State of the Cities 2010: City Fiscal Conditions

Introduction

For the seventh consecutive year the League of Minnesota Cities asked city officials to report on the fiscal challenges their cities face and the strategies used to address those challenges (see the appendix for the 2010 survey instrument)[1]. A total of 463 Minnesota cities returned the survey for a response rate of 56 percent. This report will discuss the survey results from Minnesota cities, comparing them with data from previous years in order to identify trends. It is important to keep in mind that the results must be considered as a snapshot of conditions at a particular point in time. Cities responded to this year's survey from Dec. 16, 2009, through Feb. 16, 2010.

State budget woes and the economic recession continue

Results from the last two surveys have clearly shown the negative effects on cities of the economic slowdown and recession which began in December 2007. There have been significant trickle-down effects of actions taken by the state in addressing its own financial woes. There have also been direct effects from unemployment, foreclosures, and business closures.

State government has been battered in the nationwide recession, and Gov. Pawlenty and the Legislature reduced city aids and credits for 2008, 2009, and 2010 in order to deal with the state budget crisis. Two of the state's major revenue sources—income and sales taxes—have been hit hard by the economic downturn. Income tax revenues have decreased both nationally and in Minnesota because fewer individuals are working and wages for those who are employed have fallen. According to the Bureau of Labor Statistics, the seasonally adjusted nationwide unemployment rate stood at 10 percent for November and December 2009. In May 2009, Minnesota's seasonally adjusted unemployment rate climbed to 8.4 percent, the highest since 1983. It fell to 7.4 percent by December 2009. With fewer workers, 2009 total wages in Minnesota were down approximately 5.5 percent[2]. This is the first time wages have declined over the prior year in the 40 years that personal income tax statistics have been published. Total wages account for approximately 75 percent of Minnesota's income tax base.

Retail sales tend to slow during recessions due in part to higher unemployment and lower wages, leading to a decrease in sales tax revenues. An analysis by the Rockefeller Institute shows that the recent decline in consumption of goods and services is much sharper than in the preceding

[1] For the sixth consecutive year, state leagues from across the country were invited to send the same fiscal conditions survey to their member municipalities. A total of nine leagues participated this year with an overall response rate to the survey of 39 percent (see the appendix for a list of participating states and individual state response rates).
[2] Minnesota Management and Budget. "Forecast Shows $1.203 Billion Deficit for Current Biennium." December 2, 2009.

recession[3]. Minnesota state sales tax revenues in the fourth quarter 2009 were down one percent from the same period in 2008. State revenue forecasts have adjusted projected sales tax receipts downward for the 2008-2009 and 2010-2011 biennia.

The effects of the recession on the state's budget were illuminated by the state's November 2008 economic forecast. Receipts for the individual income tax, sales tax, and corporate income tax were all projected to fall short of prior estimates. The biggest decline was forecast for the corporate income tax (3 percent). The forecasts for the individual income tax and sales tax were each reduced by roughly 2percent. A $426 million deficit was forecast for the remainder of the 2008-2009 biennium. With few options left to balance the budget as required by the Minnesota Constitution, the governor used unallotment to reduce scheduled spending. The unallotment action included reductions to the December 2008 scheduled payments to cities of local government aid (LGA) and market value homestead credit (MVHC) reimbursement. Cities under 1,000 in population were spared from the 2008 unallotments. It was clear that the state's budget problems were far from over, however, as the forecast also showed a $4.847 billion shortfall for the 2010-2011 budget period.

In February 2009, the economic forecast projected a state budget gap for the 2010-2011 biennium of $4.6 billion, down slightly from the gap in the November forecast. Revenue projections showed a 3.7 percent decline from the November estimate, or a 4.7 percent decrease from 2008-2009 levels[4]. More than 60 percent of the revenue decline was in expected individual income tax receipts due largely to wage and capital gains losses. Declines were also projected for sales tax and corporate income tax receipts.

At the end of the 2009 legislative session, despite dramatic spending cuts the Legislature made to various parts of the state budget, a $2.7 billion budget deficit remained. With no legislative agreement on how to close the gap, the governor again used his unallotment power to cut $2.7 billion in state spending[5]. Reductions to 2009 and 2010 LGA and MVHC payments were part of that unallotment package. Cities under 1,000 in population with tax bases valued under the statewide average per capita were again exempt from the cuts.

The state's November 2009 budget forecast showed a deficit of $1.203 billion for the remainder of the 2010-2011 budget period, and projected a $5.4 billion budget gap for the 2012-2013 biennium. Concern grew that cities could face yet another unallotment of remaining 2009 aids and credits. While the governor promised not to make additional cuts to cities in 2009, the potential for significant reductions to 2010 payments loomed over cities.

In addition to losses of state funds, the larger economic climate continues to create challenges for cities. One of these is the ongoing foreclosure problem. In fact, the number of households nationwide facing foreclosure in the first three months of 2010 increased 16 percent from a year

[3] Boyd, Donald J. and Lucy Dadayan. "Revenue Declines Less Severe, But States' Fiscal Crisis Is Far From Over." Nelson A. Rockefeller Institute of Government. April 2010.
[4] Minnesota Management and Budget. "February Forecast." February 2009.
[5] In May 2010 the Legislature ratified the 2009 and 2010 unallotment cuts following the May 5 Minnesota Supreme Court ruling that called the validity of these unallotment actions into question.

ago and 7 percent from the last three months of 2009[6]. Sheriff sale data for Minnesota show similar trends[7]. The number of sheriff sales statewide in the first quarter of 2010 increased 28 percent from a year ago and almost 11 percent from the last three months of 2009[8]. Because of the two-year lag in the Minnesota property assessment system, market valuations are just now catching up with the downturn in the real estate market. The result is shrinking city property tax bases, just as cities are facing repeated cuts in aids and credits and in many cases looking to the property tax as one way to cover those losses. One-third of cities responding to the survey indicated that the value of the tax base declined over the last year.

Cities also continue to be plagued by a variety of problems related to impacts of the nationwide recession on home and business owners. Just under 95 percent of cities have experienced at least one issue related to the economic downturn in the past year. Cities have been challenged by increases in unemployment among residents, increases in unpaid utility bills, and decreases in building permit revenues.

Against this challenging financial backdrop, city residents and business owners continue to have high expectations for quality public services. City officials also face public pressure to keep taxes and fees low. It is much more difficult for city councils to go to the taxpayers for additional property tax dollars given the broader economic problems. The 2010 fiscal conditions survey revealed that the share of cities implementing revenue increases was the smallest since the survey began in 2003. The proportions of cities reporting decreases in spending and in the size of the city workforce, however, are growing. Many cities reported taking multiple actions to balance their budgets.

The share of Minnesota cities reporting an increased ability to meet their financial needs drops for the third consecutive year

Continuing a trend that started in 2007, the portion of Minnesota cities that reported being better able to meet their financial needs fell from 26 percent in 2008 to just 17 percent in 2009[9] (see Chart A[10]). Looking to 2010, 18 percent of all responding cities predict an improvement in fiscal conditions. Changes in the percent of cities reporting improving financial circumstances are due in part to the fact that a different group of cities responds to the survey each year. Looking at just those cities that have responded to the survey each year, only 14 percent anticipate improving conditions in 2010.

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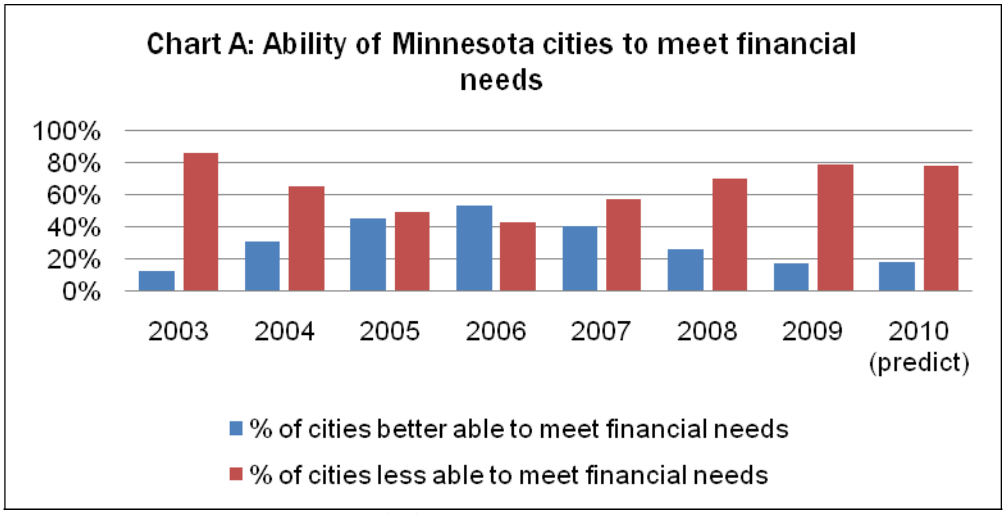
[6] Veiga, Alex. "US Homes Facing Foreclosure Jumped 16 percent in 1st-quarter as Banks Take Back More Homes." *Star Tribune.* April 15, 2010.

[7] A sheriff sale marks the end of the foreclosure process and therefore such data does not reflect all properties that enter the process.

[8] HousingLink. "Minnesota Foreclosure Update: 1st Quarter 2010." May 4, 2010.

[9] The measure of "better" or "less able" is a relative comparison between a city's fiscal condition in the current year and in the previous year. In other words, a response of "better able" does not imply that a city's financial circumstances are good, only that they improved over the previous year. Cities are not asked how well they are able to meet needs in any given year.

[10] The share of cities reporting an increased ability to meet needs and the share reporting a decreased ability may not sum to 100 percent. Cities are not required to answer all questions on the survey. Cities often leave no response if they are unsure how to answer or if the question does not apply to their city. Many cities that leave the question regarding ability to meet needs blank do so because they feel that that there is no change between years.



Cities may not have responded due to lack of information or because conditions did not change relative to the prior year

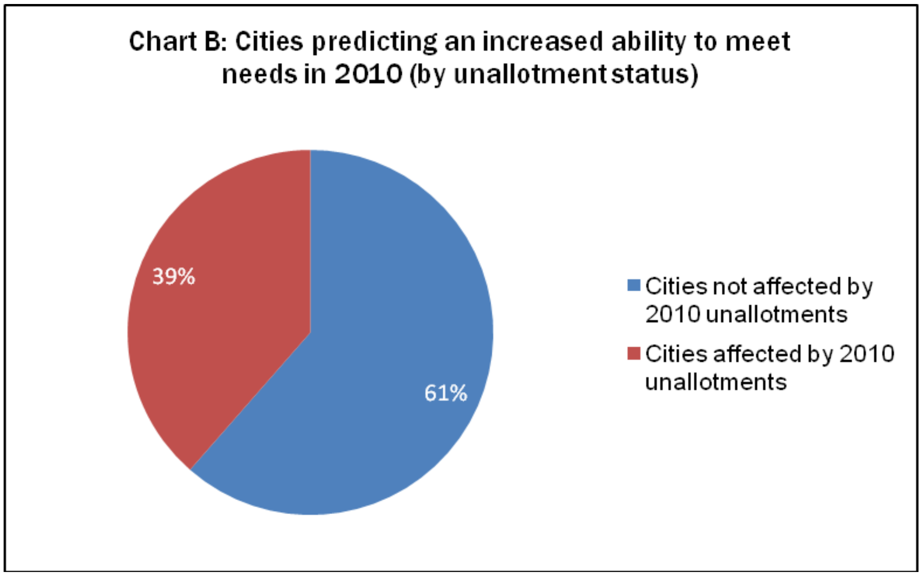
The portion of cities reporting an improved ability to meet needs increased steadily through 2006 and has declined since. In 2005 and 2006, roughly half of cities saw improvements while half experienced greater difficulty in meeting needs than in the prior year. In 2007 just 40 percent of responding cities were better able to meet needs; this fell to 26 percent in 2008. Since then, less than one in five cities views its fiscal situation favorably.

Ability of cities to meet needs related to unallotment status

Cities over 1,000 in population experienced reductions through Gov. Pawlenty's unallotment of their December 2008 state aid and credit reimbursement payments. The governor then announced cuts to 2009 and 2010 aid and credit payments as part of his unallotment plan in the summer of 2009. The unallotments of 2008 and 2009 payments occurred after aid and credit payment amounts had been determined by the state. The aid and credit cuts, therefore, represented a loss of revenue that cities were counting on for the respective budget year. Cities had only a few days to account for the losses to their budgets in 2008 and therefore had very limited options. Many cities turned to their reserves to cover the gap. While cities had a few months to adjust to the 2009 cuts, those reductions did come after cities had certified their property tax levies for 2009.Cities had more time to prepare for the 2010 cuts, but prior reductions coupled with ongoing and escalating problems created by the economic downturn reduced the number of viable options.

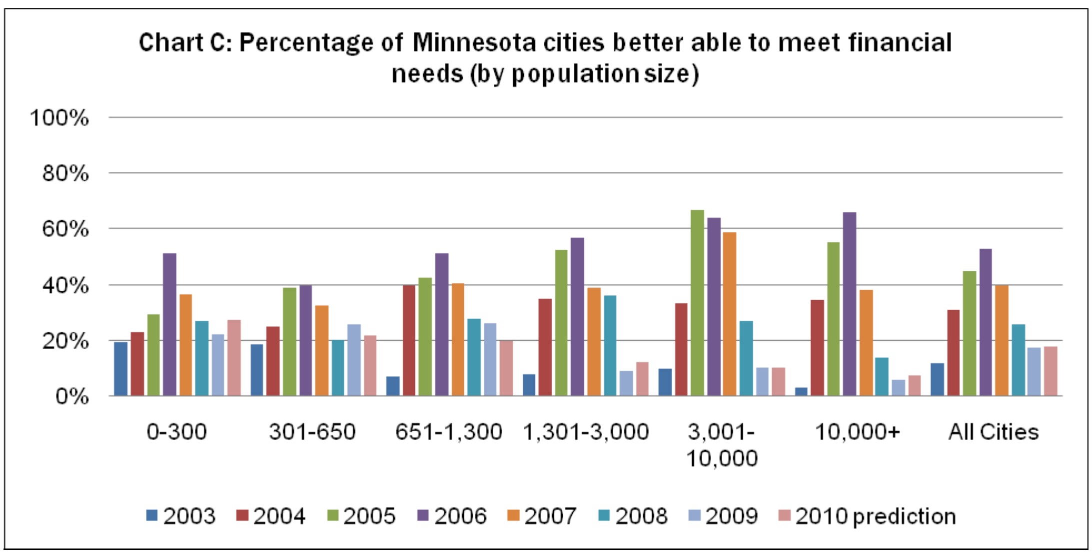
Whether or not a city experienced loss of aid and/or credit through unallotment influences its ability to meet fiscal needs. Only 9 percent of cities that lost aid and/or credit revenue at the end of 2008 reported an improvement in their ability to meet needs in 2009 over 2008. More than one-quarter of cities not subject to unallotment in 2008 were better able to meet needs.

Of the cities that faced unallotments in 2009, only 11 percent indicated that conditions improved in 2009 over 2008. Roughly one-quarter of cities that were not subject to unallotment in 2009 were better able to meet needs in 2009. Looking ahead, the share of cities predicting an improvement in their financial circumstances is greater among those cities that are currently not facing unallotments to their 2010 aids and credits than for those that are. As Chart B illustrates, cities looking to 2010 with optimism are more likely to be cities not facing unallotment in 2010. However, cities responding to the survey are more likely to be facing unallotment than not.



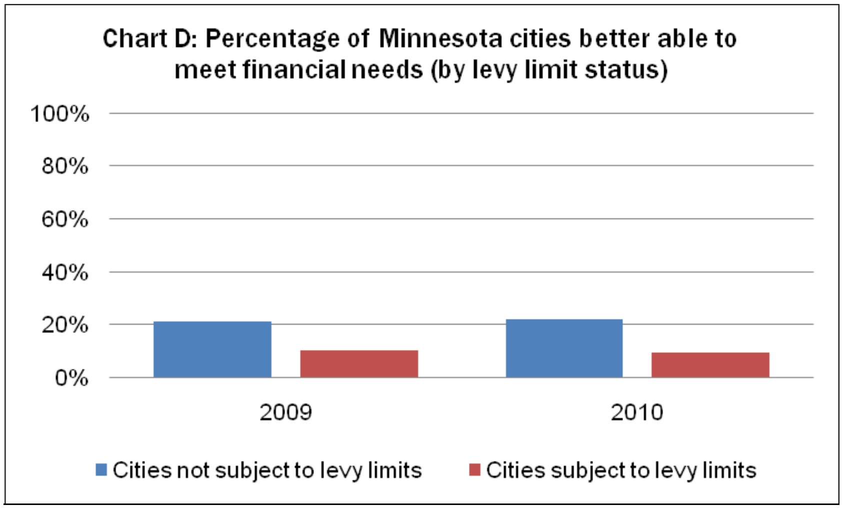
Outlook on fiscal conditions by city size echoes overall trend

For the past two years, the proportion of cities in all size categories reporting better fiscal conditions has fallen. This trend continues in the most recent data. Looking ahead, three size categories—cities under 300; between 1,301 and 3,000; and over 10,000 in population—show an increase in the percentage predicting better financial conditions.



Greater shares of cities under 1,300 in population reported improved conditions in 2009 than larger cities. The proportion of cities with populations between 1,301 and 3,000 reporting better circumstances fell from 36 percent in 2008 to just nine percent in 2009. This may be due to a different mix of cities responding in each year or reflective of the particular challenges facing these cities. All of the cities in this category faced unallotment losses in 2008 and 2009 and will see additional cuts in 2010.

The portion of cities predicting an easier time meeting needs in 2010 decreases as the population size increases. Over one-quarter of the smallest cities predict improved conditions while just 8 percent of the largest cities do so. These trends may be due in part to the fact that almost all cities with populations under 1,000 were exempt from the 2009 and 2010 unallotments[11]. Cities with populations over 2,500 may also be concerned about their ability to meet future needs with levy limits in place for 2010 and 2011. Almost one-quarter of cities under 2,500 in population are optimistic about 2010 while fewer than 10 percent of cities over 2,500 in population predict an easier time meeting needs in 2010.



Outlook on ability to meet needs varies regionally

For the second year in a row, a smaller percentage of metro cities than Greater Minnesota cities reported being better able to meet financial needs in 2009. The share of metro cities looking to 2010 with optimism is also smaller than the portion of outstate cities doing so. A larger share of non-metro cities did not report on or predict their ability to meet needs in either year. This may be due to city respondents feeling things haven't or won't change or being too uncertain about the future to respond.

Prior to 2008, a larger portion of cities classified as metropolitan statistical area[12] (MSA) cities than non-MSA cities had reported improving conditions each year (see Table A). Beginning in 2009, the reverse has been true. In 2008 and 2009 a slightly larger share of non-MSA cities reported improved conditions than did MSA cities. There is no difference in the share of cities with a positive outlook for the coming year by MSA status. It seems that any advantages to a city of being within an MSA have disappeared.

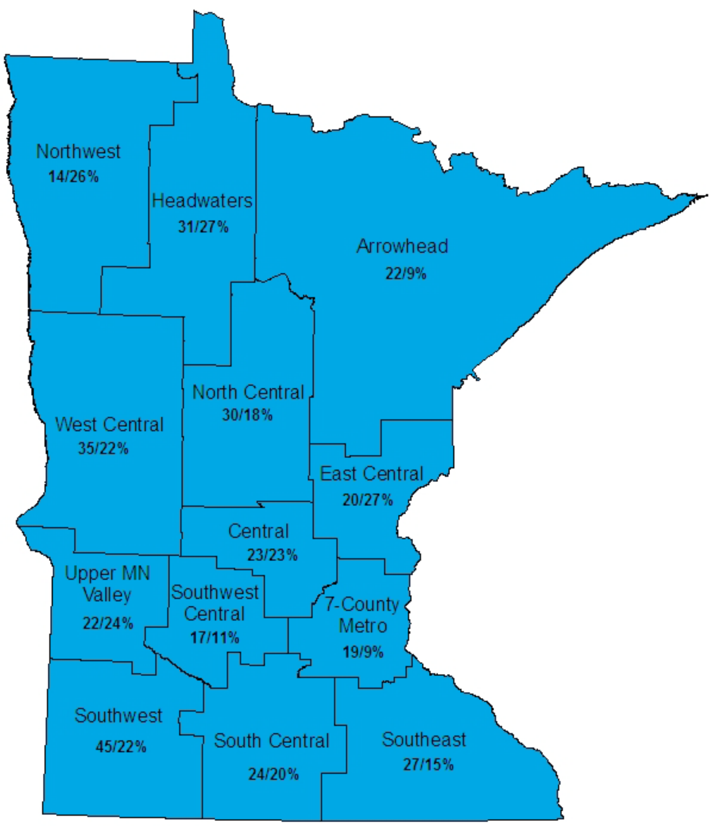
[11] Since the survey closed, aid and credit reductions have been announced for all cities for 2010 and 2011.
[12] A metropolitan statistical area (MSA) is defined by the U.S. Census Bureau as a geographical area containing at least one urbanized area of at least 50,000 inhabitants with a total area population of at least 100,000. The area consists of one or more counties. The seven MSAs that include at least one Minnesota county are: Duluth-Superior, Fargo-Moorhead, Grand Forks, La Crosse, Minneapolis-St. Paul, Rochester, and St. Cloud.

Table A: Percentage of Minnesota cities better able to meet needs (by MSA status)

	2004	2005	2006	2007	2008	2009	2010 predicted
MSA cities	35%	48%	57%	46%	24%	15%	18%
All Cities	31%	45%	53%	40%	26%	17%	18%
Non-MSA cities	29%	43%	50%	34%	27%	20%	18%

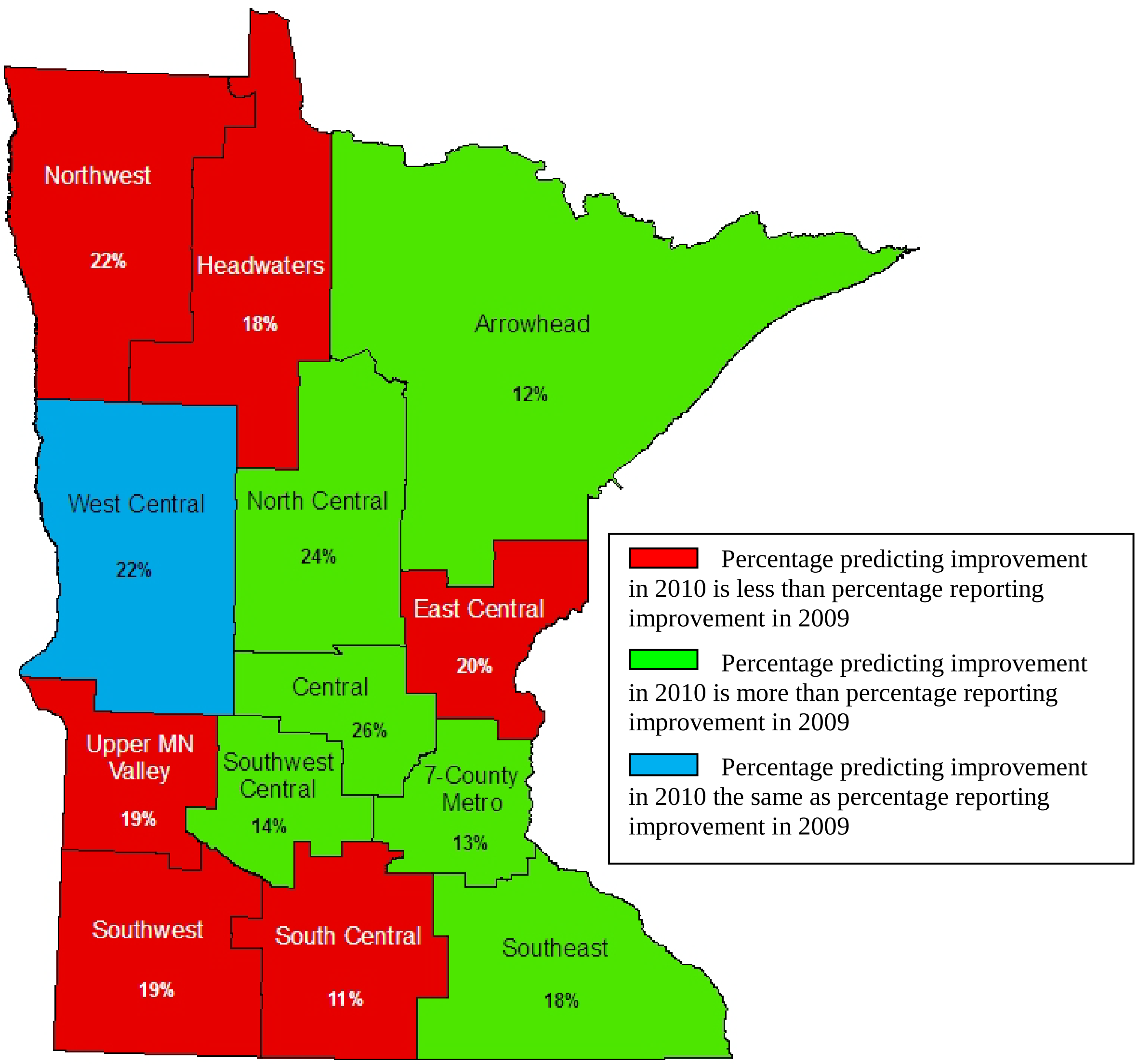
While in all regions of the state, the portion of cities reporting a decline in fiscal conditions was bigger than the portion that had experienced an improved ability to meet needs, there is some variation among regions. As shown in Figure 1, four regions—Northwest, Upper Minnesota Valley, East Central, and Central—saw an increase or no change from 2008 to 2009 in the share of cities reporting more favorable conditions. For the remaining nine regions, the share reporting an easier time meeting needs in 2009 was smaller than the share doing so for 2008.

Figure 1: Percentage of Minnesota cities better able to meet needs in 2008/2009 (by region)



When looking to 2010, the share of cities predicting improvement is greater than the share reporting better conditions in 2009 for six regions (see Figure 2). All of the regions along the growth corridor—North Central, Central, Metro, and Southeast—are in this category. While 18 percent of Minnesota cities are optimistic about their ability to meet needs in 2010, only 11 percent of cities in the South Central region share that outlook. The regions in the central part of the state have the highest shares of cities predicting favorable circumstances for 2010 (e.g., Central at 26%, North Central at 24%, East Central at 20%).

Figure 2: Percentage of Minnesota cities predicting improved conditions for 2010 (by region)



Percentage of cities reporting shortfalls in property taxes, fees, and state revenues grows

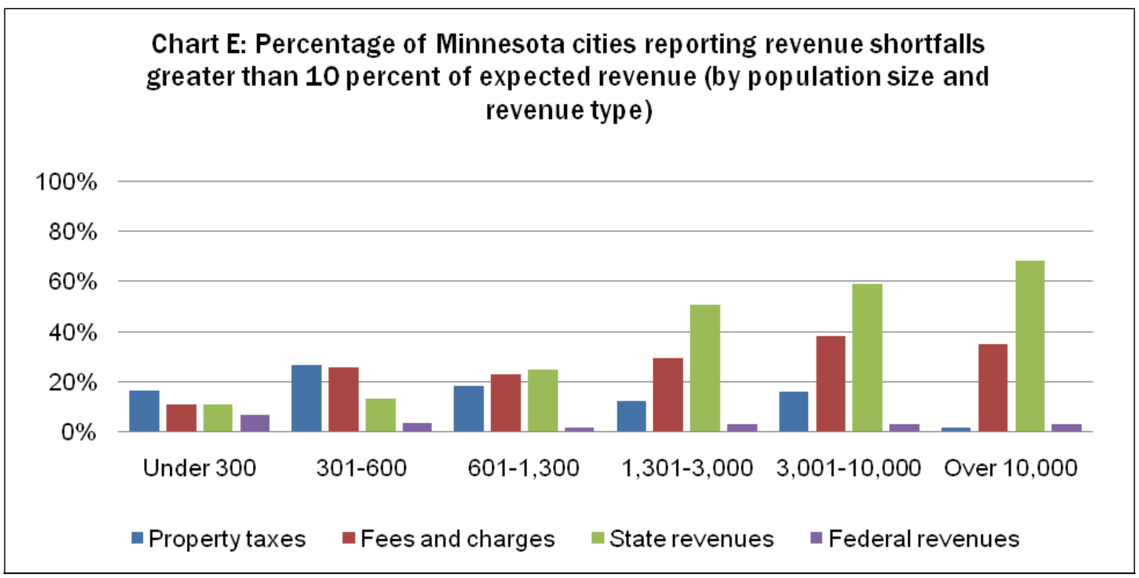
Larger shares of Minnesota cities reported shortfalls in the two main city revenue sources: local property taxes and state revenues (see Table B). The share of cities reporting a shortfall in state revenues jumped by 20 percentage points over the last year. More than half of cities saw revenues from various fees and charges fall below expectations.

Table B: Percentage of Minnesota cities reporting revenue shortfalls*

	Property taxes	Fees and charges	Sales tax	Local income tax	Lodging and restaurant taxes	State revenues	Federal revenues
2003	28%	17%	3%	n/a	5%	82%	12%
2004	27%	24%	1%	0%	3%	55%	8%
2005	40%	25%	3%	2%	4%	39%	12%
2006	40%	33%	4%	2%	4%	31%	13%
2007	43%	36%	6%	3%	5%	35%	15%
2008	54%	41%	7%	3%	8%	41%	14%
2009	62%	57%	8%	3%	12%	61%	16%

*Combines shortfalls of greater than and less than 10 percent of expected revenues.

Compared to 2003, when cities first experienced significant cuts in state aid, the percentage of cities reporting shortfalls is higher now in all revenue categories except state revenues. Just 28 percent of cities reported a shortfall in property tax revenues in 2003 while roughly two out of three cities did so in 2009. The context in which state aid cuts are occurring is very different now than it was in 2003. The Legislature or governor reduced MVHC reimbursement payments in six of the last seven years. A loss of MVHC means a city does not realize its full certified levy. The continued downturn in the economy likely contributed to the large increase in the shares of cities reporting shortfalls in property tax revenue and revenue from fees and charges. Cities were asked about challenges directly related to the recession. Half of cities have experienced an increase in requests for deferred payment of taxes or utility bills. Seventy percent of cities reported an increase in the number of residents and businesses with unpaid utility bills, and 58 percent reported an increase in unpaid property taxes.

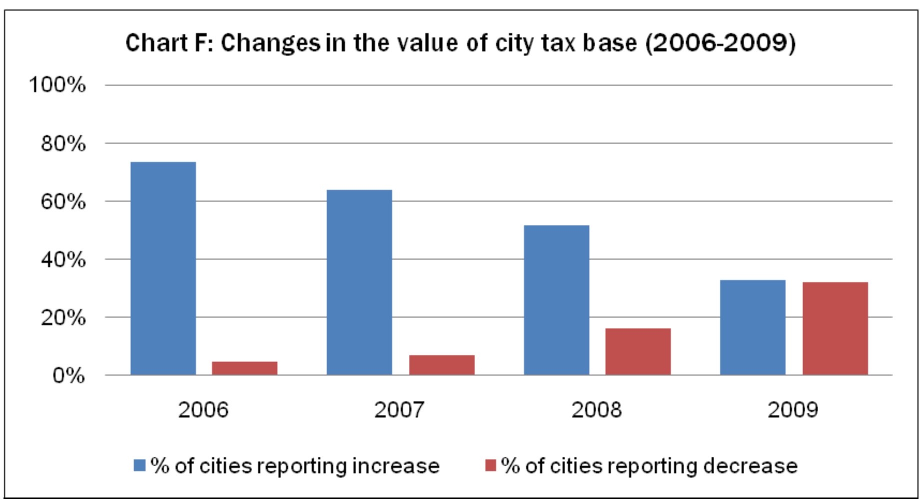


As the population size increases so too does the share of cities reporting shortfalls of more than 10 percent in state revenues. This is not unexpected as cities under 1,000 in population were generally excluded from the 2008, 2009, and 2010 aid and credit unallotment cuts. Smaller cities were more likely than larger cities to report shortfalls greater than 10 percent in property taxes. The reverse is true for significant shortfalls in revenue from fees and charges. In general, larger cities are likely to have more options for implementing fees than small cities.

Almost two-thirds of metro cities reported shortfalls in state revenue of greater than 10 percent while slightly more than a quarter of non-metro cities did so. Almost 40 percent of metro cities lost their entire 2009 aid and/or credit payments due to unallotment while just 1 percent of Greater Minnesota cities did so. Outstate cities are more likely than metro cities to report large shortfalls in property tax revenue (18 percent vs. 5 percent). A larger share of metro cities reported significant shortfalls in revenue from fees and charges (43 percent vs. 21 percent of Greater Minnesota cities).

Changes in budget factors stress city finances

Cities were asked to identify whether a wide variety of budget factors increased, decreased, or remained the same from 2008 to 2009. While many findings echo past trends, there are a few surprises. In keeping with past findings, most trends have negative consequences for city budgets and therefore create or exacerbate challenges. For example, an increase in public safety needs creates cost pressures for things like additional officers, new equipment, and more employee hours. In a major deviation from the past, 33 percent of cities reported an increase in the value of the tax base while another third saw an actual decrease. More than half of cities had reported increasing tax bases last year and only 16 percent identified a decrease (see Chart F). This is likely due to residential homestead assessed market values lagging behind declines in home prices. Assessors determine market values by January of the year before taxes are payable. In other words, market values for taxes payable in 2009 were set in January of 2008. While home values started falling a couple of years ago as a result of the bursting of the housing bubble and ongoing foreclosure crisis, the impact on city tax bases is really just starting to play out.



The five budget factors identified by the most cities as having increased in 2009 were the same ones as in 2008—cost of employee wages and salaries; prices, cost of living, and inflation; infrastructure needs; cost of employee health benefits; and cost of employee pensions.

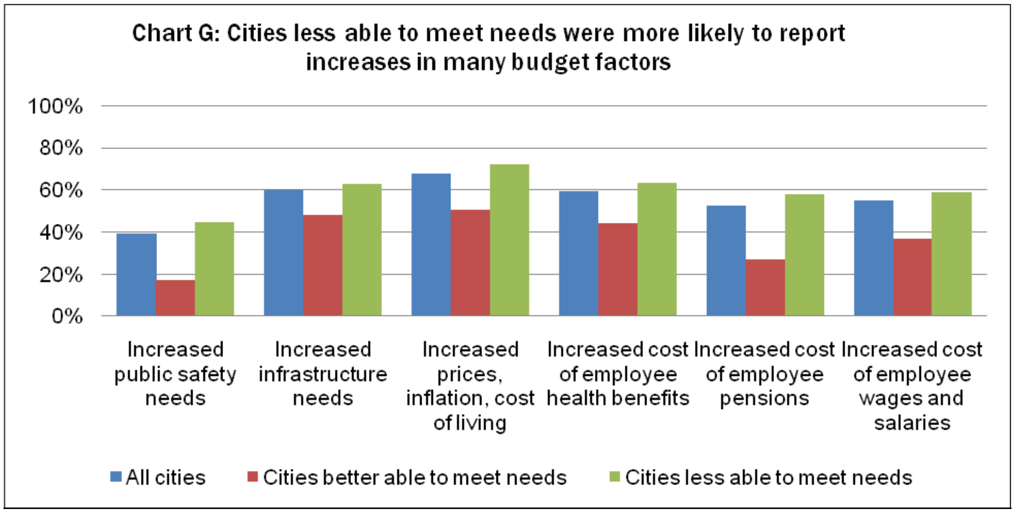
For each of the top five factors, the share reporting an increase was smaller in 2009 than in 2008. While 80 percent of cities reported increases in the cost of employee wages in salaries for 2008, just 55 percent did so for 2009. The portion maintaining these costs for 2009 increased to 40 percent from just 17 percent. Many cities were able to negotiate wage freezes with employees in light of budget challenges. Similarly, the proportion reporting increases in prices, inflation, and cost of living decreased from 83 percent to 68 percent for 2009. The implicit price deflator (IPD), the inflation index used for state and local government purchases, remained relatively flat in 2009 increasing just 0.701 percent from the first quarter of the year to the last quarter[13].

There was very little change from 2008 in the portion of cities reporting increases in four categories of mandates (state and federal environmental and non-environmental).
The share of cities reporting an increase in tax and expenditure limits increased slightly this year to 26 percent from 22 percent in 2008. This increase is far smaller than the difference between 2007 and 2008 (15 percentage points). Levy limits were imposed on cities with populations over 2,500 for taxes payable in 2009, 2010, and 2011.

The share of cities reporting an increase in local economic health declined for the third year in a row from 11 percent to just 7 percent. As in 2008, over half of cities reported a decrease in local economic health over the last year. This suggests that many of the broad economic problems plaguing cities have continued. Almost half of cities reported delayed or cancelled development projects, and 60 percent reported a decline in building permit revenues. MSA cities were much more likely to report delayed or cancelled development projects and declines in building permit revenue than non-MSA cities (62 percent vs. 37 percent, and 74 percent vs. 47 percent, respectively). These trends illustrate the effects of the slow economic recovery on cities. Some of the effects of the economic slowdown on residents and businesses in turn affect cities. One-third of cities reported an increase in the number of bad checks paid to the city, and one-quarter reported an increase in requests for financial assistance. Forty-six percent reported an increase in business closures over the last year.

Changes in all of these factors influence a city's ability to meet fiscal needs in a given year. For example, the share reporting an increase in any of the mandate categories was larger among those cities reporting a decline in their fiscal condition in 2009. Cities with negative financial outlooks were more likely to report an increase for many of the budget stressors (see Chart G). For many factors, the disparity between cities less able and cities better able to meet needs was greater than that observed in 2008.

[13] Bureau of Economic Analysis. "Table 1.1.9 Implicit Price Deflators for Gross Domestic Product." Last revised April 30, 2010.



Changes in budget factors are experienced by cities differently depending on their specific circumstances. The unique combination of cost pressures and the budget-balancing strategies available to a particular city impact how well it is able to respond to the fiscal challenges. The share of cities reporting at least a moderate impact on their 2009 budgets decreased over the shares doing so in 2008 for most budget factors.

Slightly larger shares of cities in 2009 than in 2008 reported at least moderate impacts on their budgets due to changes in the value of the tax base, tax and expenditure limits, cost of employee health benefits, and local economic health. For all other factors, the share reporting at least a moderate impact in 2009 was equal or smaller than in 2008. The greatest decline over 2008 was in the share reporting at least a moderate impact due to changes in employee wages and salaries (56 percent in 2009 vs. 75 percent in 2008).

The top factors identified as having at least a moderate impact on cities' budgets in 2009 are changes in local economic health (68 percent); prices, inflation, and cost of living (67 percent); infrastructure needs (61 percent); employee health benefits (60 percent); and tax base changes (58 percent). Except for tax base changes, which replaced employee wages and salaries, the same factors were identified by most cities in 2008. However, for all of the top categories, the shares were smaller in 2009 than in 2008.

Similarly, for most budget factors, smaller shares of cities reported major impacts in 2009 than in 2008. Several years into the recession, many of the challenges cities face are not new. Cities have been working to position themselves such that they minimize their vulnerability to some of the cost pressures.

A city's overall fiscal condition greatly influences how severely changes from budget factors are felt. For all budget factors, the share of cities reporting no impact was greater for those cities better able to meet needs in 2009. Across all budget factors, the share of cities reporting a major impact was larger among those with a decreased ability to meet needs in 2009.

Cities employ a range of strategies in addressing challenges

While some of the challenges created by state budget troubles trickling down to cities and by the economic slowdown result in less revenue, others create cost pressures for cities. How a city responds depends on several factors, including its local tax base, resident needs, the menu of services it provides, its local ordinances and policies, and its opportunities for raising revenue. A given strategy may not be viable in every community.

Cities lost state aid and credit reimbursement in 2008 and 2009. Uncertainty over state revenues posed particular challenges as budgeted funds were not received. Over the last year, cities had to not only plan for the future but also make adjustments to current year budgets due to mid-year aid and credit cuts, delinquent property tax payments, and unexpected expenditures.

The actions a city may take to address fiscal challenges include:

- Reduce or eliminate services.
- Scale back or delay infrastructure projects or capital purchases.
- Dip into reserve funds.
- Make changes to the city workforce.
- Look for new opportunities to partner with other entities to deliver services.
- Increase revenues such as user fees and property taxes.

Cities were asked which strategies they used in fiscal year 2009 in preparation for 2010. Nine in 10 cities reported employing at least one strategy in 2009. The average number of strategies utilized by a city was 3.4 (see Table C).

Table C: Number of budget-balancing strategies employed by Minnesota cities in 2009

	Implemented in 2009
Average number of strategies per city	3.4
1-3 strategies	222 cities, 48% respondents
4-7 strategies	164 cities, 35% respondents
8-10 strategies	32 cities, 7% respondents
No reported strategies	45 cities, 10% respondents

Many of the strategies cities used can be grouped into broad categories. The trends in these categories over the last seven years are shown in Table D. Revenue increases include property tax increases and increases in fees, charges, and license fees. Spending decreases include cuts in infrastructure, public safety, and other spending, as well as reductions in the overall growth rate of spending. Increases to productivity levels, contracting out or privatizing, and increasing inter-local agreements are included in the increasing efficiencies category.

Table D: Budget-balancing actions taken by Minnesota cities (2003-2009)

	Revenue increases	**Spending decreases**	**Increasing efficiencies**	**Workforce cuts**	**Service cuts**	**Draw down reserves**
FY2003	85%	55%	33%	26%	20%	60%
FY2004	84%	47%	34%	22%	15%	46%
FY2005	83%	12%	32%	5%	9%	33%
FY2006	83%	11%	31%	5%	3%	31%
FY2007	85%	12%	32%	6%	6%	32%

FY2008	76%	32%	26%	15%	13%	47%
FY2009	70%	46%	29%	26%	16%	44%

The trends reflect that cities are facing increasingly tough financial circumstances. Except for revenue increases and drawing down reserves, the share of cities taking action in each category grew. The proportion of cities enacting revenue increases fell for the second year in a row to 70 percent. This decline may be due to the imposition of levy limits on cities over 2,500 in population. However, some cities are making the policy decision to hold property taxes at current levels in recognition of the economic struggles facing their residents and businesses. The majority of cities subject to levy limits did not utilize their full levy authority for 2010, suggesting that many recognize that property tax increases are not viable. Looking at the discrete actions within the revenue increases category reveals that the share of cities implementing tax increases fell from 67 percent in 2008 to 61 percent in 2009, while the proportion increasing fees and charges decreased slightly. After a significant jump in 2008, the portion of cities reporting dipping into reserves fell slightly.

The proportion of cities decreasing spending rose from 32 percent in 2008 to 46 percent in 2009, just below the level it was in 2004. Larger shares of cities reported decreases in all categories of spending in fiscal year 2009 over the previous year (see Table E). One-third of cities reported decreases in other spending, up from just 18 percent in 2008. The proportion of cities decreasing public safety spending increased from 11 percent in 2008 to 17 percent in 2009. Cities were asked what, if any, types of cuts they have made to law enforcement over the last year. Almost one in 10 cities reported making cuts that negatively affected service levels while 11 percent made changes in the way that enforcement services are delivered. Three-quarters of cities reported making no service level cuts or delivery changes to law enforcement over the last year. The American Reinvestment and Recovery Act (ARRA) made funds available to help local entities avoid layoffs in law enforcement. Eight cities responding to the survey were able to retain law enforcement personnel thanks to this funding.

Table E: Specific budget-balancing actions taken by Minnesota cities (2007-2009)

	Increase in taxes	**Increase in reliance on reserves**	**Increase in fees/charges**	**Decrease in growth rate of spending**	**Decrease in infrastructure spending**	**Decrease in public safety spending**	**Decrease in other spending**
FY2007	79%	32%	36%	5%	6%	3%	4%
FY2008	67%	47%	36%	14%	20%	11%	18%
FY2009	61%	44%	35%	30%	21%	17%	33%

The shares of cities increasing efficiencies and making service cuts increased slightly over 2008. Cities have been pursuing efficiencies for many years. The share of cities enacting new efficiencies is smaller now than several years ago. This may be because many of the opportunities that were easier to pursue are now exhausted. Also, many cities may not have the resources or reserves to enact some efficiencies given the current budget climate. The share of cities cutting the workforce almost doubled, rising from 15 percent to 26 percent. This is equal to the percentage that reported reducing the workforce in 2004, following the significant cuts to state aid that year.

A new group of strategies—human resource-related reductions—was created this year. It includes actions on wage levels, use of furloughs, and level of employee benefits (see Table F). When workforce reductions are considered as well, the share of cities cutting back in at least one way related to human resources is 74 percent. Almost 70 percent of these cities reported just one action while 22 percent reported two, 9 percent reported three, and 2 percent took all four actions. The share of cities making workforce reductions increased as population size increased. A larger share of smaller cities maintained the size of the city workforce.

Table F: Percentage of Minnesota cities making HR-related budget-balancing reductions

Reduced workforce	26%
Cut or maintained wage levels	65%
Increased use of furloughs	6%
Reduced employee benefits	11%
Made at least one HR-related reduction	74%

Cities were asked to give details on the strategies they used in preparation for fiscal year 2010. Cities have reduced administrative and other costs by implementing furloughs, reducing or eliminating overtime, reducing travel and training budgets, and keeping vacant positions open and/or not hiring for new positions. In several cities, officials reduced or eliminated park and recreation programs. Cities have generated additional revenue by increasing building permits, park and recreation programs fees, community center rates, and utility rates. Others have teamed up with neighboring communities to provide services such as snowplowing. Several cities described strategies currently under consideration that may need to be employed in 2010 to offset significant revenue loss.

This year's survey asked cities whether they have engaged in collaborative purchasing over the last year. Just over one-third of cities responded affirmatively. These cities participated in a variety of programs including those run by the state of Minnesota, counties, and national organizations. Multiple cities wrote about purchasing through local agreements with neighboring communities. Many cities participated in more than one program. Several cities wrote that they had utilized collaborative purchasing strategies for many years.

Data from the most recent NLC survey shows that cities across the county have utilized similar strategies[14]. The most commonly reported strategies include implementing a hiring freeze, furloughs, and or/layoffs; delaying or cancelling capital infrastructure projects; and increasing the level of fees and charges (67 percent, 62 percent, and 45 percent). Just one-quarter reported increasing property tax rates.

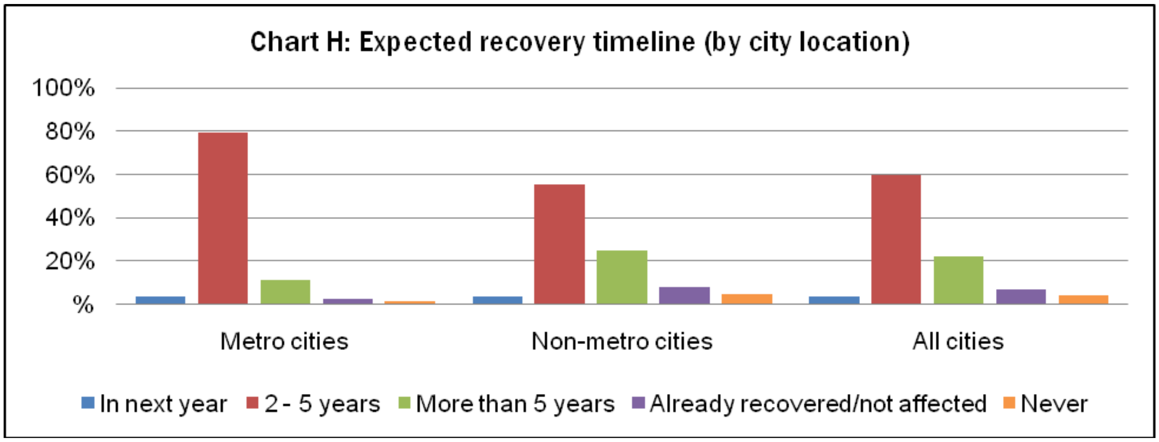
The League has been tracking city budget-balancing actions as reported in the news media since December 2008. Many of the strategies included in this database were also reported by cities on the survey. Other strategies include leasing or selling city property, implementing energy efficient technologies that save money, and increasing the use of volunteers for parks maintenance and in maintaining city flower plantings.

[14] Hoene, Christopher W. and Michael A. Pagano. "Research Brief on America's Cities: City Fiscal Conditions in 2009." National League of Cities. September 2009.

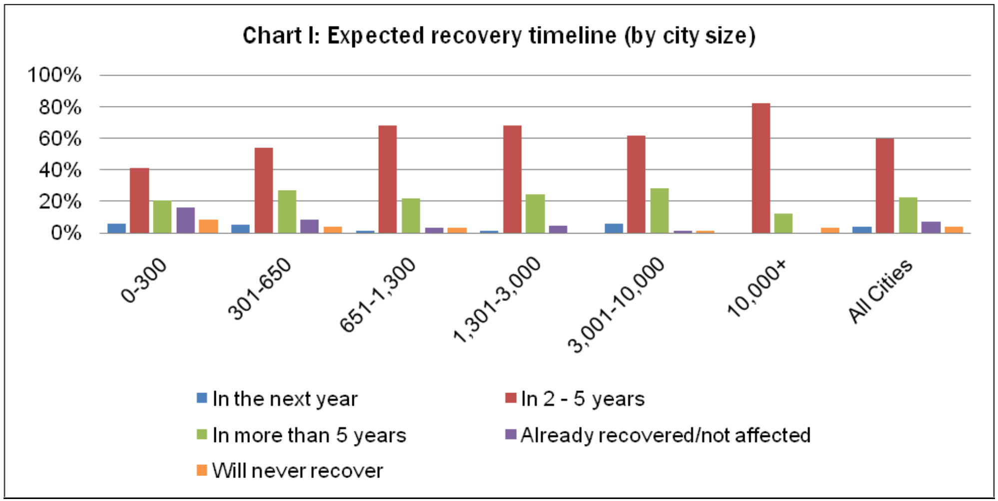
Cities see challenges continuing for several years

Just as economists are hesitant to call the end of the recession, few cities are ready to declare recovery from the 2008-2009 recession in the coming months (see Chart H). Just 4 percent of cities expect to recover from the effects of the national recession in the next year, while 7 percent stated that the city has already recovered or was not affected. The majority of cities, 60 percent, see recovery in the next two to five years. Almost one-quarter don't see recovery for at least five years, and 4 percent don't believe they will ever recover from the recession.

There was greater consensus among metro cities, with 80 percent expecting recovery in two to five years. Just 1 percent of metro cities stated that they will never recover. Slightly more than half of Greater Minnesota cities expect to recover in the next two to five years. One-quarter see recovery in more than five years, while 4 percent don't expect to ever recover from the recession's impacts.



There is great variability among the smallest cities, with 16 percent having already recovered, 41 percent expecting recovery in the next two to five years, 21 percent not seeing it for at least five years, and 9 percent not expecting to ever recover (see Chart I). Conversely, 82 percent of the largest cities expect to recover in the next two to five years. Similarly, cities not affected by state unallotments for 2010 expressed greater variability in their expectations of recovery than those cities losing state revenue. Interestingly, 7 percent of cities not facing unallotments don't expect to recover, while just 2 percent of cities losing state revenue believe recovery is not in their future. These findings suggest that size has much to do with a city's expectation for economic recovery.



Conclusion

For the third consecutive year, fewer Minnesota cities reported seeing improvement in their financial circumstances. Cities that lost state revenue to unallotment were less likely to report an improvement in ability to meet needs. The portion of cities in most size categories reporting improved circumstances decreased. Looking to 2010, the share of cities predicting an easier time meeting needs decreases as population increases. Metro cities were less likely to report improved conditions for 2009 than were Greater Minnesota cities. The same is true when looking to 2010.

Cities across the state are challenged by many budget factors. Factors that had at least a moderate impact on the majority of cities' budgets include local economic health; increasing prices, cost of living, and inflation; infrastructure needs; the cost of employee health benefits; and changes in the tax base. The state's budget troubles and the economic recession continue to exert pressure on cities.

Despite some signs of recovery—real GDP grew at a 2.2 percent annual rate in the third quarter of 2009 and at a rate of 5.9 percent in the last quarter[15]—economic challenges continue. The January 2010 state economic update shows that Minnesota collected less total tax revenue than was expected for November and December 2009. Individually, the sales tax was the only type to show a shortfall. However, this shortfall may be reflective of timing differences in the receipt of revenues. Data from the most recent economic update suggests that recent shortfalls are largely due to timing issues[16]. However, concern remains over slow growth in employment and wage levels. The employment rate and total wages paid are not expected to return to pre-recession levels until 2013 and 2011, respectively[17]. Growth in revenues will lag until more people are working.

As suspected, additional 2010 city aid and credit reductions were part of the governor's and Legislature's supplemental budget proposals. The governor's proposal, unveiled in mid-February, was made known one day prior to the closing of the survey. In early March, the latest state budget

[15] Minnesota Management and Budget. "February Forecast." February 2010.
[16] Minnesota Management and Budget. "April 2010 Economic Update." April 2010.
[17] Minnesota Management and Budget. February 2010.

forecast projected a deficit of $994 million for the biennium. The House and Senate each included city aid and credit reductions in their supplemental budgets. Reductions to LGA and MVHC were ultimately included in the supplemental budget bill that was signed into law on April 1, 2010. No cities were exempt from these cuts. Furthermore, the bill reduced the LGA appropriation for 2011 and beyond and permanently extended the governor's 2010 MVHC unallotments. A city's outlook for the coming year may have been quite different if these aid and credit reductions were known prior to the closure of the survey.

Cities employ a variety of strategies in meeting budget challenges. This year's survey showed larger shares of cities increasing efficiencies, decreasing spending, and reducing the workforce. The shares of cities increasing fees and taxes both fell. Until now, cities have cut other spending more than police and infrastructure. It remains to be seen whether or not this pattern holds in the future. Cities have suggested that many of the strategies used in prior years are no longer available. The so-called low-hanging fruit, these strategies were one-time options such as eliminating a position following retirement or cutting a little-used recreation program. Other cities have made "behind the scenes" cuts such as freezing employee wages or contracting out for some services, but now must make reductions that directly impact residents such as increasing the threshold for snowplowing, closing the youth center, or eliminating community clean-up days. All cities are losing aid and credit reimbursement in 2010. The exact strategies a city pursues in 2010 will be determined by the additional challenges it faces as well as the demands and expectations of its residents and businesses.

State of the Cities Report 2010

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The authors would like to thank the following people who contributed to this project:
Liisa Laikko, League of Arizona Cities & Towns
George Marretta, Louisiana Municipal Association
Robbie Brown, Mississippi Municipal League
Stuart Haynes, Missouri Municipal League
Sarah Werner, North Dakota League of Cities
Cheryl Dorrance & Sarah Lingenfelter, Oklahoma Municipal League
Tyler Stewart, Association of Washington Cities
Debbie Price, West Virginia Municipal League

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