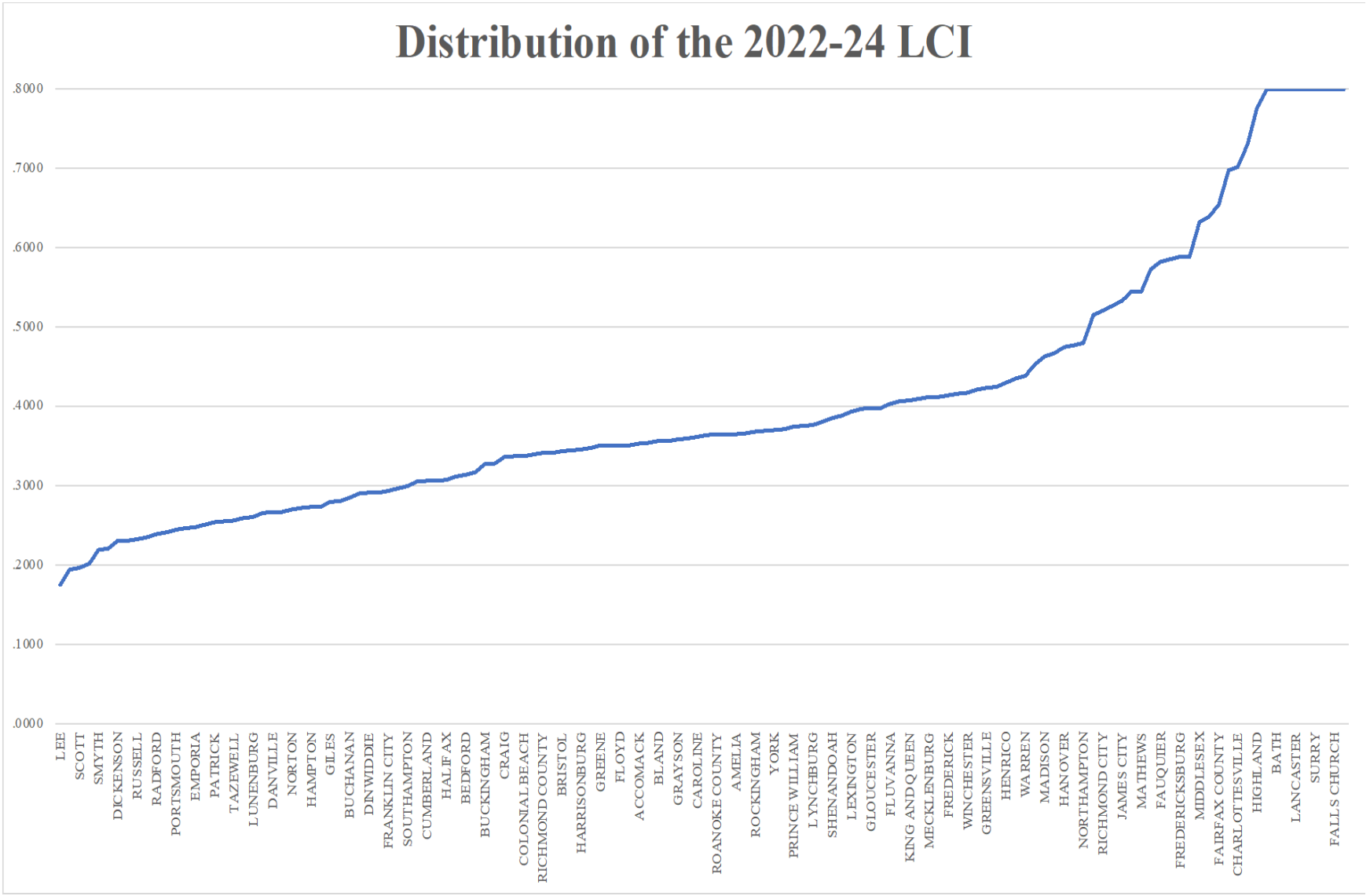
((.6667 x ADM Component) + (.3333 x Population Component)) x 0.45

ADM has a relative importance considerably higher than other indicators in the Composite Index --



36 localities have a special 2022-24 biennium adjustment due to non-resident income more than 3% of VAGI

	Unadjusted LCI	Adjusted LCI	Change		Unadjusted LCI	Adjusted LCI	Change
ACCOMACK	0.3527	0.3413	-0.0114	SURRY	0.8000	0.8000	0.0000
ALLEGHANY	0.2932	0.2900	-0.0032	WASHINGTON	0.3506	0.3402	-0.0104
BATH	0.8000	0.8000	0.0000	BRISTOL	0.3431	0.3058	-0.0373
BLAND	0.3561	0.3531	-0.0030	CHARLOTTESVILLE	0.7013	0.6952	-0.0061
BRUNSWICK	0.4349	0.4314	-0.0035	DANVILLE	0.2662	0.2524	-0.0138
CARROLL	0.2720	0.2696	-0.0024	FALLS CHURCH	0.8000	0.8000	0.0000
CHARLOTTE	0.2593	0.2551	-0.0042	FREDERICKSBURG	0.5882	0.5808	-0.0074
GRAYSON	0.3582	0.3526	-0.0056	GALAX	0.2664	0.2619	-0.0045
GREENSVILLE	0.4236	0.4067	-0.0169	MARTINSVILLE	0.2306	0.2223	-0.0083
HALIFAX	0.3076	0.3038	-0.0038	NORFOLK	0.3114	0.3064	-0.0050
HENRY	0.2211	0.2179	-0.0032	NORTON	0.2697	0.2655	-0.0042
LEE	0.1748	0.1714	-0.0034	PORTSMOUTH	0.2448	0.2413	-0.0035
MECKLENBURG	0.4114	0.4050	-0.0064	RICHMOND CITY	0.5203	0.5139	-0.0064
PATRICK	0.2534	0.2511	-0.0023	WILLIAMSBURG	0.7305	0.7217	-0.0088
PRINCE GEORGE	0.2467	0.2404	-0.0063	FAIRFAX CITY	0.8000	0.8000	0.0000
RICHMOND COUNTY	0.3411	0.3050	-0.0361	FRANKLIN CITY	0.2934	0.2858	-0.0076
SCOTT	0.1959	0.1893	-0.0066	CHESAPEAKE	0.3440	0.3403	-0.0037
SOUTHAMPTON	0.2993	0.2965	-0.0028	EMPORIA	0.2474	0.2388	-0.0086


Distribution of the 2022-24 LCI
.8000
.7000
.6000
.5000
.4000
.3000
.2000
.1000
.0000
LEE
SCOTT
SMYTH
DICKENSON
RUSSELL
RADFORD
PORTSMOUTH
EMPORIA
PATRICK
TAZEWELL
LUNENBURG
DANVILLE
NORTON
HAMPTON
GILES
BUCHANAN
DINWIDDIE
FRANKLIN CITY
SOUTHAMPTON
CUMBERLAND
HALIFAX
BEDFORD
BUCKINGHAM
CRAIG
COLONIAL BEACH
RICHMOND COUNTY
BRISTOL
HARRISONBURG
GREENE
FLOYD
ACCOMACK
BLAND
GRAYSON
CAROLINE
ROANOKE COUNTY
AMELIA
ROCKINGHAM
YORK
PRINCE WILLIAM
LYNCHBURG
SHENANDOAH
LEXINGTON
GLOUCESTER
FLUVANNA
KING AND QUEEN
MECKLENBURG
FREDERICK
WINCHESTER
GREENSVILLE
HENRICO
WARREN
MADISON
HANOVER
NORTHAMPTON
RICHMOND CITY
JAMES CITY
MATHEWS
FAUQUIER
FREDERICKSBURG
MIDDLESEX
FAIRFAX COUNTY
CHARLOTTESVILLE
HIGHLAND
BATH
LANCASTER
SURRY
FALLS CHURCH

2022-24 LCI Examples (Percent of State)

2019 Data (Percent of State)	Fairfax	Loudoun	Chesterfield	Henrico	Washington
True Value of Real Estate (50%)	20.81%	7.10%	3.23%	3.33%	0.42%
Adjusted Gross Income (40%)*	21.46%	7.66%	4.02%	3.98%	0.42%
Taxable Sales (10%)	14.24%	5.56%	4.17%	5.32%	0.62%
Numerator Weighted Average	20.41%	7.17%	3.64%	3.79%	0.44%
March 31, 2020 ADM (.667%)	14.42%	6.66%	4.92%	4.03%	0.54%
Population (.333%)	13.40%	4.85%	4.11%	3.85%	0.63%
Denominator Weighted Average	14.08%	6.05%	4.65%	3.97%	0.57%
Ratio of Numerator/Denominator	**1.450**	**1.184**	**0.782**	**0.954**	**0.776**
Local Composite Index	***0.6532***	**0.5450**	**0.3546**	**0.4297**	**0.3506**

Ten Year Change Example (Percent of State)

	Fairfax County			Washington County	
2019 Data (Percent of State)	**2012-14**	**2022-24**		**2012-14**	**2022-24**
True Value of Real Estate (50%)	20.29%	20.81%		0.47%	0.42%
Adjusted Gross Income (40%)*	22.36%	21.46%		0.49%	0.42%
Taxable Sales (10%)	15.08%	14.24%		0.70%	0.62%
Numerator Weighted Average	20.60%	20.41%		0.50%	0.44%
March 31, 2020 ADM (.667%)	13.73%	14.42%		0.60%	0.54%
Population (.333%)	13.50%	13.40%		0.69%	0.63%
Denominator Weighted Average	13.65%	14.08%		0.63%	0.57%
Ratio of Numerator/Denominator	**1.509**	**1.450**		**0.799**	**0.776**
Local Composite Index	**0.6739**	***0.6532***		**0.3533**	**0.3506**

Ten Year Change Example (Percent of State)

	Hanover County		Greensville County	
2019 Data (Percent of State)	**2012-14**	**2022-24**	**2012-14**	**2022-24**
True Value of Real Estate (50%)	1.26%	1.32%	0.07%	0.12%
Adjusted Gross Income (40%)*	1.33%	1.39%	0.09%	0.08%
Taxable Sales (10%)	1.68%	1.93%	0.04%	0.05%
Numerator Weighted Average	1.33%	1.41%	0.07%	0.10%
March 31, 2020 ADM (.667%)	1.53%	1.38%	0.13%	0.10%
Population (.333%)	1.25%	1.26%	0.16%	0.13%
Denominator Weighted Average	1.44%	1.34%	0.14%	0.11%
Ratio of Numerator/Denominator	**0.925**	**1.052**	**0.538**	**0.918**
Local Composite Index	**0.4203**	**0.4741**	**0.2174**	**0.4236**

A Localities' LCI Does Not Always Correspond to its Fiscal Stress

- "Revenue effort" necessary for locality not captured in LCI.
  - Education spending is about half of locality spending, not two-thirds as implied in the LCI.
- VAGI can be skewed with "bar bell" distribution of income. Median income rather than gross income might be a better measure.
- TVRE and VAGI influenced by cost-of-living.
- Localities with declining ADM have a relatively higher LCI.
  - JLARC recognized lack of economies of scale in smaller school divisions.
- Should local land use policy be reflected in the TVRE factor of the LCI?

JLARC Recommendations for Improving the Local Composite Index

1. Use 3-year moving average for data to smooth large changes.
2. Weight ADM and population equally in the denominator.
3. Replace the LCI with a Revenue Capacity Index. JLARC stated that "that the best measure of ability-to-pay available currently is revenue capacity.

JLARC staff calculated the RCI using three main steps.

a) Calculate statewide average yield rates for real and public service corporation (PSC) property taxes, tangible personal property (TPP) tax, and 'other' local taxes;
b) Calculate the revenue capacity for each of the main sources and aggregate them to calculate total local revenue capacity; and
c) Calculate the final RCI by comparing local revenue capacity to total statewide average revenue capacity, per pupil and per capita.

The final result of the base revenue capacity calculation is a measure of how much revenue a locality *could* generate if it implemented the statewide average tax rate. For example, if the per pupil local-state revenue capacity ratio equals 1.05, then that locality has a revenue capacity approximately 5 percent greater than the statewide average per pupil. The RCI would find that, in per pupil terms, that locality could raise more revenues than the average locality statewide for education and should receive less state aid for public education.