CONNECTING & INNOVATING
SINCE 1913

State of the Cities 2014: City Fiscal Conditions

Introduction

This marks the 11th consecutive year that the League of Minnesota Cities (LMC) has asked member city officials to identify the types of fiscal challenges faced in their cities and to describe the strategies used to confront those challenges (see the League's website for the 2014 survey instrument). A total of 411 cities participated in the survey for a response rate of 49 percent. It is important to remember that survey results must be considered as a snapshot of conditions at a particular point in time. Cities responded to the 2014 survey from Dec. 11, 2013, through Jan. 17, 2014.

Share of cities better able to meet needs increases

Highlights of this section

- The share of cities that reported an increased ability to meet needs in 2013 is 71 percent, the biggest since LMC started surveying member cities.
- Looking to 2014, 73 percent of cities predict more favorable conditions.

The share of cities reporting being better able to meet financial needs during 2013 rose for the fourth year in a row to an all-time high of 71 percent.[1] "Better able" may not mean that financial conditions are good, but rather that the city is better able to address fiscal challenges than in the prior year, regardless of how difficult those challenges may be. Circumstances may improve due to legislative changes, a city's past actions, changes to how the city operates or what services it provides, and other factors. Just over half of cities reported an easier time meeting needs in 2012 (see Chart A).[2] Looking to 2014, a slightly larger share, 73 percent, predicts improved conditions.

While the pool of cities responding to the survey changes each year and must be considered when comparing responses between years, 41 cities have responded to the survey annually. Data from just these cities show a similar trend to cities overall, with the share reporting more favorable conditions increasing from 59 percent in 2012 to 66 percent in 2013. Trends from an expanded pool, cities responding annually since 2008, mirror the overall trends even more closely. Just over

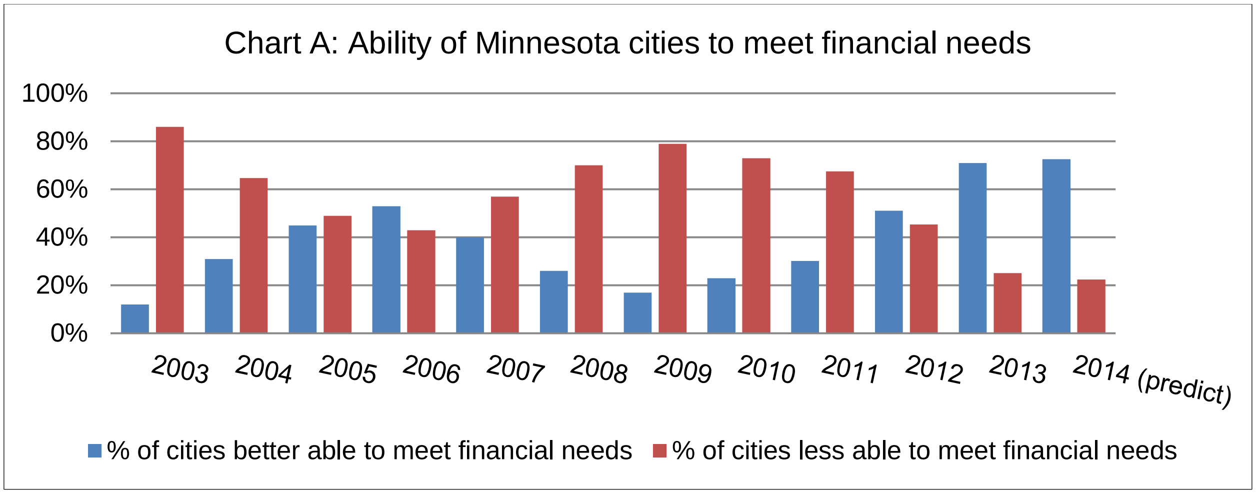
[1] The measure of "better" or "less able" is a relative comparison between a city's fiscal condition in the current year and in the prior year. In other words, a response of "better able" does not imply that a city's financial circumstances are good, only that they improved over the previous year. Cities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

[2] 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 the ability to meet needs between years.

145 UNIVERSITY AVE. WEST
ST. PAUL, MN 55103-2044

PHONE: (651) 281-1200 FAX: (651) 281-1299
TOLL FREE: (800) 925-1122 WEB: WWW.LMC.ORG

50 percent of these cities reported improved conditions in 2012. This share increases to 70 percent for 2013. Looking ahead, 70 percent of these cities predict better conditions in 2014.



The share of cities indicating an improvement in conditions increased annually between 2003 and 2006, when roughly half of cities reported being better able to meet needs. During the economic crisis this share declined, with just 17 percent of cities reporting more favorable conditions in 2009. The proportion of cities indicating a better ability to meet needs has been increasing since then, suggesting that cities have both found ways to adapt to fiscal constraints in the wake of the Great Recession and face better circumstances.

Again, it must be remembered that "better able" does not necessarily mean that conditions are good for each city in that category, just that they're more favorable for meeting financial needs when compared to the prior year. Now that cities have been operating in tighter financial conditions for several years due to the recession, they may be better able to meet needs with fewer resources. Some cities may now be doing less than they used to due to having fewer resources. Cities may also be more accustomed to addressing challenges that arose during the recession and more easily meet these challenges now. Strategies used to meet budget challenges during the past few years may have positioned cities to be better able to meet needs going forward. Also some things that used to challenge cities may no longer pose significant problems. For example, cities currently do not face strict multi-year levy limits, and foreclosures appear to be decreasing in most areas of the state.[3]

Additionally, recent legislative changes that have reduced instability and uncertainty may have allowed cities to more easily confront challenges and led city officials to feel more optimistic. Prior to taxes payable in 2012, cities received a portion of their levy through the market value homestead credit (MVHC) reimbursement program. While homeowners benefited from the credit each year, the amount owed to cities was reduced multiple times since 2003 until just 15 percent of the reimbursement due to cities in 2011 was actually received. The homestead market value exclusion (HMVE) program replaced MVHC beginning in 2012. While qualifying homeowners

[3] "Minnesota Foreclosure Update: Q3 2013," Housing Link, Nov. 19, 2013.

still receive a reduction on their property taxes, city levies are no longer funded partially by state reimbursement. Rather, the city's tax base is reduced by the excluded amount. Cities know this figure going into budget season and are not stressed by unexpected cuts to levy funds.

The Legislature has also improved the stability of the local government aid (LGA) program. After several years of cuts to the appropriation, some coming mid-year in cities' budget cycles, the 2013 Legislature enacted the first significant reforms to the program since 2003. The total appropriation was also increased by $80 million. The LGA formula compares a city's need to its ability to pay. How need is calculated was changed with the 2013 reforms. Three formulas are now used based on city population size. The old formula was largely based on 2000 Census data. While a city's LGA payment can still change from year to year, the new need factors are much less volatile, and decreases in aid are limited under the new reforms. For 2013, cities with populations over 5,000 received their 2012 amount while smaller cities received the greater of their 2012 amount or their 2013 formula amount.

A recent survey conducted by the National League of Cities (NLC) suggests that city officials nationwide may have adjusted their expectations of meeting fiscal conditions to reflect the post-recession environment.[4] That survey, conducted in the spring of 2013, shows that 72 percent of city officials reported being better able to meet needs in 2013 than in 2012. Only 57 percent of cities in 2012 reported being better able to meet needs that year than in 2011.

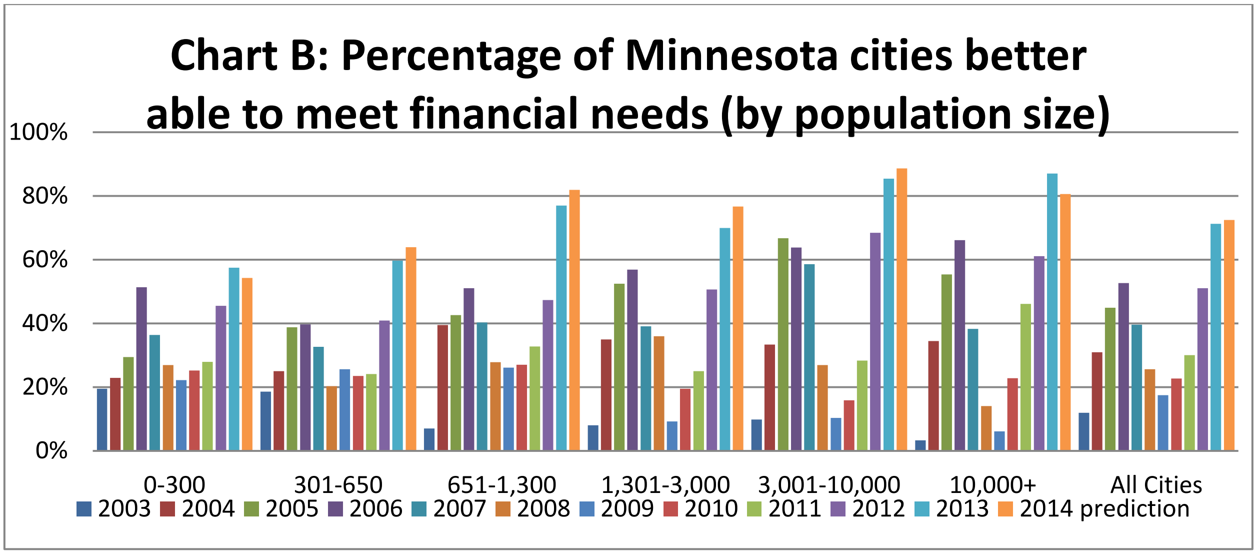
Trends by size follow pattern of cities overall

Highlights of this section

- The increase from 2012 in the proportion reporting more favorable conditions was substantial among all sizes of cities. This increase was greatest among mid-sized cities, and smallest for cities with populations between 3,001 and 10,000.
- When looking to 2014, cities in the smallest and largest population size categories showed a decrease while all of the others showed an increase in the share predicting an improved ability to meet needs.

The growth in the share indicating an improved ability to meet needs in 2013 shown by cities overall is mirrored by all population size categories (see Chart B). This trend was observed in the past two years as well. The share of cities reporting more favorable conditions is now the largest yet for all size categories. Over half of all cities in each category report better conditions in 2013. The greatest change from 2012 to 2013 in the share reporting an easier time meeting needs was seen among cities with populations between 651 and 1,300 (47 percent in 2012 compared with 77 percent in 2013). Cities with populations between 3,001 and 10,000 showed the least growth in this share (68 percent in 2012 compared with 86 percent in 2013).

[4] Pagano, Michael A. and Christina McFarland. "Research Brief on America's Cities: City Fiscal Conditions in 2013," National League of Cities, October 2013.



Looking ahead, the smallest cities and the largest cities are less likely to predict better times in 2014. This proportion increases for all other size categories. Cities over 2,500 in population are subject to levy limits for 2014, which could create additional challenges in meeting needs. However, for cities overall, the share predicting an improved ability to meet needs in 2014 is slightly greater than the share that reported improved conditions in 2013.

Cities in all regions report improved conditions in 2013

Highlights of this section

- Metro cities were more likely to report an improvement in conditions than Greater Minnesota cities.
- Across the state, all regions showed an increase over 2012 in the proportion of cities reporting an easier time meeting needs.

Like in recent years, the proportion of cities reporting an easier time meeting needs is greater for cities in the seven-county metro area than for cities in Greater Minnesota (82 percent vs. 69 percent). This gap narrows when looking to 2014, with 79 percent of metro cities and 71 percent of Greater Minnesota cities predicting improved conditions. Likewise cities classified as metropolitan statistical areas (MSAs) were more likely to report an improved ability than those that are not (see Table A).[5] Given that population is a component in MSA status, it is not surprising that MSA cities are more likely to report improved conditions. While more than half of cities in all size categories reported an increased ability to meet needs, these shares were generally greater for the larger population categories. This trend continues when looking to 2014, with 77 percent of MSA cities predicting more favorable conditions compared to 69 percent of non-MSA cities.

---

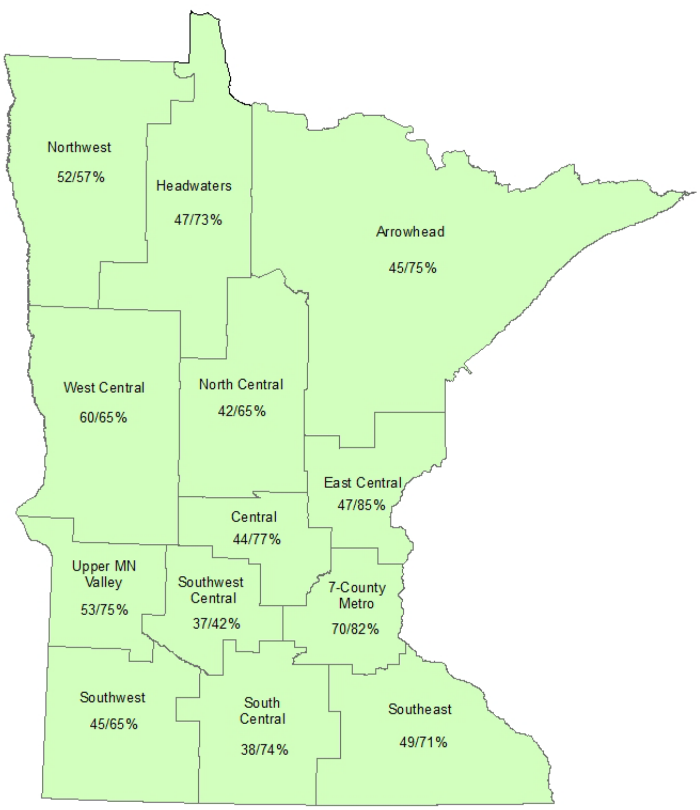
[5] A metropolitan statistical area (MSA) is defined by the U.S. Census Bureau as a geographical area containing at least one urbanized area of at least 50,000 inhabitants with a total area population of at least 100,000. The area consists of one or more counties. As of December 2009, there are eight 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.

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

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014 predicted
MSA cities	35%	48%	57%	46%	24%	15%	25%	35%	57%	78%	77%
All cities	31%	45%	53%	40%	26%	17%	23%	30%	51%	71%	73%
Non-MSA cities	29%	43%	50%	34%	27%	20%	21%	26%	47%	66%	69%

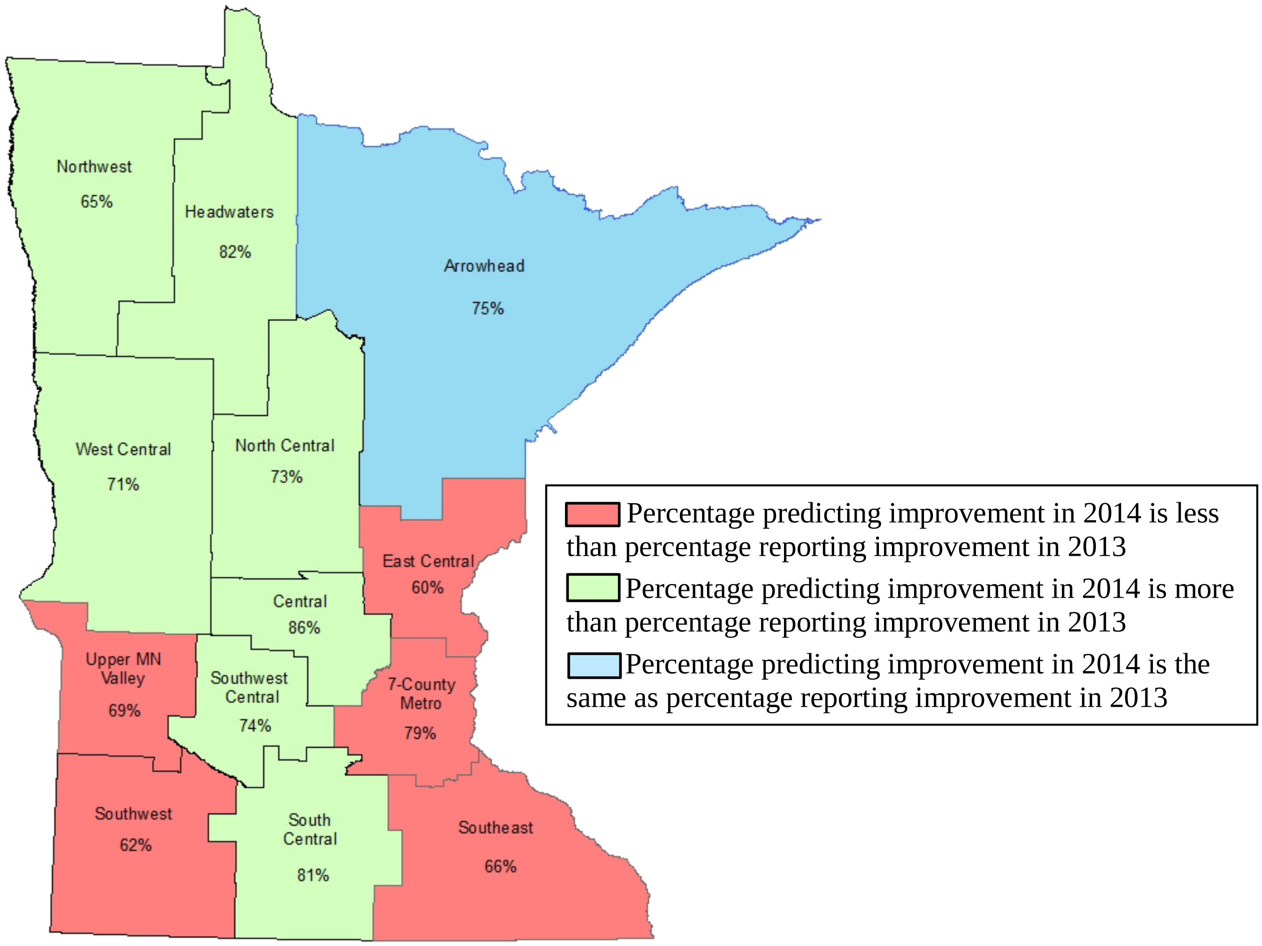
Throughout the state, all regions showed an increase over 2012 in the proportion of cities reporting an improved ability to meet needs. The South Central region experienced the biggest change in this proportion, increasing from just 38 percent in 2012 to 74 percent in 2013. Over half of cities in all but the Southwest Central region reported improved conditions in 2013 (see Figure 1).

Figure 1: Percentage of cities better able to meet needs in 2012/2013 (by region)



Looking towards 2014, more regions predict an improved ability to meet needs than those with a more negative outlook (see Figure 2). The regions running from the northwest corner through the central portion of the state show an increase in this share while regions in the east central, southeast, and southwest corner show a decrease. The Arrowhead region predicts no change. Despite less optimism in some regions no region falls below fifty percent in the share of cities predicting better conditions.

Figure 2: Percentage of cities predicting improved conditions for 2014 (by region)



Context: Bigger picture influences cities' ability to meet needs

The challenges cities face and the responses to those challenges are directly and indirectly influenced in many ways by the larger picture. While some of these influences have been discussed above, this section will delve deeper into the larger context in which cities operate.

Cities have had a difficult past few years, operating in and coming out of the Great Recession. Problems experienced during the economic crisis and the slow recovery period include unemployment, foreclosures, a lackluster real estate market, delayed or cancelled development, and business closures. Budget difficulties at the state level have added to and exacerbated the challenges facing cities. Cities experienced several years of cuts to the LGA and now-defunct MVHC programs. Cities made numerous adjustments as they navigated a constrained fiscal environment. As data from this year's survey suggest, cities may be becoming more adept at operating under challenging conditions. At the same time, the financial challenges cities have faced may be changing, perhaps becoming easier to meet.

Action taken by the state Legislature has influenced cities' ability to meet needs. Changes made to the LGA program for 2014 and beyond that improve the stability of city distributions should make budgeting for LGA easier. Aid amounts for a given year are certified the summer prior, giving cities time to build their budgets around this amount. In past years, cuts announced after certification made adjusting budgets and meeting needs very difficult for cities. Changes for the 2013 distributions—cities over 5,000 in population received their 2012 LGA amount while smaller cities received the greater of their 2012 amount or their 2013 formula amount—were part of the 2012 tax bill and thus known during the budgeting process. As discussed above, MVHC was eliminated beginning in 2012 and replaced with the HMVE program, which excludes a portion of a homeowner's market value from property taxes, but does not leave a portion of a city's levy to be reimbursed by the state.

Cities did not face levy limits for taxes payable in 2013. One-year levy limits are in place for taxes paid in 2014 for cities with populations over 2,500. A city is limited to 3 percent growth for taxes collected in 2014. Debt service levies and levies for natural disasters are outside of the levy limit. Cities overall increased levies 1.6 percent for taxes payable in 2014.

Cities and counties have been required to pay sales tax on purchases since 1992. The 2013 Legislature passed a sales tax exemption for cities and counties effective for purchases made on or after Jan. 1, 2014. The exemption does not include purchases of goods or services generally provided by a private business, such as a liquor store, gas or electric facility, golf course, marina, fitness center, or campground. Additionally current law does not exempt tax on purchases made by a joint entity. Despite the exceptions on allowable exemptions the expected sales tax savings may make meeting needs easier for cities in 2014.

In addition to legislative action, the state's own fiscal conditions influence cities' ability to meet needs. During the 2013 session, the state faced a $627 million budget deficit for the 2014-15 biennium.[6] The outlook has improved heading into 2014. The November forecast shows a projected $1.086 billion balance for fiscal year 2014-15.[7] While current law requires any balance to first repay schools, an estimated $825 million surplus remains. Stronger employment and income growth are expected to contribute to revenue growth in 2014-15 in the form of increased corporate and income tax revenues. Improving conditions at the state level may improve a city's outlook on its ability to meet needs by boosting confidence in the stability and reliability of the state-local partnership.

In November and December 2013, Minnesota's net general fund receipts totaled $3.33 billion, 5.4 percent more than forecast.[8] Most of the additional revenue was due to higher estimated individual income tax payments. It is likely that more taxpayers than usual made early payments in 2013 (estimated payments are due Jan. 15). Net sales tax revenue was also above forecast. That increase appears to be due both to stronger economic activity and recent law changes. With this growth,

[6] "February 2013 Forecast." Minnesota Management and Budget, February 2013.
[7] "Budget & Economic Forecast: At a Glance." Minnesota Management and Budget, November 2013.
[8] "January 2014 Economic Update," Minnesota Management and Budget, January 2014.

analysts are predicting accelerating economic growth during 2014. Reasons for this growth include increased consumer spending and an improved housing market.

Challenges that surfaced during the recession may be stabilizing and thus may be more easily addressed. While unemployment remains an issue, the state's unemployment rate for December 2013 fell to 4.6 percent, down from 5.4 percent in 2012.[9] The rate for the United States fell from 7.8 percent to 6.7 percent over the same period. Following six months of declines, Minnesota's labor force participation rate increased one-tenth of a percentage point to 70.1 percent in December 2013.[10] Just under 46,000 non-farm jobs were gained in 2013.[11] However, despite job vacancies being up 15.3 percent in the second quarter of 2013 compared to a year prior, the labor force participation rate is the lowest since 1980. Job vacancies were more heavily concentrated in the metro area than in Greater Minnesota (58 percent compared to 42 percent).[12]

Foreclosures continue to fall statewide. The third quarter of 2013 marks the first time since 2006 that the state saw fewer than 3,000 foreclosures. Foreclosures declined 33 percent statewide since the third quarter of 2012.[13] However, foreclosures are still twice the levels seen pre-crisis. Despite historically high foreclosure rates, the real estate market continues to show signs of improvement. The statewide median sales price in 2013 was up 13 percent over 2012 and is now the highest it's been in five years.[14] This is true throughout all regions except for the Southwest region. However, total city market value again fell for taxes payable in 2013.[15] However, this decline, just under 4.5 percent, is the smallest since 2010, when this trend was first observed. Due to lags in the assessment calendar, it will take several years for improvement in the housing market to influence tax bases.

Share of cities reporting shortfalls in main revenue categories declines for third year in a row

Highlights of this section

- For the third year in a row, the share of cities reporting a shortfall in each of the main revenue categories declined.
- For the first time since 2007, fewer than half of cities report a shortfall in property taxes.
- The share of cities reporting shortfalls in state revenues is the smallest yet.

In 2013, smaller or equal shares of cities reported shortfalls in all revenue sources during the prior fiscal year than in 2012 (see Table B). To help make sense of the historical data, the highest and lowest share reporting a shortfall in each revenue source is highlighted in Table B. This is the third year in a row that these shares have decreased. After several years of operating with fiscal constraints felt during the Great Recession, cities may have adjusted expectations for revenues.

---

[9] "State and National Employment and Unemployment," Department of Employment and Economic Development (DEED), February 2014.
[10] Ibid.
[11] "Resource," Minnesota Association of Realtors, February 2014.
[12] "Job Vacancies." DEED, February 2014.
[13] "Minnesota Foreclosure Update: Q3 2013," Housing Link, Nov. 19, 2013.
[14] "Annual Report on the Minnesota Housing Market." Minnesota Association of Realtors, January 2014.
[15] "2013 Property Tax Report." *Minnesota Cities* magazine, September-October 2013.

Legislative changes may also contribute to a shift in expectations. The share reporting shortfalls in state revenues is the smallest since the League's survey began. Aid reductions for 2012 were announced prior to certification so that a city's expected aid amount equaled the amount actually received. Knowing LGA distributions ahead of time allowed cities to plan for less revenue. The year 2013 marks the first time since 2007 that the share of cities reporting shortfalls in property taxes fell below 50 percent. With the conversion to the HMVE program, cities no longer have property tax shortfalls due to reduced MVHC reimbursement payments.

Table B: Percentage of Minnesota cities reporting revenue shortfalls*

	Property taxes	Fees and charges	State revenues	Federal revenues
2003	28%	17%	82%	12%
2004	27%	24%	55%	8%
2005	40%	25%	39%	12%
2006	40%	33%	31%	13%
2007	43%	36%	35%	15%
2008	54%	41%	41%	14%
2009	62%	57%	61%	16%
2010	68%	51%	73%	22%
2011	67%	43%	65%	17%
2012	60%	39%	35%	13%
2013	43%	34%	18%	9%

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

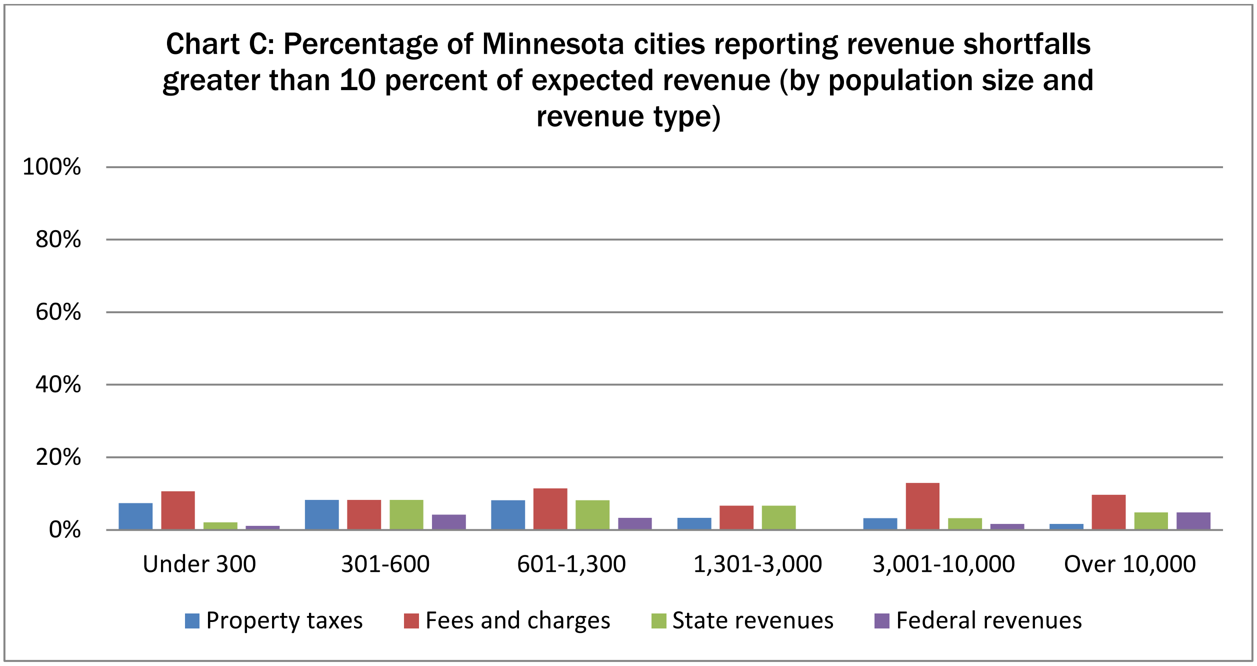
High Point   Low Point

During and immediately following the Great Recession, the shares of cities reporting shortfalls in the four main revenue sources (property taxes, fees and charges, state revenues, and federal revenues) generally increased each year. Beginning in 2011, these shares began to fall, suggesting that cities have been adapting to tighter financial conditions that arose during the Great Recession, budgeting for less. Some challenges, such as budgeting for potential losses in MVHC or multi-year levy limits, are not currently issues for cities. Cities have faced problems associated with foreclosures and unemployment for several years and may have developed strategies for addressing them. Additionally, growth in the real estate market and fewer foreclosures statewide may be lessening related challenges.

For the first time since 2007, fewer than half of cities report a shortfall in property taxes. The conversion from MVHC to HMVE is likely responsible for some of this decrease as cities are no longer reliant on state reimbursement for a portion of their levy. Some cities may experience property tax shortfalls due to foreclosures and delinquent payments. Like last year, the share of cities reporting a shortfall of less than 10 percent was much larger than the share reporting a significant shortfall (38 percent vs. 6 percent). Unlike in recent years, cities were likely to report shortfalls in the property tax regardless of location in the metro area or Greater Minnesota (44 percent and 43 percent).

Like last year, the smallest cities were least likely to report any shortfalls in property taxes (37 percent). Cities with populations between 651 and 1,300 were most likely to report this type of shortfall (57 percent). The smaller cities were more likely to report significant shortfalls in property taxes (see Chart C). However, in no size category was this share 10 percent or greater.

Fees and charges are generally used more broadly by larger cities; 13 percent of the smallest cities report not being authorized to collect such revenue, meaning they do not impose fees and charges. Typically survey results show larger shares of the bigger cities reporting significant shortfalls in fee revenue. However, on last year's survey just 2 percent of the largest cities reported fee revenue shortfalls of greater than 10 percent. This year, just under 10 percent of these cities did so. There is no clear pattern by size in the share reporting significant shortfalls in fee revenue. In no size category was this share greater than 13 percent.



As in past years, Greater Minnesota cities were more likely than metro cities to report shortfalls of greater than 10 percent in property tax revenue (6 percent vs. 4 percent). The pattern is reversed when looking at significant shortfalls in fee revenues—9 percent of outstate cities, and 12 percent of metro area cities reported a shortfall of more than 10 percent in fee revenues. Metro cities were also slightly more likely to report significant shortfalls in state and federal revenues.

Little difference in reported changes in most budget factors compared to 2012

Highlights of this section

- The proportion of cities reporting an increase in the value of the tax base rose in 2013. This growth continues an upward trend first observed last year. The share reporting a decrease in value fell below 50 percent.

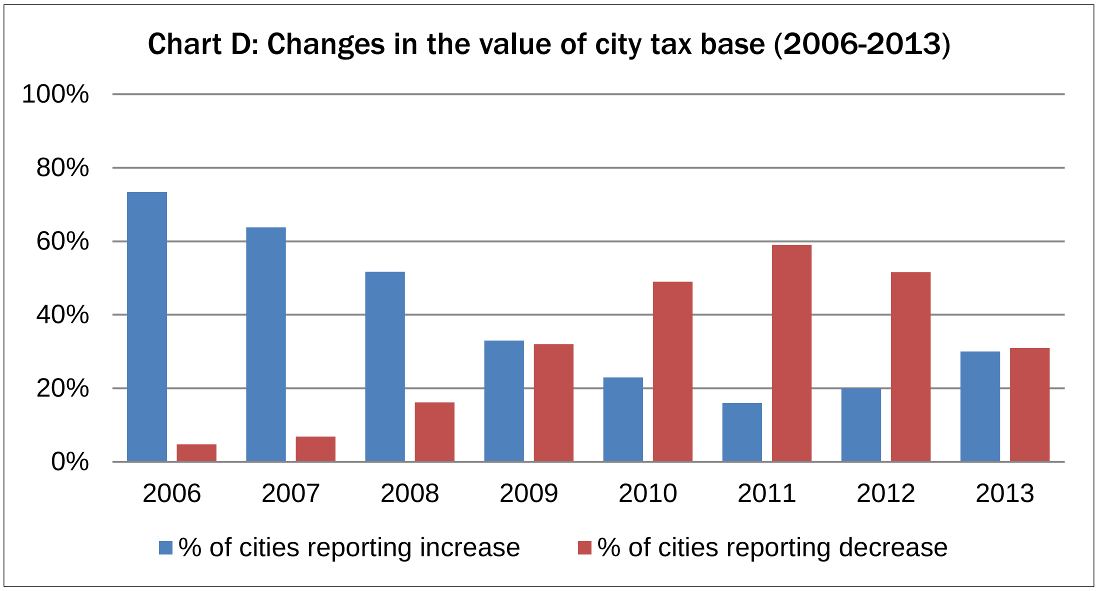
- While little difference was observed in most budget factors when compared to last year, the shares reporting increases in factors related to employee costs rose slightly in 2013.
- The shares reporting change in the health of the local economy support the notion of improving conditions. Larger shares report an increase or no change while a smaller share reports a decline in local economic health.
- The five budget factors identified by the most cities as having increased in 2013 were cost of employee wages and salaries; prices, cost of living, and inflation; infrastructure needs; cost of employee health benefits; and public safety needs.
- The top factors identified as having at least a moderate impact on cities' budgets in 2013 were prices, inflation, and cost of living; employee wages and salaries; infrastructure needs; value of the tax base; and cost of employee health benefits.

Each year cities are asked to indicate whether a wide variety of budget factors increased, decreased, or remained the same when compared with the previous year. Trends observed this year mirror those seen in prior years, with most differences being very slight. For many factors, changes from last year are positive. For example, the share of cities that reported receiving more federal aid increased from 4 percent to 13 percent. For other factors, like public safety needs, infrastructure needs, and human service needs, the share reporting no change increased while the share reporting a decrease fell, suggesting that if conditions aren't improving, at least they are not worsening.

The housing crisis and slow recovery have held down growth in the value of the property tax base in many cities. From 2006 to 2011, the share reporting an increase fell each year while the share reporting a decrease grew (see Chart D). This trend reversed in 2012 and continued in 2013. While the share of cities indicating a decline in the tax base is still greater than the share reporting growth, this portion is now below 50 percent.

The median residential sales price increased 13 percent in 2013 to the highest in five years.[16] The average sales price is also at a five-year high. Because of the gap in the assessment calendar—values for taxes payable in 2013 were determined in January 2012—it will take time for the continued growth in the real estate market to fully influence the tax base. Of course, city tax bases are also influenced by changes in the other categories of property—commercial, agricultural, and other. From 2012 to 2013, agricultural market value in Minnesota increased just under 1.5 percent while commercial and industrial market value fell just over 1 percent.[17]

[16] "Annual Report on the Minnesota Housing Market," Minnesota Association of Realtors, January 2014.
[17] "2013 Property Tax Report," *Minnesota Cities* magazine, September-October 2013.



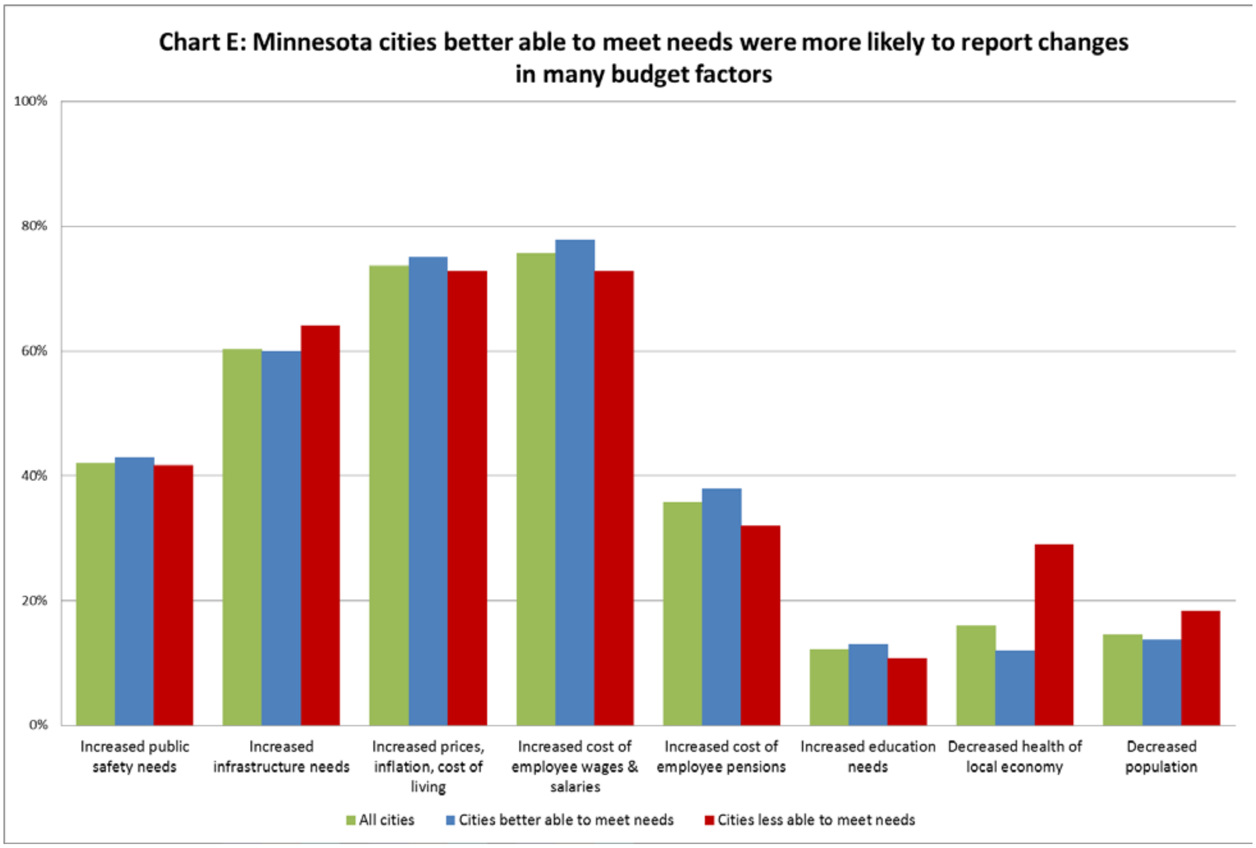
Related to changes in the property tax base are changes in the service needs of new development. An increase in service needs likely means an increase in the property tax base as new development is completed and sold. In 2013, roughly one in five cities reported an increase in the service needs of new development. Just 17 percent indicated such an increase in 2012.

Positive change was also observed in the shares reporting changes in the health of the local economy. Larger shares reported an increase or no change in local economic health while the share indicating a decline fell from 26 percent to just 16 percent. These changes suggest that, increasingly, many of the economic problems that have plagued cities are stabilizing and, in some cases, are even improving.

The cost of employee wages and salaries; prices, cost of living, and inflation; infrastructure needs; cost of employee health benefits; and public safety needs were the five budget factors identified by the most cities as having increased in 2013. The same top factors have been identified since 2009, with the exception of public safety needs, which replaced the cost of employee pensions in 2011. Changes over 2012 were very slight for most of these factors. The proportion of cities indicating an increase in the cost of employee wages and salaries rose from 61 percent to 76 percent. Wage freezes have been prevalent the last several years and may now be no longer in effect. Additionally cities may be beginning to hire back positions eliminated or left vacant during the recession. While prices, cost of living, and inflation continued to increase for a majority of cities, this share fell from 77 percent in 2012 to just less than 74 percent in 2013.

Most of these top five factors were also the leading factors identified by city officials across the U.S. in the recent NLC survey. The cost of pensions was included in the top five instead of public safety demands. The shares identifying an increase in each factor were larger among city officials nationwide than for officials in Minnesota cities.

Changes in each budget factor are linked to a city's ability to meet fiscal needs (see Chart E). Of course, a city's response to changes in budget factors is dependent on its own circumstances. An increase in one budget factor might pose a challenge to one city while a different city may not be challenged by a similar increase. Unlike in past years, cities better able to meet fiscal needs in 2013 were more likely to report negative changes in many budget factors. Cities may be more accustomed to dealing with challenges so that changes in certain budget factors don't hamper their overall ability to meet needs. Increased costs in several of these factors—employee wages and salaries; employee health benefits; and employee pensions—may be more indicative of a city with more favorable conditions. As cities become more stable, some have been able to fill vacancies and catch up on employee wage increases that had been postponed for several years. As in past years, cities less able to meet needs were more likely to report negative changes in infrastructure needs, city population, and local economic health.



In addition to being asked how a particular budget factor changed over the last year, cities were also asked about the impact of those changes on their 2013 budget. For all but four budget factors, the share reporting at least a moderate impact on their budget in 2013 fell from the share doing so in 2012. And for three of the four budget factors with increased impact, these increases were very slight. Like last year, the greatest increase is in the share indicating at least a moderate impact due to changes in employee wages and salaries (66 percent in 2013 vs. 60 percent in 2012). Also like in 2012, the largest year-over-year decrease was in the share reporting at least a moderate impact due to changes in the value of the tax base (64 percent in 2012 vs. 54 percent in 2013). In most budget factors, the share of cities reporting a major impact was down in 2013 compared with 2012. Increases were very slight and likely due more to the change in the mix of cities responding than to severity of impacts.

The top factors identified as having at least a moderate impact on cities' budgets in 2013 were prices, inflation, and cost of living (67 percent); cost of employee wages and salaries (66 percent); infrastructure needs (59 percent); tax base changes (54 percent); and cost of employee health benefits (53 percent). The same leading factors were identified in 2012, with the exception of health benefits, which replaced local economic health. The share of cities identifying an impact decreased from 2012 for each of these factors.

Not only is a city's ability to meet fiscal challenges affected by the combination of challenges 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 2013. For some budget factors, this difference was very small. The difference in this share was greatest for the cost of employee wages and benefits, with 31 percent of cities better able to meet needs reporting no impact compared with 18 percent of cities less able to meet needs. Cities that reported a less difficult time meeting needs in 2013 were just as or less likely to indicate a major impact from changes in budget factors. A similar pattern has been observed in prior years.

For the second year in a row, cities report utilizing fewer budget strategies in 2013

Highlights of this section

- The majority of cities (87 percent) reported undertaking at least one strategy in 2013. The average number of strategies utilized by a city was 2.06, down slightly from 2012 (2.69 strategies on average).
- The portion of cities taking action in each category fell in 2013.

How a city responds to fiscal challenges is dependent on several factors. The unique mix of challenges facing a city—as well as its local tax base, resident needs and preferences, services provided, local polices and ordinances, state laws and mandates, and revenue-raising opportunities—all inform the response. Given the variety of factors, not every strategy is available to or appropriate for every city. Certainly cities may need to change their strategy as conditions change in order to meet needs most effectively.

After enduring years of cuts to state aid and credit reimbursement payments, many cities have adjusted how they budget. The economic recession and recovery has also challenged cities in the budget process. Some cities have developed budgets that do not rely on state aid payments for ongoing or operating costs, using these payments instead for one-time expenditures. Others have tried new strategies or a different mix of strategies.

Cities were asked to report on the strategies taken in 2013 in preparation for 2014. Most cities (87 percent) identified at least one strategy taken in 2013. The average number of strategies utilized is down slightly from 2012 to 2.06 percent (see Table C). Cities may be able to meet needs with a smaller number of strategies. Cities may also have found a combination of strategies that allow them to meet challenges. The share of cities utilizing between one and three strategies increased slightly over 2012, growing from 69 percent to 71 percent in 2013. Growth was also observed in the proportion of cities not reporting any strategies (13 percent in 2013 compared with 5 percent in both 2012 and 2011). Accordingly, the shares of cities utilizing greater numbers of strategies are down. These trends were also observed in the last two years.

Table C: Number of budget-balancing actions employed by Minnesota cities in 2013

	Implemented in 2013
Average number of strategies per city	2.06
1 - 3 strategies	71%
4 - 6 strategies	16%
7 - 9 strategies	1%
No reported strategies	13%

Most of the budget-balancing strategies cities are asked about can be grouped into broad categories. Table D presents the trends in these categories for the past 11 years with the historic highest and lowest share highlighted for each category. The "revenue increases" category is comprised of property tax increases and increases in fees, charges, and license fees. Cuts in infrastructure, public safety, and other spending, as well as reductions in the overall growth rate of spending, are included in the "spending" category. "Increasing efficiencies" includes increases to productivity levels, contracting out or privatizing, and increasing inter-local agreements.

Table D: Budget-balancing actions taken by Minnesota cities (2003-2013)

	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%
FY2012	69%	22%	31%	16%	9%	32%
FY2013	61%	12%	27%	8%	4%	25%

High Point   Low Point

The portion of cities taking action in each category fell in 2013. The share reporting cuts to the workforce has trended down since 2009. Conversely, the share indicating an increase in the size of the workforce has grown since 2009 and is now at 11 percent.

The share of cities implementing spending decreases fell for the fourth year in a row. However, this does not mean that cities are spending more. Just 16 percent of cities reported an increase in each one of the four actions that comprise the spending category. Over three-quarters of cities indicated no change in at least one of these actions while one in five reported no change in all of these actions. No cities reported significant increases in all four of these actions; 21 percent reported a significant increase in at least one of the actions. Repeatedly cutting spending may not be possible in all areas without negatively influencing service levels. Pushing off spending, especially in regards to infrastructure improvements, may increase costs later as conditions further deteriorate. Cities may also choose to spend on infrastructure projects to take advantage of low interest rates. Some cost increases may be out of the control of cities.

Table E: Specific budget-balancing actions taken by Minnesota cities (2007-2013)

	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%
FY2012	58%	30%	9%	10%	7%	8%	15%
FY2013	49%	29%	6%	5%	3%	4%	14%

Last year, the proportion of cities implementing tax increases was up slightly after trending downward for four years (see Table E). This share dipped down again in 2013. Nine out of 10 of those reporting an increase for 2014 indicated that this increase was slight. Just less than half of cities made the policy decision to reduce or hold taxes steady for 2014. As noted above, cities over 2,500 in population were subject to one-year levy limits for taxes payable in 2014. Additionally, the bump in LGA given by the 2013 Legislature was given in hopes of property tax relief statewide. Of course, the reasons for tax levy changes are many. Cities may not be able to maintain or decrease property tax levels due to past action (i.e., years of little or no change), planned projects or expenditures, service level demands, or cost increases beyond their control.

For several specific actions, differences in the share that reported change are very small when compared with 2012. This may be partially due to the different mix of cities responding to this year's survey. It may also provide further support of the idea that cities are adjusting to conditions that arose during and following the Great Recession and adapting to meeting different challenges. Cities may be able to meet needs by maintaining current spending or revenue-raising levels.

While the share of cities reporting an increase in the number or scope of inter-local agreements is down slightly from 2012, many cities are actively engaged in these types of arrangements. Fewer than 1 percent of cities reported a decrease in this category while 71 percent reported making no changes. Many of these collaborative efforts have been underway for years. The economic recession did renew the push for cities to work together, and many cities did find new ways to work with other partners. Some cities may wish to enter into these types of partnerships, but may need to overcome barriers to collaboration. Other times a partnership may not make sense if it does not result in reduced costs or improved service delivery outcomes.

Human resource-related changes are another way cities may address budget challenges. For the third year in a row, the portion of cities taking these types of actions fell from the prior year (see Table F). The share of cities taking each action in 2013 was down from 2012. Just 38 percent of cities took at least one HR-related action. Repeatedly taking some actions may not be sustainable without severely influencing service levels. Many cities kept positions vacant during the recession, and data suggest that some cities are beginning to add staff. Just 2 percent of cities reported increasing the workforce in 2009, and now 11 percent of cities indicate a larger workforce than in the prior year. Some cities are beginning to increase wages again after several years of freezes or even cuts. Almost 70 percent of cities reported increasing wages in 2013 while just under one-third of cities did so in 2009.

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

	2009	2010	2011	2012	2013
Reduced workforce	26%	25%	20%	16%	8%
Cut or maintained wage levels	65%	63%	48%	39%	28%
Increased use of furloughs	6%	3%	1%	1%	0%
Reduced employee benefits	11%	9%	8%	6%	4%
Made at least one HR action	74%	70%	61%	51%	38%

Cities responding to the recent NLC fiscal conditions survey were also asked about actions taken to address budget challenges.[18] The most common expenditure-related actions reported by officials nationwide were HR-related and included hiring freezes (38 percent), reductions to the size of the municipal workforce (32 percent), reductions to employee health care benefits (24 percent), and reductions to pension benefits (22 percent). The share taking action in each of the first three categories is down from the share doing so in 2012 while the portion reducing pension benefits is up. The most common revenue-related actions reported were increases to the level of fees (39 percent), increases to the number of fees (22 percent), increases to the level of impact fees (19 percent), and property tax rate increases (19 percent). The options available to cities nationwide vary depending on state and local laws.

Conclusion

The share of cities reporting being better able to meet financial needs during the last fiscal year rose in 2013 for the fourth year in a row to an all-time high of 71 percent. It must be stressed 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." Cities may have adjusted expectations for meeting needs. The strategies cities used in recent years have influenced their ability to meet needs today. After several years of a down, and then recovering, economy, cities have adapted to operating with financial constraints.

---

[18] 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.

The increase in the share reporting improved conditions was mirrored by all population size categories. As in past years, metro cities were more likely to report more favorable conditions in 2013 than were cities in Greater Minnesota.

The share of cities reporting a shortfall in each of the main budget categories fell for the third year in a row. The year 2013 marks the first time fewer than half of cities report a shortfall in property taxes for the prior fiscal year.

How well a city is able to meet fiscal needs is influenced by changes in a variety of budget factors. Little change was observed in most budget factors when compared to 2012, but the shares reporting increases in factors related to employee costs rose slightly in 2013. Larger shares of cities reported an increase or no change in local economic health when compared to last year.

One of the influences on a city’s ability to meet fiscal needs is the impact that changes in budget factors have on the city. The top factors identified as having at least a moderate impact on cities’ budgets in 2013 were prices, inflation, and cost of living; employee wages and salaries; infrastructure needs; value of the tax base; and cost of employee health benefits.

A city’s response to fiscal challenges is dependent on multiple factors. Cities were asked to identify the strategies taken in 2013 in preparation for 2014. The majority of cities reported undertaking at least one strategy. The portion of cities taking action in each category fell in 2013, and the average number of strategies utilized by an individual city decreased.