State of the Cities 2012: City Fiscal Conditions

Introduction

This marks the ninth consecutive year that the League of Minnesota Cities has asked member city officials to report on the kinds of fiscal challenges faced in their cities and to describe the strategies used to address those challenges (see the League's website for the 2012 survey instrument). A total of 449 cities participated in the survey for a response rate of 54 percent. It is important to remember that survey results must be considered as a snapshot of conditions at a specific point in time. Cities responded to the 2012 survey from December 6, 2011, through January 12, 2012.

This year city officials responded to four questions that have been asked every year as well as to several new questions about how police services are provided in their community. This report will discuss the responses to these four base questions, comparing them with data from prior years. City officials were also asked questions about police services, and a separate report explores those responses.

View report on Provision of Police Services Across Minnesota (pdf)

Cities continue to face recession and recovery-related challenges

The Great Recession and its slow recovery have been difficult for cities. Many problems that arose during the recession—unemployment, foreclosures, delayed or cancelled development, a weak housing market, and business closures—have become ongoing challenges. The state's continued budget difficulties (as demonstrated by yet another budget deficit during the 2011 legislative session) have also influenced city fiscal conditions. Many cities are making a variety of changes to adjust to the so-called "new normal."

Signs of recovery at the state level are slowly emerging. Minnesota's net general fund revenues in November and December were greater than forecast, due largely to stronger than projected individual income tax payments.[1] In contrast, sales tax collections were approximately $1 million less than forecast (A recent nationwide report found that overall state revenues are now back above pre-recession levels but are still below their peak levels.[2])

The state, however, continues to struggle to balance its budget. The 2011 regular legislative session opened with the state facing a $5 million deficit and ended without a budget agreement. Failure of the Legislature and governor to reach an agreement by the end of the biennium resulted in a state government shutdown beginning July 1, 2011. A court ruling was issued that ordered

[1] "January 2012 Economic Update," Minnesota Management and Budget (MMB), Jan. 2012.
[2] Dadayan, Lucy. "Tax Revenue Keeps Rising, But Growth Again Ticks Downward," Nelson A. Rockefeller Institute of Government, Jan. 2012.

specific state functions relating to the health and safety of Minnesotans to continue. Payment of city aid and market value credit reimbursement was included in this order. Gov. Dayton and legislative leaders came to agreement on major funding bills, a bonding bill, and tax bill on July 19. 2011. The governor called for a special session that afternoon, and all bills were signed into law the next day, officially ending the shutdown.

Cuts to city aid and credit reimbursement payments were included in the final budget agreement. While not as dire as some originally predicted, cities collectively lost $102 million in local government aid (LGA) and $48 million in market value homestead credit (MVHC) in 2011. The total LGA appropriation for 2012 and beyond was frozen at $426 million. The MVHC program was eliminated beginning in 2012 and replaced with a homestead market value exclusion program (HMVE). Under the new program, a portion of a homeowner's market value will be excluded from property taxes. The exclusion is calculated similarly to MVHC, but will shift taxes to all other property.

Some challenges cities have dealt with over the last several years may be lessening or at least not worsening. Levy limits, which have been in place for cities with populations over 2,500 since 2009, expired with taxes payable in 2011. There have been slight improvements in job numbers and the state's unemployment rate. Jobs were up slightly in the second quarter of 2011; overall wages were also up from 2010.[3] The state's unemployment for December fell to 5.7 percent from 6.9 percent the year prior.[4]

While foreclosures still plague many communities, data suggests that their numbers may be decreasing. Data from the second quarter 2011 shows a decline in foreclosures statewide over the same period in 2010.[5] However, the foreclosure crisis and recession continue to affect the real estate market in general. The statewide median sales price in 2011 was down 8 percent compared to a year earlier.[6] Total market value in cities was down almost 6 percent in 2011 compared to 2010.[7]

Despite these challenges, cities continue to provide services that many expect and rely on. As they make decisions about how to meet the community's needs given resource constraints, city officials employ various budget-balancing strategies, including cutting spending, collaborating with other local governments, and increasing property taxes or fees. As cities continue to navigate the new normal, strategies for addressing needs may change from those used in the past.

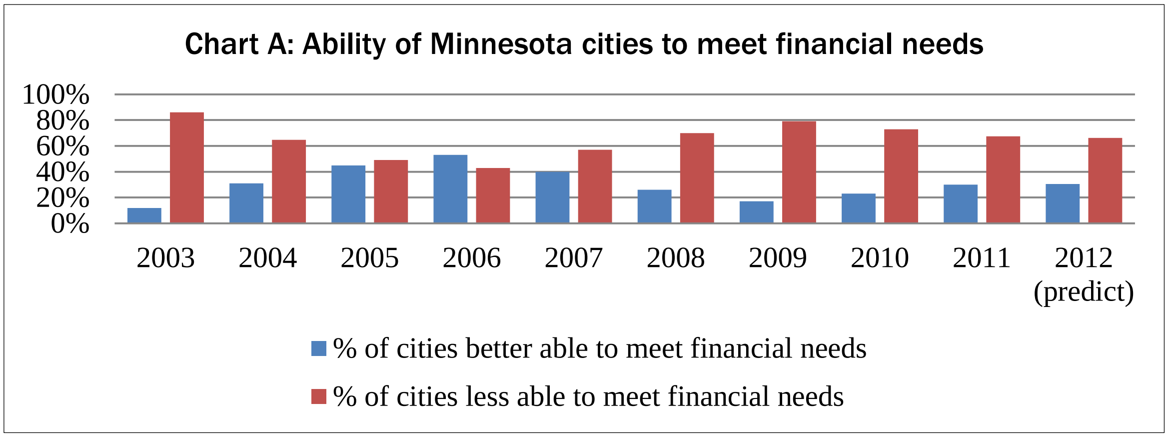
Share of cities reporting an improved ability to meet financial needs increases for second year in a row

Highlights of this section

[3] "Quarterly Census of Employment and Wages," Minnesota Department of Employment and Economic Development (DEED), Jan. 2012.
[4] "State and National Employment and Unemployment," DEED, Jan. 2012.
[5] check Housing Link in Feb. for Q3 data
[6] "Local Market Update for December 2011," Minnesota Association of Realtors, Feb. 2012.
[7] "2011 Property Tax Report," *Minnesota Cities*, Sept.-Oct. 2011.

- The share of cities that reported an increased ability to meet needs rose for the second year in a row, from 23 percent in 2010 to 30 percent in 2011.
- Looking to 2012, 31 percent of cities predict more favorable conditions.

The share of cities that reported being better able to meet financial needs during the past year grew from 23 percent in 2010 to 30 percent in 2011[8] (see Chart A[9]). This is the second time since 2006 that this figure has increased. Looking to next year, a slightly larger share of cities, 31 percent, predicts an easier time meeting needs in 2012. While the mix of cities responding to the survey changes each year and must be considered when comparing responses from multiple years, 59 cities have responded to the survey in all nine years. Data from this group show a similar trend with 31 percent reporting improved conditions in 2011, and 27 percent predicting better times in 2012.



The proportion of cities reporting an improvement in conditions increased annually between 2003 and 2006, when roughly half of cities reported being better able to meet needs. From 2007 to 2009 this share declined, until just 17 percent of cities reported more favorable conditions. This share edged upward in both 2010 and 2011; it remains to be seen whether this growth will continue. It is important to remember that "better able" does not mean that conditions are good, just that they're more favorable than in the prior year. Also, cities are working to adapt to the "new normal." Cities may be becoming more adept at meeting needs with fewer resources. Cities may now be accustomed to confronting problems that arose during the recession and may be less surprised by these challenges. Actions taken over the last several years may have improved their ability to meet needs now.

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[8] The measure of "better" 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.

[9] 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 of how to answer or if the question does not apply to their city. 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.

Likewise, a recent survey conducted by the National League of Cities (NLC) suggests that city officials nationwide may be adjusting their assessment and expectations of meeting fiscal conditions to reflect the new normal.[10] The survey, conducted in the spring of 2011, shows that 43 percent of city officials were better able to meet needs in 2011 than in 2010. Just 13 percent reported more favorable conditions on the 2010 nationwide survey.

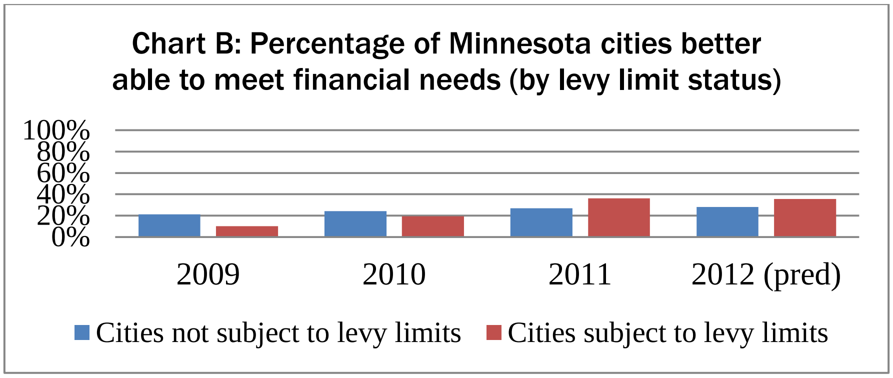
Cities have now been subject to aid and credit reimbursement cuts for four years. Many of these cuts have occurred midyear, beginning with then-Gov. Pawlenty's unallotment in December 2008, which reduced aid and credit reimbursement payments to cities over 1,000 in population. The now-ratified unallotment cuts for 2009 and 2010 were announced during the summer of 2009; additional cuts were enacted in 2010. Cities did have time to prepare for the 2010 and 2011 reductions, but have had to meet these challenges in the midst of addressing problems related to the recession such as a shrinking tax base and increased resistance to property taxes.

Survey responses reveal very few differences between cities that lost LGA payments each year since 2008 and those that did not experience cuts in each year. Roughly 30 percent in each group reported being better able to meet needs in 2011. The gap widens slightly when looking to 2012, with 29 percent of cities that did not have cuts in all four years predicting an easier time meeting needs, and 34 percent of cities with cuts each year doing so. Again, cities are likely adjusting to operating in the new normal and have reset their expectations for revenues and expenditures. Cities have prepared by making cuts, instituting layoffs, and implementing other reductions for the last several years.

The share of a city's revenue that is comprised of LGA varies from city to city. The LGA program was designed to equalize property tax bases around the state and ensure that Minnesotans in all communities have access to services without having to pay unreasonably high property taxes. The LGA formula measures a city's need against its capacity to pay for those needs. Some cities do not receive any LGA. For other cities, LGA is a very important revenue source. On this year's survey, 47 percent of cities that did not receive any LGA in 2011 reported being better able to meet needs. Over three-quarters of these cities have not been certified to receive LGA since 2008 and, thus, have not had to plan for a potential cut in aid. A smaller share, 27 percent, of cities that did receive LGA in 2011 reported an easier time meeting needs.

Levy limits were in place for cities with populations over 2,500 for 2009, 2010, and 2011. On last year's survey 24 percent of cities not governed by levy limits reported an improved ability to meet needs while 19 percent of cities bound by levy limits did so. This year cities that were restricted by levy limits were more likely to report an increased ability to meet needs than cities that were not subject to levy limits (36 percent and 27 percent, respectively) (see Chart B). This difference is likely due in part to population size (see next section).

[10] Hoene, Christopher W. and Michael A Pagano. "Research Brief on America's Cities: City Fiscal Conditions in 2011," National League of Cities, Sept. 2011.

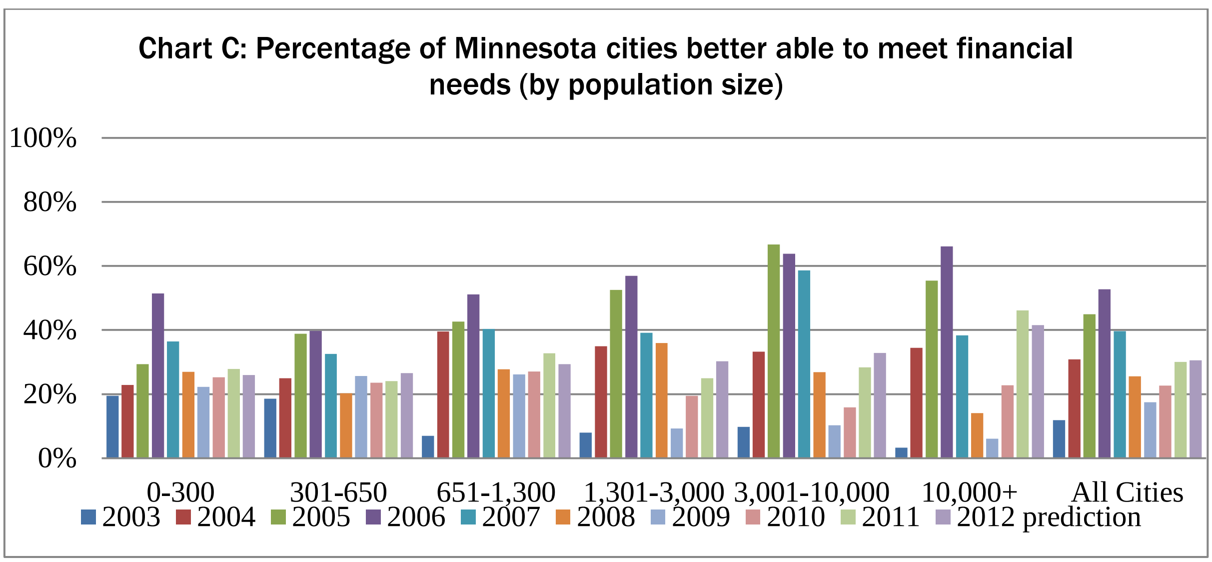


Trends by size follow pattern of cities overall

Highlights of this section

- The increase in the proportion reporting more favorable conditions from 2010 to 2011 is greatest among the largest cities. However, this share grew across all size categories.
- There is no clear trend in the share of cities predicting an easier time meeting needs in 2012. Cities in three size categories showed a decrease while the others showed an increase in the share predicting an improved ability to meet needs in 2012.

Just as the share of cities overall reporting an improved ability to meet needs in 2011 grew, so too did this share across all population size categories. For the past two years the proportion of cities with populations between 301 and 650 reporting positive conditions has fallen from the prior year. This year, the share grew ever so slightly, from just under 24 percent in 2010 to just over 24 percent in 2011 (see Chart C).



The increase in the proportion reporting more favorable conditions from 2010 to 2011 is greatest among the largest cities. This share also experienced a large jump in 2010. Since 2009 cities of all sizes have been subject to aid and credit reimbursement cuts. Looking ahead there is no clear trend in the share of cities predicting an easier time meeting needs in 2012. Three size categories—the smallest cities, the largest cities, and those between 651 and 1,300—showed a decrease while the others showed an increase in the share predicting an improved ability to meet needs.

Trends by region vary from overall trends

Highlights of this section

- Metro cities were more likely to report an improvement in conditions than Greater Minnesota cities.
- Across the state, all but two regions showed an increase over last year in the proportion of cities reporting an increase ability to meet needs.

Like last year, the share of cities reporting being better able to meet needs is larger for cities in the seven-county metro area than for Greater Minnesota cities (44 percent and 27 percent, respectively). The same trend is true among cities classified as metropolitan statistical areas compared with those that are not[11] (see Table A). Because population is a component in MSA status, it is not surprising, given the trends by population discussed above, that MSA cities are more likely to report improved conditions. This trend continues when looking to 2012, with 32 percent of MSA cities predicting more favorable conditions compared to 29 percent of non-MSA cities.

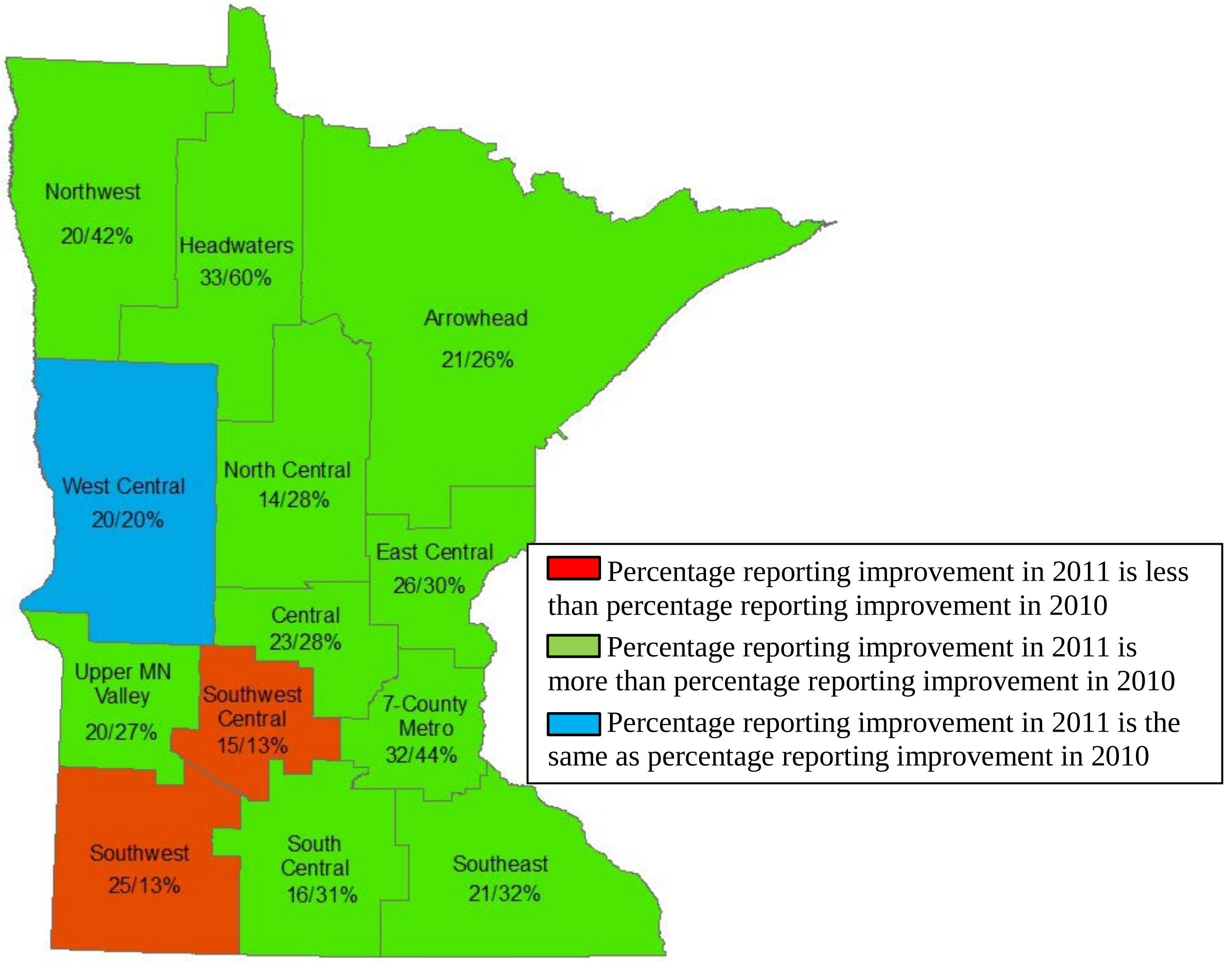
Table A: Percentage of Minnesota cities better able to meet needs (by MSA status)

	2004	2005	2006	2007	2008	2009	2010	2011	2012 predicted
MSA cities	35%	48%	57%	46%	24%	15%	25%	36%	32%
All Cities	31%	45%	53%	40%	26%	17%	23%	30%	31%
Non-MSA cities	29%	43%	50%	34%	27%	20%	21%	26%	29%

Across the state, all but two regions showed an increase over last year in the proportion of cities reporting an increased ability to meet needs. Both the Southwest Central and the Southwest region experienced a decrease in this share. These regions did experience an increase in this share from 2009 to 2010. The percentage of cities reporting an improvement in ability to meet needs did not change from 2010 to 2011 in the West Central region (see Figure 1).

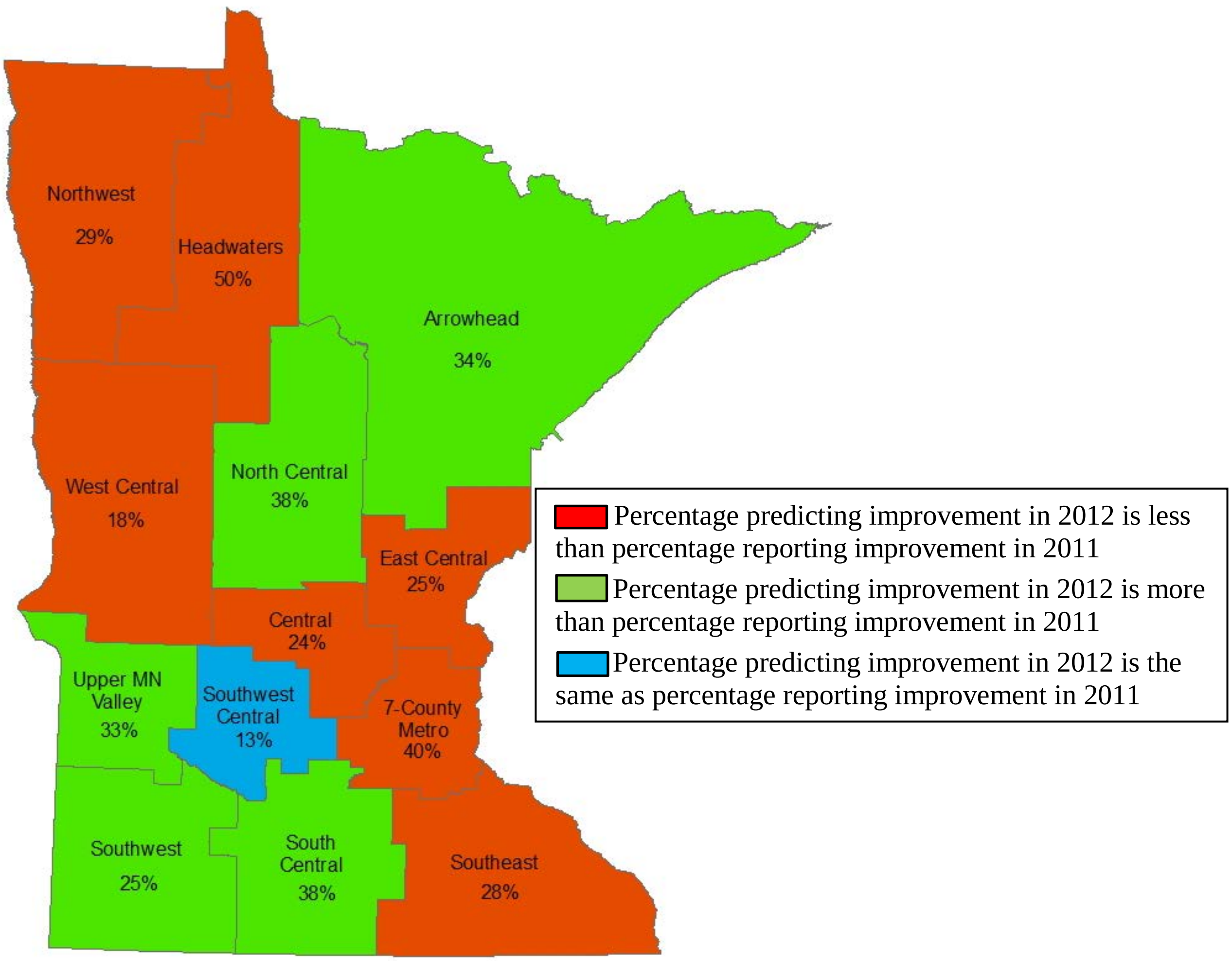
[11] A metropolitan statistical area (MSA) is defined by the U.S. Census Bureau as a geographical area containing at least one urbanized area of at least 50,000 inhabitants with a total area population of at least 100,000. The area consists of one or more counties. As of December 2009, there are eight MSAs that include at least one Minnesota county: Duluth, Fargo, Grand Forks, La Crosse, Mankato-North Mankato, Minneapolis-St. Paul-Bloomington, Rochester, and St. Cloud.

Figure 1: Percentage of cities better able to meet needs in 2010/2011 (by region)



Looking to 2012, the portion predicting more favorable conditions is larger than the share reporting better conditions in 2011 for five regions (see Figure 2). Seven regions show a decline in this share and one, the Southwest Central region, shows no change. The regions in the southwestern corner of the state see an increase while the regions along the southeastern border of the state see a decrease.

Figure 2: Percentage of cities predicting improved conditions for 2012 (by region)



Share of cities reporting shortfalls declines in all categories

Highlights of this section

- Last year the only major revenue source associated with a decline in the share of cities reporting a shortfall was fees and charges; this year fewer cities saw a drop in each source.
- More than half of all cities saw property taxes and state revenues fall below expectations in 2011.

For 2011, smaller shares of cities reported shortfalls in all revenue sources (see Table B). For some revenue sources, such as property taxes and state revenues, the share has not decreased in many years. Cities may have lowered their expectations of aid and credit reimbursement payments from the state after several years of reductions. Last year the only major revenue source where there was a decline was fees and charges. It remains to be seen whether this decline in revenue shortfalls will continue into the future. The shares of cities reporting shortfalls in property taxes and state revenues remain over 50 percent.

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%
2011	67%	43%	4%	2%	7%	65%	17%

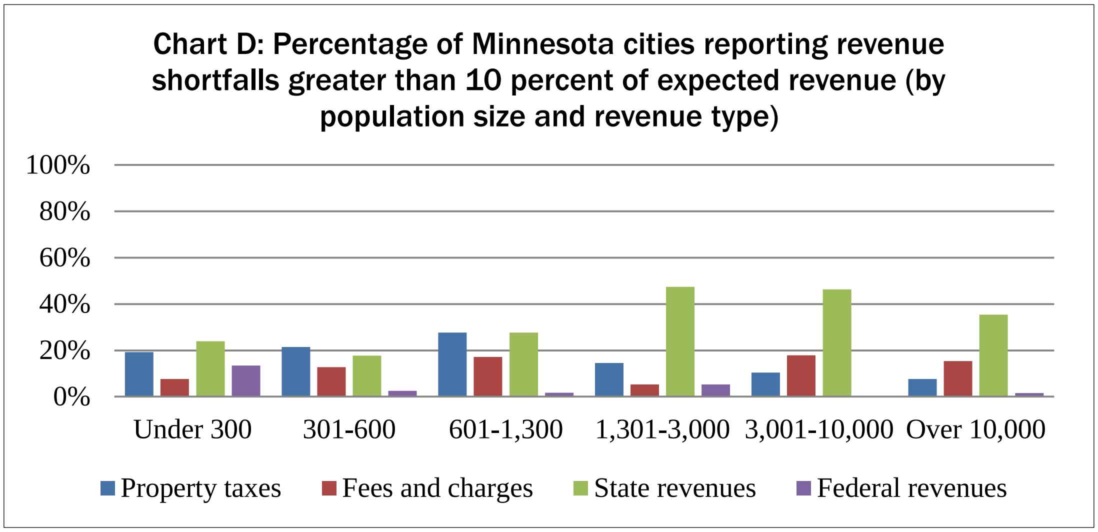
* Combines shortfalls of greater than and less than 10 percent of expected revenues

The portions of cities reporting shortfalls in the four main revenue sources (property taxes, fees and charges, state revenues, and federal revenues) have generally grown each year since 2006. The slight dip this year may be another sign that cities are becoming accustomed to operating in the new normal. Many problems brought about by the recession and slow recovery are no longer new. Cities may also have adjusted expectations and made changes to how they operate. After multiple years of state aid and MVHC reimbursement cuts, some cities are starting to budget for less than their certified LGA amount. Others have planned on receiving less than their certified levy due to a reduction in MVHC reimbursement payments or may have levied above what was needed in order to net the necessary amount.

Reduced MVHC reimbursement payments are one reason cities may report a shortfall in property taxes.[12] Cities may experience delinquent property tax payments as residents struggle with the economic recession. Cities may have experienced business closures, stalled development, and foreclosures, all of which can result in property tax revenue shortfalls. Shortfalls in revenue from fees and charges may also stem from problems associated with the recession and slow recovery. However, the drop in this share from 2010 suggests some of these effects may be stabilizing as cities adapt to the new normal.

[12] Some cities may report a loss of MVHC reimbursement as a loss of property taxes, as it accounts for a portion of their property tax levy, while others report it as a shortfall in state revenue.

As in past years, smaller cities were generally more likely than larger cities to report shortfalls in property taxes. The reverse is typically true for significant shortfalls in revenue from fees and charges, as larger cities generally have more options for implementing fees. However, this year, cities between 1,301 and 3,000 in population, followed closely by the smallest cities, were least likely to report significant shortfalls in fee revenue (see Chart D). The share of larger cities reporting shortfalls in fee revenue was much smaller than in 2010. Cities have likely adjusted their expectations for fee revenues. For example, cities may now budget for less fee revenue from building permits as development activity has slowed. Just 14 percent of cities reported an increase in the service needs of new development over the last year.



Greater Minnesota cities were more likely than metro cities to report shortfalls of 10 percent or more in property tax revenue (19 percent vs. 6 percent). The gap is much smaller when looking at significant shortfalls in state revenues—29 percent of metro cities and 33 percent of Greater Minnesota cities reported a shortfall of 10 percent or more in state revenues. All cities were subject to aid and credit reimbursement cuts in 2010 and 2011. The pattern in significant shortfalls of fee revenue changes this year, with 10 percent of metro cities and 13 percent of outstate cities reporting a significant shortfall. Last year 28 percent of metro cities and 18 percent of Greater Minnesota cities reported a gap of 10 percent or more in expected fee revenue.

Larger shares of cities reporting no change in many budget factors

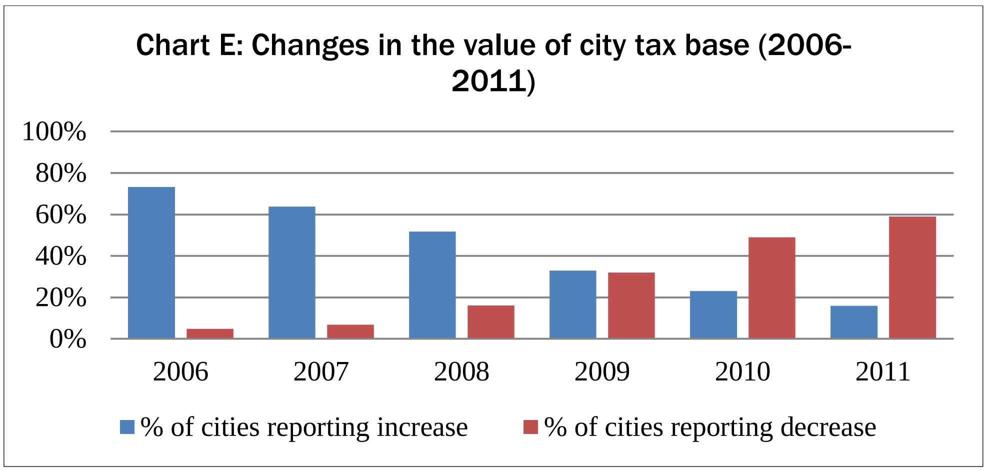
Highlights of this section

- Two years ago roughly one-third of cities saw increasing tax bases while another third experienced an actual decrease in value. Last year the share reporting an actual decline jumped to just under 50 percent. This year that share rose further, to 59 percent. The share reporting an increase in value in 2011 was just 16 percent.
- The five budget factors identified by the most cities as having increased in 2011 were prices, cost of living, and inflation; infrastructure needs; cost of employee health benefits; public safety needs; and cost of employee wages and salaries.

- The top factors identified as having at least a moderate impact on cities' budgets in 2011 are prices, inflation, and cost of living; tax base changes; infrastructure needs; local economic health; and employee wages and salaries.

The annual survey asks cities to indicate whether a wide variety of budget factors increased, decreased, or remained the same compared to the prior year. Many of this year's findings follow trends seen in prior years. However, in many factors the share indicating no change increased over the share doing so in 2010. This gives further support to the idea that cities have prepared for and are adjusting to life in the new normal. For some factors this shift is due to a smaller share of cities reporting an increase. For example, the share reporting an increase in the restrictiveness of tax and expenditure limits fell from 15 percent in 2010 to just 8 percent in 2011. This is likely due to the fact that levy limits for cities over 2,500 in population expire after taxes payable in 2011. Other factors saw smaller shares of cities reporting decreases, such as in public safety needs (0.4 percent in 2011 vs. 4 percent in 2010).

Last year there was a new pattern of reported changes in the value of the tax base (see Chart E). In 2009 roughly one-third indicated an increase in value while another third reported a decrease. In 2010, the share reporting an actual decline jumped to almost 50 percent while the portion that saw an increase fell to 23 percent. This pattern is seen again this year with 59 percent reporting a decrease in the value of the tax base and just 16 percent indicating an increase in value. This is likely due to the lag between residential assessed values and continued erosion of the housing market. Assessors determine market values by January of the year before taxes are payable. In other words, values for taxes payable in 2011 were determined in January 2010. Thus, the effects of the steep declines experienced by the housing market over the last several years are finally being seen on tax bases.



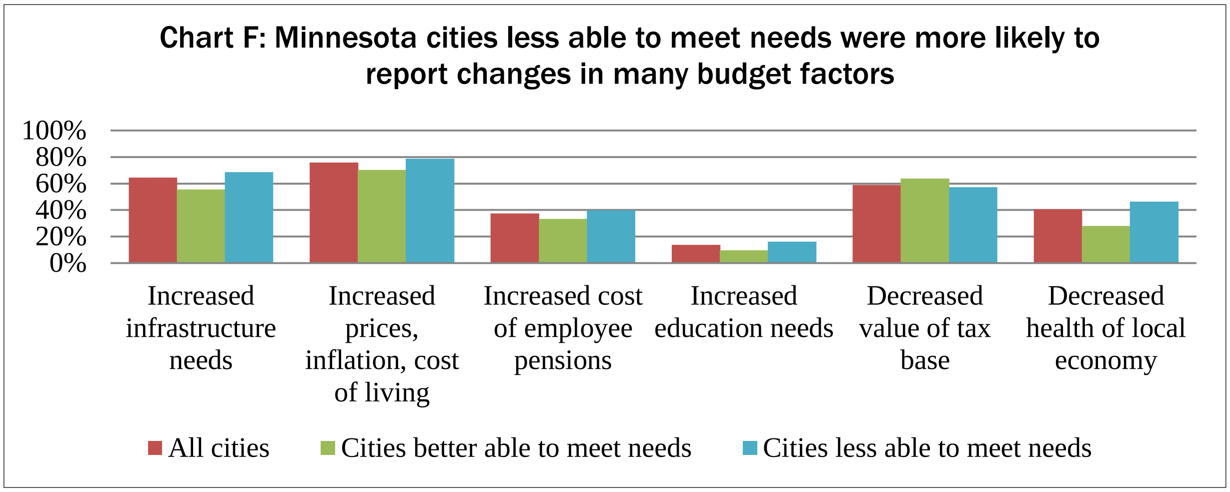
Prices, cost of living, and inflation; infrastructure needs; cost of employee health benefits; public safety needs; and cost of employee wages and salaries were the five budget factors identified by the most cities as having increased in 2011. The same top factors were identified in 2009 and 2010, with the exception of public safety needs, which replaced the cost of employee pensions. The portion of cities reporting an increase in the latter factor dropped from 56 percent in 2010 to just 37 percent in 2011. This drop is likely due to the interplay of several factors including retirements, declines in the size of the city workforce, and several years of pay freezes. For the leading factors overall, the size of these shares changed very little over 2010. The shares reporting an increase in prices, cost of living, and inflation; infrastructure needs; and cost of employee wages and salaries increased in 2011, while the shares reporting increases in the other two factors decreased.

Many of these top factors were also the leading factors identified by city officials across the U.S. in the recent NLC survey. Pension costs was included in the top five instead of cost of employee wages and salaries. The shares identifying an increase in each factor were larger among city officials nationwide than for officials in Minnesota cities.

The share of cities reporting an increase in population grew to 36 percent in 2011, up from 23 percent last year. The share reporting a decrease also rose this year, from 24 percent in 2010 to 26 percent in 2011. This may be due to the fact that cities received 2010 Census data during the last year. Between Census years, cities rely on population estimates. The share of cities reporting an increase in population grows as population size grows. The inverse is generally true as well; the smallest cities were more likely than the largest cities to experience population decline. Across all size categories, the share reporting an increase in 2011 is much larger than the share doing so in 2010. Little difference was observed between years in the shares reporting population decline. Roughly 36 percent of cities in the metro area and in Greater Minnesota reported a population increase in 2011. The share reporting a decrease was much larger among outstate cities (28 percent vs. 17 percent in the metro).

The percentage of cities reporting a decline in the health of the local economy fell for the second year in a row, from 53 percent in 2010 to 41 percent in 2011. With 46 percent of cities reporting no change in this factor, it appears that many of the broad economic problems challenging cities are not worsening. Cities may also have adjusted expectations for the local economy as the new normal unfolds.

How well cities are able to meet fiscal needs is influenced in part by changes in each budget factor (see Chart F). Changes in these factors affect cities differently depending on their unique circumstances. Cities less able to meet needs were more likely to report negative changes in many budget factors. However, cities that reported being better able to meet needs in 2011 were more likely to report a decrease in the value of the tax base.



In addition to indicating how a particular budget factor changed over the last year, cities are also asked whether each factor had a moderate, major, or no impact on their 2011 budget. Just five of the budget factors saw an increase in the proportion of cities reporting at least a moderate impact on their budget in 2011 over the share doing so in 2010. The greatest increase is in the share reporting at least a moderate impact due to changes in employee wages and salaries (56 percent in 2011 vs. 50 percent in 2010). The largest decline between 2010 and 2011 was in the share reporting at least a moderate impact due to changes in the cost of employee pensions (53 percent in 2010 vs. 41 percent in 2011).

The top factors identified as having at least a moderate impact on cities' budgets in 2011 are prices, inflation, and cost of living (72 percent); tax base changes (71 percent); infrastructure needs (68 percent); local economic health (57 percent); and employee wages and salaries (56 percent). Except for employee wages and salaries, which replaced the cost of employee health benefits, the same leading factors were identified in 2010 and in 2009.

A city's ability to meet fiscal challenges is affected not only by the combination of problems it faces, but also by how great an impact budget factors actually have on the city. For all budget factors, the share of cities reporting no impact on the budget was greater for those cities that reported being better able to meet needs in 2011. Except for the cost of employee pensions, the share of cities indicating a major impact was greater among cities that indicated a tougher time meeting needs in 2011. A similar pattern was observed last year.

Percentage of cities taking action in broad categories down in 2011

Highlights of this section

- Almost all cities (95 percent) reported taking at least one strategy in 2011. The average number of strategies utilized by a city was 3.16.
- Except for drawing down reserves, the portion of cities taking action in each category remained the same or fell slightly when compared to 2010.

How a city responds to fiscal challenges is dependent on a variety of factors. Its response may be shaped by its local tax base, resident needs and preferences, services provided and their delivery methods, local ordinances and policies, state laws and mandates, and opportunities for raising revenue. A city's response is also shaped by the unique mix of challenges it must respond to. Some of these challenges create cost pressures while others result in less revenue. Not every strategy is workable for all cities.

Cities have lost state aid and credit reimbursement payments annually since 2008. With repeated cuts, many of which occurred mid-year, some cities have adjusted how they prepare budgets. Some have developed budgets that minimize or even eliminate reliance on these payments. Others have prepared budgets that can be adjusted if mid-year cuts occur. Cities may also undertake new strategies as they struggle to meet needs amidst numerous fiscal challenges.

Cities were asked to identify the strategies taken in 2011 to prepare for 2012. Almost all cities (95 percent) reported taking at least one strategy in 2011. The average number of strategies utilized by a city was 3.16, slightly lower than in past years (see Table C). Cities may indicate no change on a particular strategy. Compared to 2010, the share of cities that did not take action in 2011 increased for most strategies. Almost 60 percent of cities reported undertaking between one and three strategies in 2011. This is slightly higher than in 2010 and 2009 when roughly half reported three or fewer strategies.

Table C: Number of budget-balance actions employed by Minnesota cities in 2011

	Implemented in 2011
Average number of strategies per city	3.2
1 - 3 strategies	263 cities, 59% respondents
4 - 6 strategies	129 cities, 29% respondents
7 - 10 strategies	36 cities, 8% respondents
No reported strategies	21 cities, 5% respondents

Most of the strategies cities are asked about can be grouped into broad categories. Trends in these categories for the past 9 years are shown in Table D. Property tax increases and increases in fees, charges, and license fees make up the revenue increases category. The spending category is comprised of 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 (2003-2011)

	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%
FY2010	71%	35%	30%	25%	16%	35%
FY2011	68%	32%	30%	20%	11%	40%

Except for drawing down reserves, the portion of cities taking action in each category remained the same or fell slightly when compared to last year. The share drawing down reserves grew after decreasing for two years. Cities may be left with only this option after exhausting all other budget-balancing actions viable for the community. The state auditor recommends that cities maintain a fund balance of roughly 35 to 50 percent of operating revenues or no less than five months of operating expenditures.[13] Additionally, a city may set a policy regarding the minimum fund balance allowed. Cities may also utilize reserves transferred from enterprise funds such as a liquor store that turns a profit.

While the share of cities implementing spending decreases fell for the second year in a row, this does not mean that cities are spending more. Almost 80 percent of cities reported no change in at least one of the actions that comprise the spending decreases category. Some cities may not be able to continually cut spending in certain areas without compromising service levels. Many cities have already implemented spending cuts and are already operating at bare bone levels. The shares of cities reporting increases in infrastructure and public safety spending grew slightly over 2010 (see Table E). Some cities have experienced increased costs associated with continually delaying infrastructure improvements. Other cities have utilized grant money to fund projects or services such as public safety.

Table E: Specific budget-balancing actions taken by Minnesota cities (2007-2011)

	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**
FY2007	79%	36%	5%	6%	3%	4%	12%
FY2008	67%	36%	14%	20%	11%	18%	13%
FY2009	61%	35%	30%	21%	17%	33%	13%
FY2010	60%	37%	20%	14%	13%	23%	14%
FY2011	55%	33%	18%	12%	10%	17%	17%

The proportion of cities implementing tax increases is down for the fourth year in a row. Cities with populations over 2,500 were subject to levy limits for taxes payable in 2009, 2010, and 2011. However, cities of all sizes have made the policy decision to reduce or hold taxes steady out of recognition of the economic challenges facing taxpayers. For 2012, city levies statewide increased just 0.9 percent, the smallest levy increase in at least 15 years.[14] Changes in the share that reported taking actions are very slight for many categories. This may be partially reflective of the fact that a

[13] "Statement of Position: Fund Balances for Local Governments (GASB 54 Version)," Office of the State Auditor, Dec. 2010.
[14] "Certified Property Tax Increase at Near Record Low Levels," *Cities Bulletin*, Feb. 8, 2012.

different mix of cities responds to the survey each year. It may also provide further support of the idea that cities are adjusting to the new normal and adapting to meeting different challenges.

The share of cities implementing efficiencies increased over the share doing so in 2010. While cities have engaged in these types of activities for years, there has been renewed push for cities to examine these types of strategies. Innovation and redesign have become hot topics in recent years. Cities may pursue new ways of doing things or engage in collaboration with other entities instead of or in addition to other budget-balancing strategies. However, barriers to collaboration can be difficult to overcome, and not all strategies are viable for all cities.

Human resource-related reductions are another way cities may meet budget challenges. The share of cities implementing these types of actions fell to 61 percent from 70 percent in 2010 (see Table F). The share of cities taking each action in 2011 fell for the second year in a row. After several years of not increasing employee wages, some cities are beginning to implement increases again. The share of cities granting a wage increase in 2011 grew to 50 percent from 35 percent in 2010. One in five cities reported a workforce reduction in 2011. This may be done through layoffs or by not filling positions left open by retirement or resignation.

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

	2009	2010	2011
Reduced workforce	26%	25%	20%
Cut or maintained wage levels	65%	63%	48%
Increased use of furloughs	6%	3%	1%
Reduced employee benefits	11%	9%	8%
Made at least one HR action	74%	70%	61%

The recent NLC survey asked cities about actions taken to address budget challenges.[15] The most common spending-related actions reported by officials nationwide were personnel-related cuts, capital project delays or cancellations, and cuts to services other than public safety and human-social services (72 percent, 60 percent, and 42 percent). The leading revenue-related actions were increases to the level of fees, increases to the number of fees, and property tax increases (41 percent, 23 percent, and 20 percent).

Conclusion

The share of cities reporting an improvement in fiscal conditions climbed upward for the second year in a row. It must be remembered that the ability to meet needs is a relative measure and does not indicate how well a city is able to meet needs. In other words, conditions may be better than last year but still not "good." After several years of fiscal challenges, cities may have adjusted expectations for their ability to meet needs. Cities have also taken actions—cutting spending, reducing staff, or doing things differently—that have influenced their ability to meet needs going forward. The specific needs may also have changed. After operating in a down, and now recovering, economy for several years, cities are adapting to the new normal.

[15] The list of actions cities were presented with differed from that on the Minnesota survey. Cities in different states may have different actions and strategies available to them.

Like cities overall, the share of cities in each size category reporting an increased ability to meet needs edged upward in 2011. Metro cities were more likely to report better conditions in 2011 than were cities in Greater Minnesota. Cities subject to levy limits in 2011 and those that did not receive LGA were also more likely to report better conditions than those not subject to levy limits and those that did receive LGA.

The share of cities reporting a shortfall in 2011 fell across all revenue sources. For some, such as property taxes and state revenues, this share has not decreased in many years. However, for these two sources over 50 percent of cities saw a shortfall.

How well a city is able to meet fiscal needs is influenced by changes in a variety of budget factors. This year, the share indicating no change increased over the share doing so in 2010 for many factors. However, the share reporting a decrease in the value of the city tax base increased from just under 50 percent to just under 60 percent in 2011. Just 16 percent of cities saw an increase in the value of the tax base. A city's ability to meet fiscal needs is influenced by how much changes in budget factors impact the city. The top factors identified as having at least a moderate impact on cities' budgets in 2011 are prices, inflation, and cost of living; tax base changes; infrastructure needs; local economic health; and employee wages and salaries.

How a city responds to fiscal challenges is dependent on a variety of factors. Cities were asked to identify the strategies taken in 2011 in preparation for 2012. Almost all cities reported undertaking at least one strategy. Except for drawing down reserves, the share of cities taking action in each category remained the same or fell slightly when compared to last year.