



Critical Issues for City Budgets

Updated 1/4/10

Update: A Ramsey County judge has ruled that Gov. Pawlenty's use of unallotment to cut funding for a nutrition program was unconstitutional. The rationale expressed by Judge Gearin suggests that the entirety of Governor Pawlenty's 2009 and 2010 unallotments could be overturned. Here is a link to the ruling: <http://minnesota.publicradio.org/features/2009/12/documents/Unallotment-Case.pdf>

Cities across the state have just finalized their 2010 budgets and are already thinking ahead to 2011. Budgeting at the city level has been made much more challenging because the foundation upon which budgets are generally based is quickly shifting. This memo is intended to highlight several of the more significant uncertainties facing city budgets. As the League learns more about the state budget and other issues outlined here, this document will be updated.

State Budget

What is the current status of the state budget?

The state budget forecast was released on December 2. The deficit for the remainder of the current biennium stands at \$1.203 billion. According to Minnesota Management and Budget, much of the deficit—about 70%—stems from lower than expected income tax receipts. The decline in income tax revenues paid to the state is due to a drop in wages. Minnesota wages overall are projected to decrease by 5.5% in 2009 and this decrease is the first time wages have dropped year to year in 40 years. The projected deficit for the 2012-13 biennium, from which the 2011 aids and credits are paid, is now estimated at \$5.4 billion (up from the estimate of \$4.4 billion at the end of the 2009 session). This figure does not include inflation (projected to be \$1.179 billion for the biennium).

What impact does the national economy have on the state budget forecast?

The last forecast, released in February 2009, assumed that the recent recession would extend into the early fall of 2009 and that the economy would begin to grow but at a slower pace than recent trend rates. That forecast also assumed that national unemployment would reach 9.4 percent in early 2010 and remain at that level until the fall of that year.

By the third quarter of 2009, real GDP growth turned positive but for the year overall is expected to decline by 2.7%. Employment is significantly lagging behind the slight recovery in GDP and is now projected to increase nationally over the next six months. The state's forecasting firm now expects a decline of 4.5% in wages for 2009. This compares to a 0.4% prediction for wage decline back in February. The recovery from the recession is projected to be one of the slowest in history.

The state's most recent budget forecast documents can be found at <http://www.finance.state.mn.us/fu-current-fore>

What is the status of the Governor's proposed Constitutional amendment to limit state spending?

The Governor has proposed a constitutional amendment that states:

Shall the Minnesota Constitution be amended to require that state government general fund expenditures be limited to the amount of actual general fund revenues received by the state in the previous two-year budget period?

At this point, the governor's proposal is only a suggestion but the idea will likely be introduced during the 2010 session. Constitutional amendments must be approved by a simple majority of the House and Senate. If the amendment is approved, it would then be sent to the voters in the next general election where it must be supported by a majority of those voting in the election. League staff testified against the proposed amendment at a legislative hearing on December 7.

State Aids and Credits

Could we see additional unallotments of December 2009 LGA and MVHC payments?

The Governor announced on December 8 that he will **not** further reduce (unallot) the December aid and credit payments scheduled to go out to cities at the end of this month.

Could we see additional cuts to 2010 LGA and MVHC payments?

Given the \$1.203 deficit for the remainder of this biennium, the governor's actions could include further unallotments to the 2010 payments. In his letter to the League to confirm no additional cuts in December 2009, the Governor warned that further cuts to the 2010 payments may be made. The 2010 legislature could also further reduce 2010 state aids beyond the \$128.3 million of unallotment cuts already imposed. Additional information on the state's fiscal health will be available to the Legislature in the form of the February forecast. Given that a decision on cuts would not likely be made until May, these would be mid-year cuts to city budgets, leaving perhaps seven months for cities to respond.

http://www.lmc.org/media/document/1/cityunallot2009_2010.pdf

What happens to state aid in 2011?

If the 2010 legislature takes no action on 2011 state appropriations for LGA and MVHC, the governor's unallotment reductions made to date would be restored. The 2011 aids and credits are paid from the state's 2012-2013 budget and unfortunately, the state is facing an official projected deficit for the 2012-2013 biennium of roughly \$5.4 billion (before inflation). The governor suggested on December 2 that this deficit is manageable if the Legislature makes permanent the 2010-11 unallotments already announced.

If the legislature decides to allow these appropriations to be restored to levels set in current law, levy limits on cities over 2,500 population for 2011 would be commensurately reduced. However, if the 2011 legislature later decides to retroactively reduce LGA and MVHC payments to balance the deficit of more than \$5.4 billion, cities would again face mid-year budget cuts after certifying their 2011 property tax levies based on the lower levy limits.

What about cities under 1,000 population?

Cities under 1,000 population and with lower than average tax base per capita were exempt from the state aid and credit unallotments announced by the Governor in June. Given the magnitude of the projected 2012-2013 deficit, the budget-balancing solution will almost certainly include cuts to all sectors of the state budget, including LGA and MVHC. The structure of any cuts would be determined by the legislature and there is no guarantee that the same small city exemption would be continued.

What is the LGA Study Commission working on?

The group held its first meeting in mid-October and heard a lengthy presentation from House Research staff on the history of LGA. The next meeting will be held in January 2010 and the discussion will focus on what the goals and purposes of a state aid program should be. This group is not required to make recommendations to the legislature until December, 2010 and therefore, action on any recommendations will not likely occur until the 2011 session. That said, city officials are encouraged to share their ideas and comments on the LGA program with League staff.

Are other state aids to cities at risk?

At this point, it is not clear if other general fund state aids such as police, fire and PERA pension aids could be at risk. The governor and legislature have only briefly discussed these other aid programs and during the 2009 session there were no active proposals to cut this funding.

Several other aid programs such as the municipal state aid (MSA) funds are not funded through the state's general fund and therefore, would not be subject to cuts to solve a deficit in the state's general fund.

City Property Taxes

How has the economy affected property taxes?

The weak economy has dramatically softened the real estate market and as local assessments continue to catch up to the effects of the economy, property values for many types of real estate will continue to adjust. Last year, residential homestead property values overall fell in cities. Recently, however, we have heard that commercial and industrial property values are declining rapidly in some areas. As a result, cities could see more of the burden of their property tax levy shifting to homeowners into the foreseeable future. Another issue is that many communities have seen an increase in delinquent property taxes due to broad economic trends like high unemployment.

What are other local governments doing?

Cities are not the only level of government being hit by state budget cuts and the weak economy. Counties and school districts are also likely to be looking to the property tax to fill at least a portion of the loss of state aids. The combined effect of the decisions of city councils, county boards and school boards could place an undue burden on property taxpayers. The property tax is already the least favored tax and taxpayer resistance has grown stronger in recent years.

Unallotment Litigation

What is the current status of unallotment litigation?

The Ramsey County judge ruled on December 30th that the Governor's use of unallotment to reduce funding for a nutrition program aimed at low income individuals was inappropriate. The judge issued a restraining order to reinstate the money unallotted. Another hearing on the underlying case is scheduled for March 1, 2010. The Governor has announced that he would appeal the decision announced last week.

What could be the outcome of the pending unallotment lawsuits?

For cities, the decision potentially creates more fiscal uncertainty. City 2010 budgets have just been set with 2010 LGA and MVHC appropriations reduced by \$128 million. With Judge Gearin's decision, it is possible that an additional legal challenge might restore the \$128 million in 2010 unallotments and possibly even the \$64 million in 2009 cuts. However, given the broader state budget problems, it might only add tremendous uncertainty to city budgets in 2010.

Since the underlying state budget deficit is currently estimated to be \$1.2 billion for the balance of the 2010-2011 biennium, the restoration of any portion of the previous unallotments would add to the state's deficit. If the entire \$2.7 billion unallotment were overturned and added to the recent \$1.2 billion forecasted deficit, the Governor and Legislature would have to address a \$3.9 billion problem when the session begins in February. With a deficit that large, it is almost certain that virtually all sectors of the state budget will be subject to appropriations reductions—including city LGA and MVHC.

Is the League taking a position on these lawsuits?

In the fall of 2009, the Board of Directors debated this issue at length and decided to await the trial court outcome of the two current lawsuits before making a final determination on whether to intervene. Now that the judge has ruled, the Board will reconsider if and how to act. One way that the Board could act would be to file an amicus brief if either case makes it to the appellate level. That said, the success of the legal challenges does not necessarily translate into smaller reductions for cities. In fact, it is entirely possible that city aid and credit programs could be further cut as the legislature balances its priorities. Accordingly, a decision to intervene in either of the lawsuits involves a multitude of practical and political considerations that go well beyond the legal merits of the particular suits.

In November, the Board adopted a recommendation forwarded by the Fiscal Futures Policy Committee that supports limitations on the timing and magnitude of the governor's unallotment authority.

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Resources on city budget issues:

- <http://www.lmc.org/media/document/1/propertytax101.pdf>
- <http://www.lmc.org/media/document/1/lga101.pdf>
- <http://www.lmc.org/media/document/1/mvhc101.pdf>
- http://www.lmc.org/media/document/1/2010_levylimits.pdf
- http://www.lmc.org/media/document/1/unallotment_faq.pdf