State of the Cities 2011: City Fiscal Conditions

Introduction
This marks the eighth consecutive year that the League of Minnesota Cities has asked member city officials to report on fiscal challenges in their cities and the strategies used to address those challenges.[1] A total of 463 cities participated in the survey for a response rate of 56 percent. It is important to remember that any survey results must be considered a snapshot of conditions at a specific point in time. Cities across Minnesota responded to the 2011 survey from Nov. 26, 2010, through Jan. 7, 2011. Throughout the report key findings are highlighted at the beginning of each section.

Cities are struggling to provide services in face of myriad challenges

Highlights of this section:

- Unemployment, foreclosures, a slowdown in development, and business closures have created both spending pressures and revenue losses for cities. Actions taken by the state to address its own budget situation exacerbate these challenges.
- Local government aid (LGA) and market value homestead credit (MVHC) reimbursement payments have been subject to significant cuts imposed by the executive branch and Legislature. Cities lost more than $300 million from 2008 through 2010.

As results from the last three surveys have shown, the past few years have been difficult for cities. Across Minnesota, city councils have wrestled with how to provide the services residents and businesses expect in the midst of economic turmoil and the trickle-down effects of state policies. The economic slowdown and recession presented multiple challenges to cities, many of which have become ongoing problems. Unemployment, foreclosures, a slowdown in development, and business closures have created both spending pressures and revenue losses for cities. These and other challenges have been made more difficult by the actions taken by the state to address its own budget situation.

During the economic recession and even into the recovery, the state budget has been hampered by declines in two of its major revenue sources—income and sales taxes. Although the recession is

[1] The complete survey instrument is available in the Appendix at the end of this report. This year's survey included four questions that have been asked on each annual survey as well as several additional questions on a variety of topics related to city fiscal conditions. This report will discuss the responses to these four base questions, comparing them with data from prior years.

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officially over, recovery has been slow. Employment gains for November and December 2010 were less than expected.[2] The unemployment rate for December 2010 stood at 7 percent for Minnesota and 9.1 percent for the nation as a whole.[3] These rates are slightly lower than those for the previous December when the unemployment rate was 7.4 percent in Minnesota and 9.7 percent in the United States. However, there has been some improvement in wages and income tax collections. According to the state's January 2011 economic update, income tax receipts for November and December 2010 exceeded expectations by $33 million. Total wages in Minnesota for the second quarter of 2010 are up 3 percent over the same period in 2009.[4]

Sales tax collections tend to be lower during a recession as retail sales lag. Unemployment, lower wages, foreclosures, and uncertainty about the future contribute to less spending. As employment and wages start to tick upward, sales are also beginning to pick up. A recent report from the Rockefeller Institute shows sales tax collections for the country as a whole starting to rebound from record lows.[5] The growth, however, is significantly slower than it was prior to the recession. In Minnesota, the January state economic update shows that sales tax receipts for November and December 2010 were slightly less than projected. However, the Rockefeller Institute report shows sales tax collections for Minnesota up 24.2 percent for the third quarter of 2010 compared to the same period in 2009.

Several years of slow or no growth in various revenue categories have stressed the state budget. Significant upward pressure on health and human service spending has exacerbated that stress. State forecasts over the last several years have shown projected biennial deficits in the billions. The most recent forecast, released in November 2010, projects a $6.2 billion shortfall for the 2012-2013 biennium.

LGA and MVHC reimbursement payments have been subject to significant cuts imposed by the executive branch and the Legislature over the last several years. Cities lost $66.5 million in aids and reimbursement in 2008, $64 million in 2009, and $180 million in 2010. The cuts totaled more than $300 million. The overall appropriations for 2011 and beyond were reduced by $57 million. Additional cuts for 2011 have not yet been enacted but, with the state facing a projected $6.2 billion deficit for fiscal year 2012-2013, further reductions to aid and credit reimbursement payments are certainly a possibility.

Cities' challenges stem not only from a loss of state dollars, but also from problems created by the general economic condition. Foreclosures continue to plague cities, creating both cost and revenue problems. Recent data show an increase in the number of foreclosures statewide. The third quarter of 2010 saw the second-highest number of foreclosures in the state since the current crisis began.[6] This growth was likely driven by increases in the seven-county metro area, which saw an increase of 21 percent over the second quarter of 2010. Cities incur costs related to securing vacant and

[2] Minnesota Management and Budget. "January Economic Update." January 2011.
[3] Minnesota Department of Employment and Economic Development. "State and National Employment and Unemployment." Last accessed 2/2/2011.
[4] "Quarterly Census of Employment and Wages." Minnesota Department of Employment and Economic Development. Last accessed 2/3/2011.
[5] Boyd, Donald J. and Lucy Dadayan. "State Tax Revenues Gained New Strength in Fourth Quarter: Every Quarter of 2010 Showed Growth, But Recession's Harsh Impact Will Linger." February 2011, No. 82.
[6] HousingLink. "Minnesota Foreclosure Update Q3 2010." November 5, 2010.

foreclosed properties, including snow removal, boarding windows, and preventing vandalism and other criminal activity. Property tax delinquencies as well as unpaid utility bills often increase as homeowners go into default, and tax bases shrink as properties lose value.

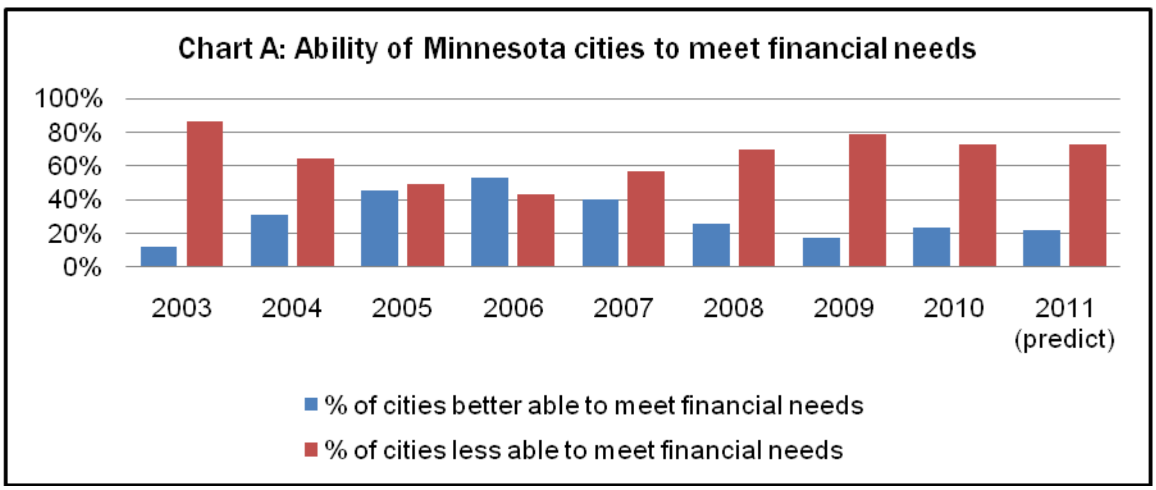
Despite facing numerous fiscal challenges, cities continue to provide services that residents and businesses expect and rely on. Elected officials have had to make tough decisions about whether to increase revenues or cut services. In many communities, they have had to take the painful step of doing a combination of cutting services and raising the property tax levy. Around the state, cities have undertaken a variety of strategies to balance their budgets.

Fewer than one-quarter of cities were better able to meet needs in 2010

Highlights of this section:

- The share of cities reporting an improved ability to meet needs increases slightly from just 17 percent in 2009.
- Looking ahead, 22 percent of cities predict an improved ability to meet needs in 2011.

The share of cities that reported being better able to meet their financial needs increased from 17 percent in 2009 to 23 percent in 2010[7] (see Chart A[8]). This is the first time this share has increased since 2006. Looking ahead, a slightly smaller share of cities, 22 percent, predict an improved ability to meet needs in 2011. While the mix of cities responding to the survey naturally varies each year and must be considered when comparing yearly data, responses from only those cities that have completed the survey every year show a similar trend. The portion of these cities reporting improved conditions increased from 16 percent in 2009 to 27 percent in 2010. Just under one-quarter of these cities anticipate an increased ability to meet needs in 2011.



[7] The measure of "better able" or "less able" is a relative comparison between a city's fiscal condition in the current year and in the prior 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're able to meet needs in any given year.

[8] 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 cities. Many cities that leave the question regarding ability to meet fiscal needs blank do so because they feel that there is no change in this ability between years.

The share of cities reporting an increased ability to meet needs grew annually between 2003 and 2006 when roughly half of cities reported an improved ability to meet needs. From 2007 to 2009, this trend reversed, with the proportion reporting a diminished ability to meet needs growing while the share reporting an easier time fell. In 2010 this pattern changes with a slightly greater share reporting better conditions and a slightly smaller share reporting more difficulty. It remains to be seen whether the share reporting improved conditions will continue to grow. It is important to remember that this is a relative measure; "better able" does not necessarily mean conditions are favorable, only that they're better than in the prior year. Also, cities are working to adapt to the "new normal." Finally, cities had some time to prepare for the 2010 aid and credit reimbursement cuts while they did not have much time at all to react to the earlier reductions. More certainty may translate into feeling more optimistic.

The National League of Cities (NLC) survey conducted in the spring of 2010 shows that just 13 percent of city officials nationwide were better able to meet fiscal needs in 2010 than in 2009.[9] Although conducted at a different point in time, survey results from Minnesota cities are slightly more positive with 23 percent reporting an easier time meeting needs in 2010. Looking to 2011, this trend holds with 80 percent of officials nationwide compared with 73 percent of Minnesota city officials predicting a decreased ability to meet needs.

Aid and levy limit status create fewer differences in fiscal outlook among cities

Highlights of this section:

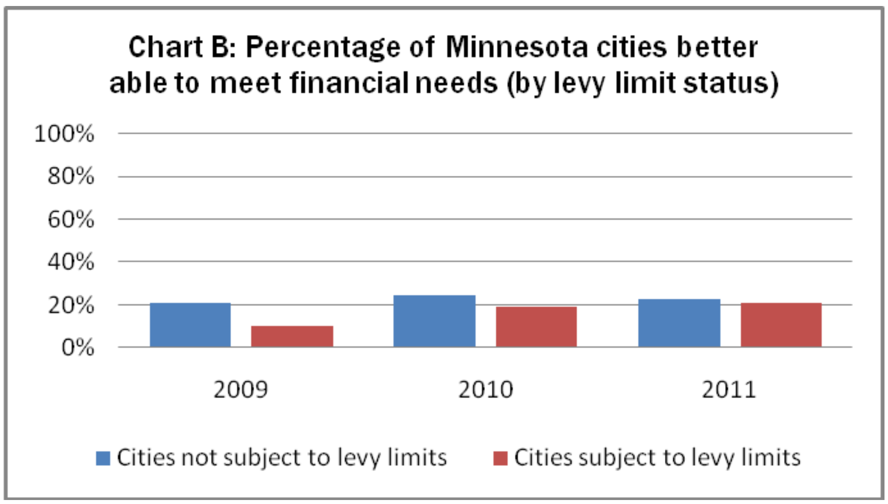
- The gap between cities that lost aid and/or credit reimbursement payments in all three years and those that did not is much smaller than in the past.
- The gap between cities governed by levy limits and those not subject to them narrows compared with prior years.

This year's survey responses reveal fewer differences between groups of cities that face specific challenges. Cities over 1,000 in population lost state aid and credit reimbursement payments through Gov. Pawlenty's unallotment in December 2008. This cut occurred just days before the end of the budget year and left cities with few options. The governor later announced cuts to 2009 and 2010 aid and reimbursement payments as part of his unallotment plan in the summer of 2009. This announcement came midway through cities' budget year after property tax levies for 2009 had been certified. Although the 2009 and 2010 unallotments were ruled unconstitutional, they ultimately did affect cities as they were ratified into law by the Legislature. In efforts to erase another state budget deficit, the 2009 Legislature enacted additional cuts to city aid and reimbursement payments in 2010. Even though cities were given more time to prepare for the 2010 reductions, the repeated cuts combined with challenges created by the economic downturn reduced the options available. Cities under 1,000 in population and with tax bases under the statewide per capita average were exempt from the 2009 and 2010 ratified unallotment cuts. There were no exemptions to the additional cuts in 2010.

[9] Hoene, Christopher W. and Michael A. Pagano. "Research Brief on America's Cities: City Fiscal Conditions in 2010." National League of Cities. October 2010.

Last year, just 9 percent of cities that lost aid and credit reimbursement payments through unallotment in 2008 reported an improvement in ability to meet needs while more than one-quarter of cities not subject to those unallotments did so. A similar trend held for cities subject to the 2009 ratified unallotments. This year, the gap between cities that had payment cuts in all three years and those that did not is much smaller; 20 percent of cities that lost aid and/or credit reimbursement in all three years report being better able to meet needs in 2010 compared to 24 percent of cities that did not lose funds in all three years. This trend is due in part to the fact that at least somewhat, cities are adapting to the "new normal," and that cities did not have to deal with mid-cycle cuts in 2010.

Cities with populations over 2,500 have been subject to levy limits for tax years 2009, 2010, and 2011. On last year's survey, 21 percent of cities not subject to levy limits reported an improved ability to meet needs while just 10 percent of cities bound by levy limits did so. This year the gap narrows with 24 percent of cities not governed by levy limits and 19 percent of cities restricted by levy limits reporting increased ability to meet needs (see Chart B).

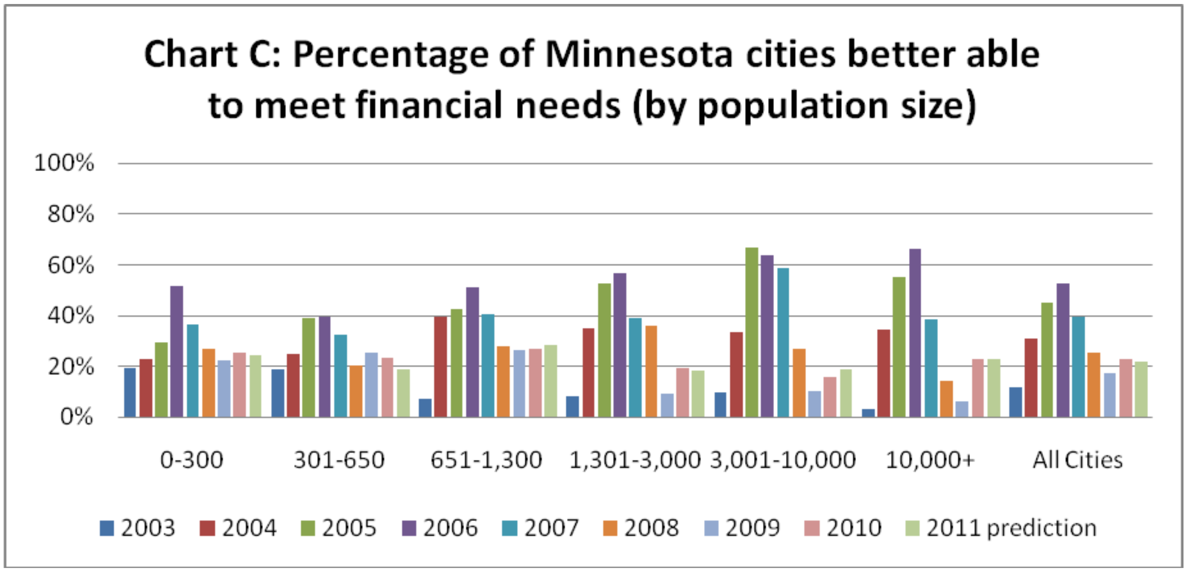


Outlook on ability to meet needs by city size echoes overall trend

Highlights of this section:

- The increase in the share reporting favorable conditions from 2009 to 2010 is greatest among cities over 1,300 in population. Just 6 percent of cities over 10,000 in population reported an easier time meeting needs in 2009.
- For 2011, city officials' predictions for the future revealed no clear trend as to what size cities are predicting more favorable conditions.

When looking at cities by population size category, the trend looks similar to that of the overall trend for cities. The percentage of cities reporting an increased ability to meet needs grew for the first time since 2006 in all but one population size category. The proportion of cities with populations between 301 and 650 reporting positive conditions fell from the proportion doing so in 2009. This size category deviated from the overall trend in 2009 as well (see Chart C).



The increase in the share reporting favorable conditions from 2009 to 2010 is greatest among cities over 1,300 in population. Just 6 percent of cities over 10,000 in population reported an easier time meeting needs in 2009. This share jumped to 23 percent in 2010. The annual change in this share over the last several years has been much smaller for cities under 1,300. Larger cities have been subject to aid and reimbursement cuts since 2008; the smallest cities lost aid and/or reimbursement payments beginning in 2009. Looking to 2011 there is no clear trend in the share of cities predicting more favorable conditions. Three size categories show a decrease, like cities overall; two categories see an increase; and there is no difference for cities over 10,000.

Regional trends differ from those in years past

Highlight of this section:

- One-third of metro cities compared to just 21 percent of outstate cities report an easier time meeting needs.

For the past two years, a smaller percentage of metro cities than Greater Minnesota cities reported being better able to meet financial needs than in the prior year. This year, that trend flips with almost one-third of metro cities and just 21 percent of outstate cities reporting an easier time meeting needs. The same reversal is seen among cities classified as metropolitan statistical area (MSA)[10] cities compared to those that are not (see Table A).

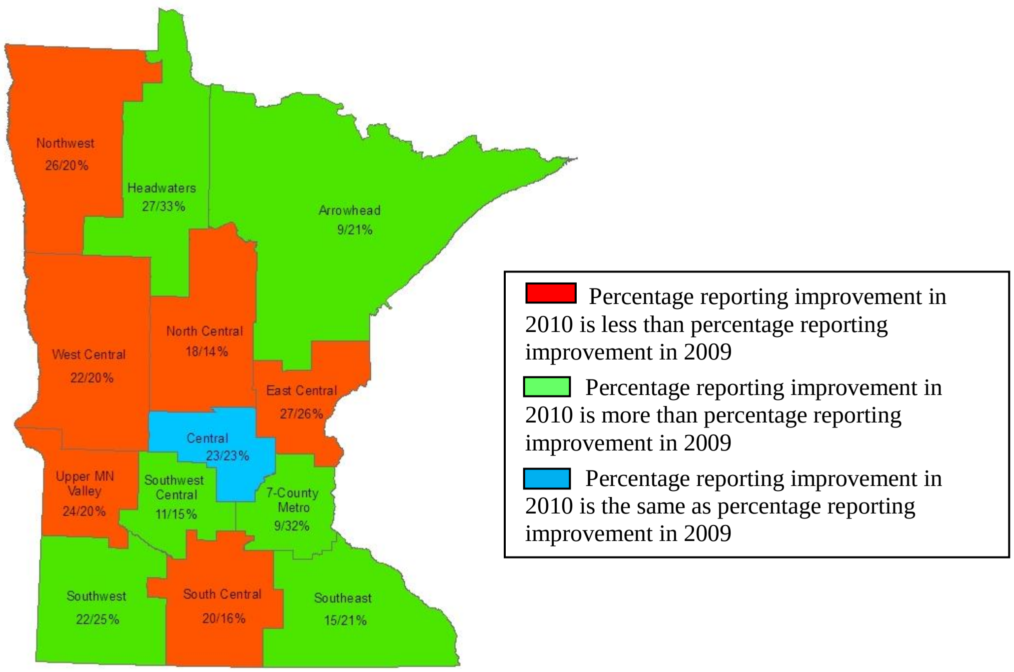
[10] A metropolitan statistical area (MSA) is defined by the U.S. Census Bureau as a geographical area containing at least one urbanized area of at least 50,000 inhabitants with a total area population of at least 100,000. The area consists of one or more counties. The seven MSAs that include at least 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	2011 predicted
MSA cities	35%	48%	57%	46%	24%	15%	25%	24%
All Cities	31%	45%	53%	40%	26%	17%	23%	22%
Non-MSA cities	29%	43%	50%	34%	27%	20%	21%	21%

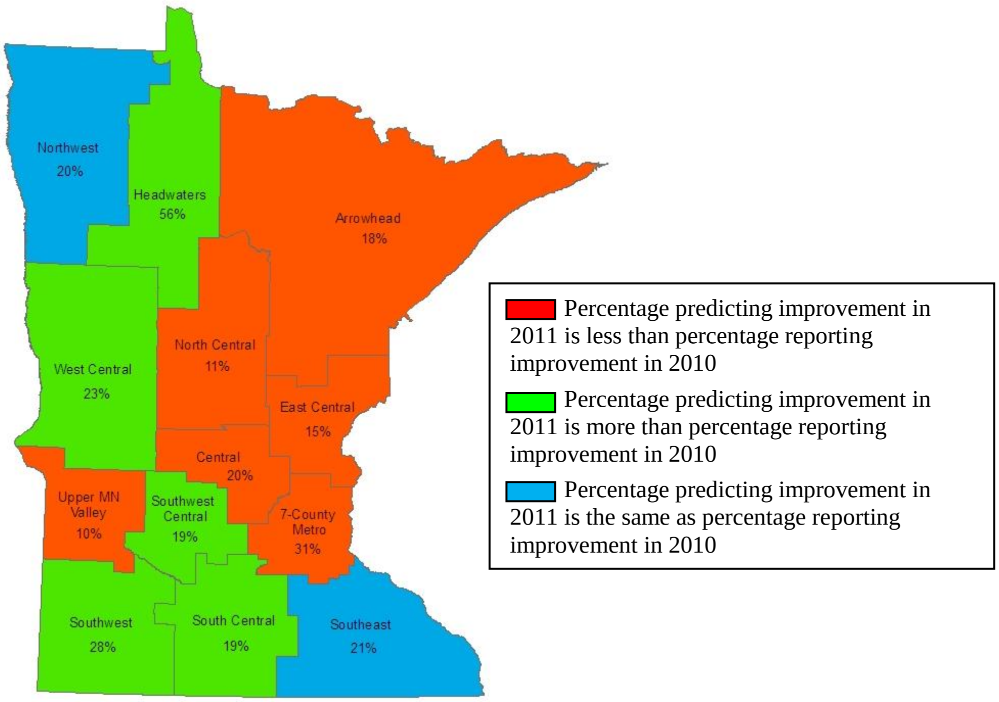
While the share of cities reporting an improvement in fiscal conditions was smaller than the portion reporting a decline in all regions, there is some variation among the regions. The Central region saw no change from 2009 to 2010 in the share of cities reporting improved conditions. The remaining 12 regions were split equally among those where the share reporting improved conditions increased over last year and those where it decreased (see Figure 1).

Figure 1: Percentage of cities better able to meet needs in 2009/2010 (by region)



When looking ahead to 2011, the portion of cities predicting more favorable conditions is greater than the share reporting better conditions in 2010 for five regions (see Figure 2). With the exception of the Upper Minnesota Valley region, all the regions in the western half of the state are in this category or see no change in this share. The Headwaters region is especially optimistic with 56 percent of cities predicting an easier time in 2011. The regions in the eastern half of the state either see a decrease in this share or no change.

Figure 2: Percentage of cities predicting improved conditions for 2011 (by region)



Share of cities reporting shortfalls in property taxes, state revenues and federal revenues grows

Highlights of this section:

- For 2010 larger shares of cities reported shortfalls in the two primary city revenue sources: local property taxes and state revenues.
- Just over half of cities saw fee revenue fall below expectations in 2010.
- The share of cities reporting shortfalls in property taxes has grown the most, with just 28 percent reporting less than expected revenues in 2003 compared with 68 percent for 2010.

For 2010, larger shares of cities reported shortfalls in the two primary city revenue sources: local property taxes and state revenues (see Table B). More than two-thirds of cities experienced shortfalls in each category. These increases were slightly smaller than the jumps seen in these categories from 2008 to 2009. For the first year ever, the share of cities reporting shortfalls in fees and charges fell over the prior year. However, just over half of cities still saw fee revenue fall below expectations in 2010.

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%
2010	68%	51%	8%	3%	11%	73%	22%

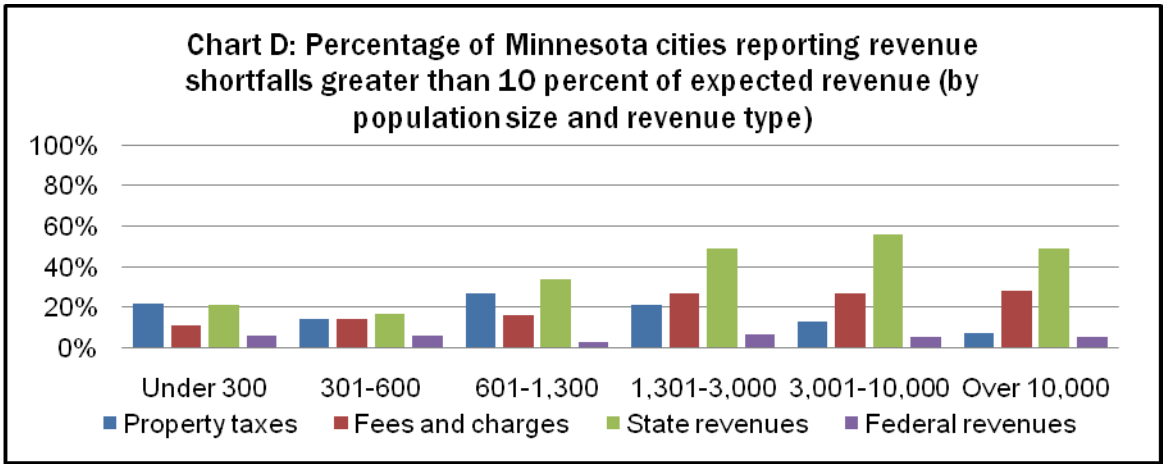
*Combines shortfalls of greater than and less than 10 percent of expected revenues

Cities experienced significant cuts in state aid during the state budget crisis of 2003. Compared to that year, the share of cities reporting shortfalls in 2010 is higher in all revenue categories except state revenues. However, almost three-quarters of cities did experience shortfalls in state revenues in 2010. The fact that all cities were affected by state aid and credit reimbursement reductions in 2010 likely explains some of this increase. The proportion of cities reporting shortfalls in federal revenues grew noticeably from 16 percent in 2009 to 22 percent in 2010. This share had fluctuated between 12 and 16 percent over the last five years.

The share of cities reporting shortfalls in property taxes has grown the most. Only 28 percent reported less than expected property tax revenues in 2003 compared with 68 percent for 2010. One reason for this increase is likely the fact that MVHC reimbursement payments have been reduced substantially.[11] In 2010 alone, cities lost almost $70 million, or 85 percent, in reimbursement payments. A loss of MVHC means a city does not realize its full certified levy even as homeowners continue to receive the credit on their tax bills. Another potential reason for this response is delinquent property tax payments as taxpayers struggle with the economic recession and the growing number of foreclosures. The recession also likely contributed to the increase in cities experiencing shortfalls in fee revenue. Just 16 percent of cities reported an increase in service needs of new developments suggesting a slowdown in development which results in less revenue from permits.

In past years, the share of cities reporting shortfalls of more than 10 percent in state revenues has generally increased as population size increased. As Chart D illustrates, that pattern is not found this year. Cities under 1,000 were generally exempt from the 2008, 2009, and 2010 aid and reimbursement unallotment cuts. However, all cities were subject to the 2010 supplemental cuts. After multiple years of cuts, some cities are starting to budget to expect less than their certified LGA amount.

[11] Some cities may report a loss of MVHC in this way. Other cities may report such a loss as a shortfall in state revenue.



As in past years, smaller cities were generally 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. Larger cities generally have more options for implementing fees than small cities do.

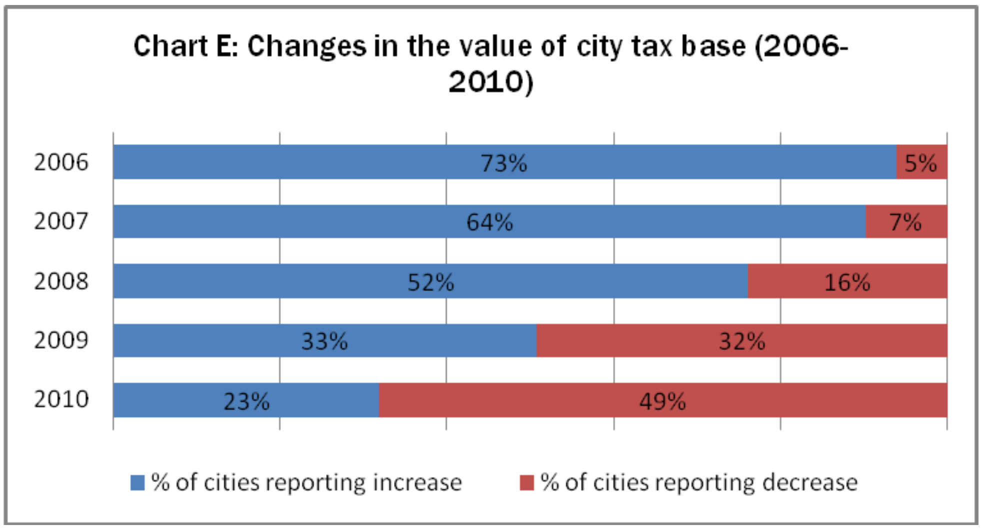
Cities within the seven-county metro area were more likely than Greater Minnesota cities to report significant shortfalls in state revenue (45 percent vs. 33 percent). While the share of metro cities reporting these shortfalls is smaller in 2010 than it was in 2009 when just under two-thirds did so, the share of outstate cities reporting such shortfalls increased. This is likely due to the fact that the supplemental 2010 aid and credit reimbursement cuts affected all cities whereas previous cuts had mainly affected cities over 1,000 in population. Non-metro cities are more likely than metro cities to report shortfalls over 10 percent in property tax revenue (20 percent vs. 10 percent). The reverse is true when looking at revenue from fees and charges, with 28 percent of metro cities reporting significant shortfalls compared to just 18 percent of outstate cities.

Changes in a variety of budget factors contribute to city fiscal challenges

Highlights of this section:

- In 2009 roughly one third of cities saw increasing tax bases while another third experienced an actual decrease in value. For 2010, the share reporting an actual decline jumps to just under 50 percent while the share seeing an increase falls to 23 percent.
- The five budget factors identified by the most cities as having increased in 2010 were the same as in 2009—prices, cost of living, and inflation; infrastructure needs; cost of employee health benefits; cost of employee pensions; and cost of employee wages and salaries.
- The top factors identified as having at least a moderate impact on cities' budgets in 2010 are changes in prices, inflation, and cost of living (69 percent); tax base changes (67 percent); infrastructure needs (65 percent); local economic health (63 percent); and employee health benefits (56 percent).

Each year cities are asked to identify whether a wide variety of budget factors increased, remained the same, or decreased over the prior year. While most of this year's findings follow trends seen in past years, there are a few deviations. As in past years, most trends impact the budget negatively by creating new fiscal challenges or exacerbating existing ones. For example, an increase in public safety or infrastructure needs creates cost pressures to meet those growing needs. The biggest change over prior years is in how cities report changes in the value of the tax base. Last year roughly one-third of cities saw increasing tax bases while another third experienced an actual decrease in value. This year the share reporting an actual decline jumps to just under 50 percent while the share seeing an increase falls to 23 percent. As recently as 2008 the reverse was true with over 50 percent of cities experiencing growth in the value of the tax base (see Chart E). This change is likely due to the lag between residential assessed market values and declines in housing prices. Assessors determine market values by January of the year before taxes are payable, meaning that values for taxes payable in 2010 were set in January 2009. The impact on city tax bases of the foreclosure crisis and bursting of the housing bubble are being seen.

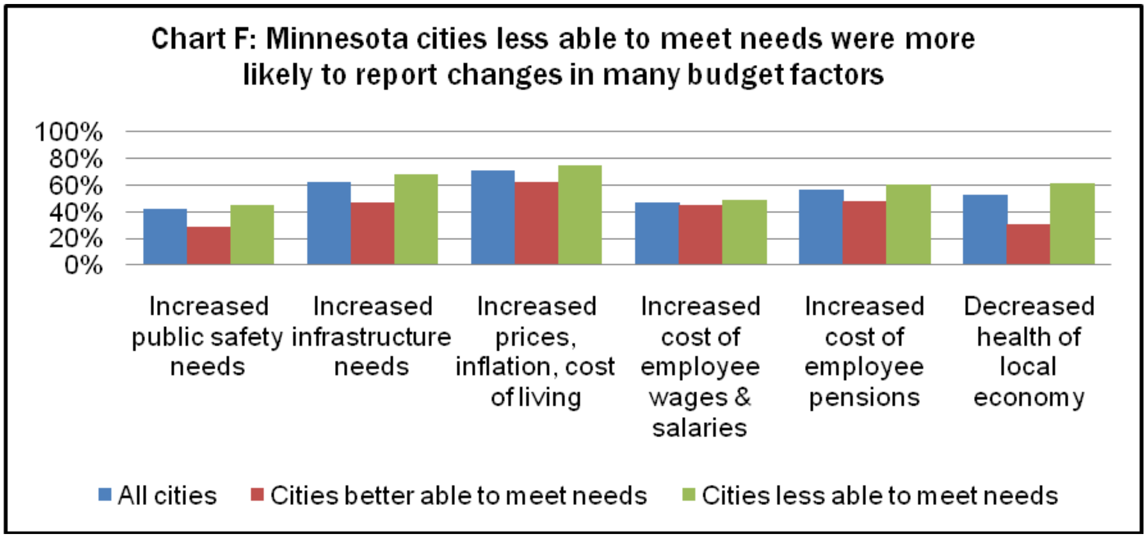


The five budget factors identified by the most cities as having increased in 2010 were the same as in 2009—prices, cost of living, and inflation; infrastructure needs; cost of employee health benefits; cost of employee pensions; and cost of employee wages and salaries. For most of these factors the share reporting an increase changed very little over the share doing so in 2009. However, while 55 percent of cities reported an increase in employee wages and salaries in 2009, just 47 percent did so in 2010 (48 percent report maintaining wages and salaries over the last year).

Many of these leading factors were also the top factors identified by city officials nationwide in the recent NLC survey. The cost of employee health benefits, pension costs, and infrastructure needs were all identified as increasing by at least three-quarters of respondents.

While about one-quarter of cities reported an increase in tax and expenditure limits in 2009, just 15 percent did so in 2010. The last tax year for which cities over 2,500 in population are subject to levy limits under current law is 2011. Levy limits were imposed on these cities for taxes payable in 2009, 2010, and 2011.

Survey findings suggest that many of the broad economic problems challenging cities may be easing or at least not worsening. The proportion of cities reporting an increase in the local economy increased slightly from 7 percent in 2009 to 9 percent in 2010. This small turnaround comes after three straight years of decreases in this measure. Similarly the share seeing a decline in the local economy fell from 58 percent in 2009 to 53 percent this year while the share reporting no change increased to 35 percent from 31 percent. Changes in all of these budget factors are related to a city's overall ability to meet fiscal needs (see Chart F).



Cities experience changes in these budget factors differently depending on their unique circumstances. How well a city responds to fiscal challenges is influenced by the combination of challenges facing a city and the budget-balancing strategies available to it. Cities are asked to indicate how much impact the change in each budget factor had on their city over the prior year. The proportion of cities reporting at least a moderate impact on their 2010 budgets increased slightly over the share doing so in 2009 for roughly two-thirds of budget factors. The greatest increase is in the share reporting at least a moderate impact due to changes in the value of the tax base (67 percent in 2010 vs. 58 percent in 2009). This is not surprising as the share reporting a decrease in the tax base increased dramatically over 2009.

A smaller share of cities in 2010 than in 2009 reported at least moderate impacts on their budgets due to changes in tax and expenditure limits, cost of employee health benefits, cost of employee wages and salaries, and local economic health. The greatest decrease was in the share reporting at least moderate impacts due to changes in tax and expenditure limits, with just over a quarter doing so in 2010 compared with 35 percent that did so in 2009. This decrease may be due to the fact that 2010 marked the third and final year, under current law, that cities over 2,500 in population had to work with levy limits when preparing their 2011 levy.

The top factors identified as having at least a moderate impact on cities' budgets in 2010 are changes in prices, inflation, and cost of living (69 percent); tax base changes (67 percent); infrastructure needs (65 percent); local economic health (63 percent); and employee health benefits (56 percent). These are the same top factors as identified in 2009.

A city's response to its fiscal challenges is influenced not only by the unique combination of hardships it faces but also by how severely changes from budget factors are felt. For all budget factors, the proportion of cities reporting no impact was greater for those cities that indicated being better able to meet needs in 2010. For all budget factors except employee wages and salaries, the share of cities reporting a major impact was greater among cities reporting a decreased ability to meet needs in 2010. Similar patterns were observed last year.

Cities respond in multiple ways to budget challenges

Highlights of this section:

- Nearly all cities, 95 percent, reported using at least one strategy in 2010. The average number of strategies employed by a city was 5.4.
- Almost half of cities reported using between four and seven different strategies in 2010 versus in 2009 when half reported using just one to three strategies.
- The share of cities making human resource-related cuts is 70 percent. One-quarter of cities reduced the workforce in 2010.

Cities respond to their unique combinations of fiscal challenges in a variety of ways depending on several factors. A city's response may depend on its local tax base, resident needs and preferences, the services provided, local ordinances and policies, and opportunities for raising revenue. The type of challenge—one that results in less revenue or one that means increased cost pressures—also influences how a city responds. Further, not every strategy is viable in every community.

Cities lost state aid and credit reimbursement in 2008, 2009, and 2010, and many see this trend continuing into the future given the state's ongoing structural budget problems. The mid-year aid and credit reimbursement cuts in 2008 and 2009 resulted in cities having to not only plan for the future but make mid-year adjustments to the current budget. With uncertainty over future cuts looming, cities may prepare budgets that can be adjusted to account for mid-year cuts.

Cities were asked to identify the strategies they used in 2010 to prepare for 2011. Almost all cities, 95 percent, reported using at least one strategy in 2010. The average number of strategies employed by a city was 5.4 (see Table C). This is greater than the average last year, 3.4 strategies. Cities are likely using a larger combination of strategies to address needs. Almost half of cities reported using between four and seven different strategies in 2010. In 2009, half reported using just one to three strategies.

Table C: Number of budget-balancing actions employed by Minnesota cities in 2010

	Implemented in 2010
Average number of strategies per city	5.4
1-3 strategies	104 cities, 22% respondents
4-7 strategies	228 cities, 49% respondents
8-10 strategies	82 cities, 18% respondents
11-15 strategies	24 cities, 5% respondents
No reported strategies	25 cities, 5% respondents

Most of the strategies cities are asked about can be grouped into broad categories. Table D shows the trends in these categories over the last eight years. Revenue increases include property tax increases and increases in fees, charges, and license fees. Cuts in infrastructure, public safety, and other spending along with reductions in the overall growth rate of spending comprise the spending decreases category. Increasing efficiencies includes increases to productivity levels, contracting out or privatizing, and increasing inter-local agreements.

Table D: Budget-balancing actions taken by cities (2003-2010)

	Revenue increases	Spending decreases	Increasing efficiencies	Workforce cuts	Service cuts	Draw down reserves
FY 2003	85%	55%	33%	26%	20%	60%
FY 2004	84%	47%	34%	22%	15%	46%
FY 2005	83%	12%	32%	5%	9%	33%
FY 2006	83%	11%	31%	5%	3%	31%
FY 2007	85%	12%	32%	6%	6%	32%
FY 2008	76%	32%	26%	15%	13%	47%
FY 2009	70%	46%	29%	26%	16%	44%
FY 2010	71%	35%	30%	25%	16%	35%

Except for decreasing spending and drawing down reserves, the share of cities taking action in each category remained roughly the same as last year. A smaller share of cities reported drawing down reserves in 2010 than the share that did so in 2009 (35 percent vs. 44 percent). Half of cities reported making no changes to their reliance on reserves. The state auditor recommends that cities maintain a fund balance of roughly 35 percent to 50 percent of operating revenues or no less than five months of operating expenditures.[12] Cities may also set a policy regarding the minimum fund balance allowable. For many cities, the option to dip into reserves may not exist. They may have exhausted their reserves in order to absorb aid and/or reimbursement reductions.

Cities were asked if, over time, they've changed what their fund balance is used for. While the majority of cities, 70 percent, have not, 16 percent reported changing their use of the fund balance over time. An additional 11 percent reported not knowing whether or not there has been a change. Many of the responses from cities that have changed what the fund balance is used for suggest that cities are relying on reserves more for short-term, day to day needs rather than for long-term or future, planned expenditures. One city characterized their fund balance as necessary for survival now whereas it used to be a "just in case" fund. Several cities wrote about now using the fund balance to cover general operating expenses instead of for planned capital projects, emergencies, or other future expenses. Others described needing to use reserves to cover necessities or shortfalls in the general fund. Some attributed these shortfalls are due to cuts in state aid and credit reimbursement payments. Another city has used reserves to make up for unpaid assessments.

The portion of cities implementing spending decreases fell from 46 percent in 2009 to 35 percent in 2010. This drop does not mean that cities spent more in 2010. In fact, 77 percent of cities reported no change in at least one of the discrete actions that make up the broader category of spending decreases. Cities may not be able to continually reduce spending without jeopardizing core services. Providing public services is a people-intensive activity. For many cities in the state with small staffs—1 or 2 people—there just aren't opportunities to eliminate positions (and therefore costs) without devastating service quality and availability. Just 13 percent of cities

[12] Office of the State Auditor. "Statement of Position: Fund Balances for Local Governments (GASB 54 Version)." December 2010.

reported decreasing public safety in 2010 (see Table E). Cities that have made reductions to their police department reported declines in service levels. Several cities that cut back on patrol officers have experienced an increase in vandalism or crime in general. Another city police department with decreased patrol hours has seen an increase in response time and has been unable to respond to some non-emergency calls.

Table E: Specific budget-balancing actions taken by Minnesota cities (2007-2010)

	Increase in taxes	Increase in fees/charges	Decrease in growth rate of spending	Decrease in infrastructure spending	Decrease in public safety spending	Decrease in other spending	Increase in number/scope of inter-local agreements
FY 2007	79%	36%	5%	6%	3%	4%	12%
FY 2008	67%	36%	14%	20%	11%	18%	13%
FY 2009	61%	35%	30%	21%	17%	33%	13%
FY 2010	60%	37%	20%	14%	13%	23%	14%

Both of the revenue-increasing actions, increasing taxes and increasing fees and charges, saw slight changes from 2009. The proportion of cities implementing tax increases has trended down since 2007. This may be due to the imposition of levy limits on cities over 2,500 in population. It could also be due to cities making the policy decision not to increase property taxes in recognition of the economic struggles facing their taxpayers. The share of cities implementing increases in fees and charges is up two percentage points over 2009. Cities may need to adjust fees to cover the cost of providing the service or may be moving some services, such as street light provision, off of the property tax. The changes in these actions could also be due to the different mix of cities responding in each year.

The share of cities increasing efficiencies trended up slightly for the second year in a row. Cities have engaged in these types of activities for many years. As cities continue to face fiscal challenges, finding new ways of doing things or collaborating with other local governments may be pursued as other approaches are exhausted. Of course, not all strategies are viable for all cities.

Cities have also employed human resource-related reductions to meet budget challenges. The survey first included questions on these types of actions last year. When workforce reductions are included, the share of cities making human resource-related cuts is 70 percent. As Table F illustrates, the share of cities taking each action in 2010 is slightly smaller than the share that did so in 2009. Again, cities may not be able to repeatedly make cuts in these areas without dramatically impacting service levels. However, challenges related to the economy and the state’s budget situation have forced cities to make tough choices with regard to their staff. One-quarter of cities reduced the workforce in 2010. This may be done through layoffs or by not filling a position when someone retires or resigns.

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

	2009	2010
Reduced workforce	26%	25%
Cut or maintained wage levels	65%	63%
Increased use of furloughs	6%	3%
Reduced employee benefits	11%	9%
Made at least one HR action	74%	70%

Cities responding to the NLC survey were also asked about actions taken in response to budget challenges. While the list of actions varied from that presented to Minnesota cities, the most commonly reported strategies include enacting some type of personnel-related cut, delaying or cancelling capital infrastructure projects, and cuts in services other than public safety and human-social services (79 percent, 69 percent and, 44 percent). On the revenue side, 40 percent of cities nationwide increased the level of fees, and 23 percent increased the local property tax rate.

As cities reduce the workforce and contend with tight budgets, the use of volunteers may become an attractive option. Some cities have used volunteers for many years to help with tasks such as parks maintenance through adopt-a-park programs or with recreation offerings. As reported in recent news stories, some cities such as Mankato and Wayzata have organized volunteer programs.[13] Red Wing posts volunteer opportunities on the city website. Other cities use volunteers on a case by case basis such as Ham Lake where volunteers and a federally subsidized worker took over coordination of the senior center when the city could no longer fund a paid coordinator position. Other cities are using volunteers to help clean bus shelters, rake the city cemetery, stake city construction projects, and staff phones so paid staff can tend to other duties. There are some tasks that are not appropriate for volunteers due to the training required or the need for confidentiality. For example, Wayzata did not have success in using volunteer receptionists as they were unable to provide information callers requested.[14]

Cities were asked whether their use of volunteers has changed over the last year. While the majority of cities reported no change, 16 percent reported using volunteers for more things and 15 percent reported an increase in the number of volunteers. Just 12 percent replied that their city does not use volunteers. There are some differences by city size. Over one-quarter of the largest cities reported using volunteers for more things while just 15 percent of the smallest cities did so. The smallest cities had the greatest share of cities responding the city does not use volunteers, with 20 percent of cities under 300 in population doing so. This share decreased as city size increased; just four percent of cities over 10,000 reported not using volunteers to help with city work.

Minnesota cities were asked to describe any unintended negative consequences their budget-balancing actions have had. The responses can be grouped into the broad categories shown in Table G. Just under one third of the unintended consequences are employee-related. Several cities commented on the impact reductions have had on employees, including decreased morale, lower

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[13] Goerdt, Jana. "Adopting a helpful attitude, volunteers keep Iron Range, other cities spruced up." Duluth News Tribune. 28 February 2011. And Hopfensperger, Jean. 27 February 2011.

[14] Hopfensperger, Jean. "Volunteers help fill holes that budget cuts left in cities' staffs." Star Tribune. 27 February 2011.

job satisfaction, and increased workloads. A knowledge gap following the early retirements of several long-time employees is facing one city.

Table G: Unintended consequences of budget actions reported by cities

Type of consequence	Share*
Employee related	30%
Impact of delayed purchases/projects	23%
Public safety related	23%
Impact on residents	19%
Future budget	4%

*share is of reported unintended consequences

Almost one-quarter of cities wrote about negative impacts stemming from delays in projects or purchases. Cities that have reduced spending on street repairs have experienced severe degradation of city streets. One city shared that its streets are now in such poor condition due to deferred repairs that they require complete replacement. Roughly another quarter describe the effects cuts to public safety have had on the city. Several cities wrote about a decrease in coverage or an increase in response times following a reduction in police staff or hours. Others described the increase in vandalism, graffiti, parking violations, and traffic violations following cuts to the police department.

Several cities described the impact budget actions have had on residents. A city that increased utility rates has seen an increase in delinquencies as residents struggle to pay higher bills. The residents of a city that contracted out election services to the county experienced a loss of absentee voting opportunities. One city that has left several staff positions open wrote that residents now perceive these positions as unnecessary. Conversely, the city intended this as a short-term strategy and worries about overburdening remaining staff over the long term.

A few cities wrote about the effect recent budget decisions will have on future budgets. One city that used reserves to balance the 2011 budget without a levy increase commented that this practice would not be sustainable into the future. Another city that has increased its levy in recent years suggested that this action likely contributed to the failure of two school referendum levies.

Conclusion

After three consecutive years of declines in the share of Minnesota cities reporting improvement in their financial circumstances, this share edged upwards in 2010. It is important to remember that the ability to meet needs is a relative measure comparing a city's ability in one year to another. A city reporting improvement is not necessarily facing favorable conditions but is more easily able to meet needs compared to last year. After several years of a down economy, cities are working to adapt to the "new normal." Cities that lost state revenue to unallotment and legislative cuts in each year between 2008 and 2010 were again less likely to report being better able to meet needs. However, the gap between those losing funds each year and those that didn't narrowed considerably. Cities had more time to prepare for the 2010 aid and credit reimbursement cuts than they did for past reductions. A similar trend was observed between cities subject to levy limits and those not limited. Like cities overall, except for one size category, the portion of cities reporting an increased ability to meet needs grew for cities of all sizes. Metro cities were more likely to report better conditions in 2010 than were cities in Greater Minnesota.

Shortfalls in revenue impact a city's ability to meet needs. Slightly larger shares of cities reported shortfalls in property taxes, state revenues, and federal revenues in 2010. For the first time ever the portion reporting shortfalls in revenue from fees and charges fell compared to the prior year.

Cities are challenged by a variety of budget factors. Reported changes in most factors for 2010 follow past trends. However, almost half of cities now report a decrease in the value of the tax base. Last year just one-third did so. Changes in these budget factors can affect cities differently depending on their unique circumstances. The top factors identified as having at least a moderate impact on cities' budgets in 2010 include changes in prices, inflation, and cost of living; tax base changes; infrastructure needs; local economic health; and employee health benefits.

Cities use a variety of strategies to address fiscal challenges. Slightly larger shares of cities reported increasing revenues and efficiencies this year. The shares of cities reporting spending decreases, workforce cuts, and drawing down reserves fell over the prior year. Many strategies cities have used in the past may be exhausted or would severely compromise service levels. Many cities have been preparing for 2011 with the expectation of further cuts to aids and reimbursements. Cities are also mindful of burdens property tax increases may create for their taxpayers given the sluggish economy.