State of the Cities 2015: City Fiscal Conditions

Introduction
For 12 consecutive years the League of Minnesota Cities has asked member city officials to identify types of fiscal challenges faced in their cities and to describe the strategies used to address those difficulties. A total of 405 cities responded to the 2015 survey for a response rate of 49 percent. Cities responded to the survey from Nov. 24, 2014, through Jan. 13, 2015.[1]

The discussion of survey responses is organized by observation of current trends. Observations are grounded in historical trends seen in past surveys. Questions raised by current trends are offered as well.

The larger picture
Before discussing the trends observed this year, it is important to lay out the context in which cities operated during the past year. The challenges cities face and the responses to those challenges are directly and indirectly influenced in numerous ways by the larger picture.

The last several years have been challenging, as cities have navigated operating in and coming out of the Great Recession. During this time, cities have dealt with difficulties related to unemployment, foreclosures, a slow real estate market, delayed or cancelled development, business closures, changing transportation needs, and budget difficulties at the state level. Additionally, some of these challenges may have led to delayed projects, increased infrastructure needs, and a growing list of necessary projects and maintenance needs. While recovery has been underway for several years, as the Minnesota Association of Realtors described housing recovery, it can be seen as one of "two steps forward, one step back."[2] As data from this and last years' surveys suggest, cities may be becoming more adept at operating under challenging conditions. Concurrently, these challenges may be changing, perhaps becoming less burdensome.

Legislative changes
Legislative changes influence a city's ability to meet needs. The 2013 Legislature made changes to the local government aid (LGA) program formula that was first effective for aids payable in 2014. The updated formula uses separate need calculations for cities with populations under 2,500; between 2,500 and 10,000; and over 10,000. The new formula is intended to reduce year-to-year volatility in a city's distribution. No city received a reduction in aid in 2014; roughly 90 cities are expected to receive less aid beginning in 2015. The total appropriation for aids payable in 2014 was $507.6 million. This increases to $509.1 million for 2015 and $511.6 million for aids payable

[1] It is important to keep in mind that survey results must be considered as a snapshot of how things are at particular point in time.
[2] "Annual Report on the Minnesota Housing Market: 2014." Minnesota Association of Realtors, January 2015.

in 2016 and beyond. Changes made to the program in 2013 improved stability of the program and likely eased some budgeting challenges for 2014. Despite increases made to the total appropriation for 2015 and 2016, this amount is still below the certified 2003 funding level of $586.8 million. Additionally, an annual inflationary adjustment has not been included in the funding formula.

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 reimbursed to cities was reduced multiple times since 2003 until just 15 percent of the reimbursement due to cities in 2011 was actually received. The conversion from MVHC to the homestead market value exclusion program (HMVE), made by the 2011 Legislature, likely lessened budgeting challenges for cities. While qualifying homeowners 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 challenged by unexpected cuts to levy funds.

From time to time, cities with populations over 2,500 have been subject to levy limits. Cities over 2,500 in population were limited to 3 percent growth for taxes collected in 2014. Debt service levies and levies for natural disasters were outside of the levy limit. Cities overall increased levies 1.6 percent for taxes payable in 2014. There are no levy limits in place for 2015 and beyond under current law.

Beginning on Jan. 1, 2014, cities and counties were no longer required to pay sales tax on many purchases. This exemption was passed by the 2013 Legislature and clarified in 2014. While claiming the exemption on purchases related to construction materials remains a large burden, the sales tax exemption has likely contributed to more favorable fiscal conditions in many cities.

State's fiscal condition

In addition to legislative action at the state level, the state's own fiscal condition influences cities' ability to meet needs. The February 2014 state forecast showed a projected $1.23 billion fund balance, after required repays and adjustments were made.[3] This allowed the state to replenish the Rainy Day Fund, used when recession or other unexpected events cause revenue declines or spending increases and to use cash to supplement bonding for capital improvements. The projected balance for 2016-2017 was $603 million. A stronger state fiscal condition may boost confidence in the stability and reliability of the state-local partnership. A stronger state-local partnership likely influences a city's fiscal outlook positively.

In November and December 2014, Minnesota's net general fund receipts totaled $3.52 billion, 6.4 percent more than forecast.[4] Most of the additional revenue was due to higher estimated individual income tax payments, but net receipts from all major tax types were above forecast. The state's 2015 February forecast showed continued improvement, with a projected balance in the next

[3] "Revenue & Economic Update: January 2015." Minnesota Management and Budget, January 2015.
[4] Ibid.

biennium of $1.87 billion, an increase of $832 million over the last forecast.[5] Analysts are predicting continued economic growth during 2015. Reasons for this growth include increased consumer spending and business investment in equipment, trade, and contributions from the federal government. Falling gas prices throughout late 2014 and early 2015 are also boosting consumer and business confidence and also reducing city costs. Gas prices are expected to stabilize during the year.

Economic changes

Given the improvements at the state level and in the economy in general, challenges that surfaced during the recession may be stabilizing and thus may be more easily addressed. Unemployment continues to fall. In December 2013 the state's unemployment rate was 4.6 percent and fell to just 3.6 percent in December 2014, the lowest since May of 2001.[6] The rate for the U.S. as a whole fell from 6.7 percent to 5.6 percent over the same time period. For 2014 overall, the number of unemployed Minnesotans fell by nearly 31,000 while the labor force grew by over 20,000, for a labor force participation rate of 70 percent in December. Baby boomer retirements and continued job growth both contributed to the tightening of the labor market. The number of job vacancies in the second quarter of 2014 grew 16.7 percent compared to the year prior.[7] The strongest growth was seen in health care support, office and administration support, and food preparation and serving-related fields. As in the past, job vacancies were more heavily concentrated in the metro area than in Greater Minnesota (56 percent compared with 44 percent).

The real estate market continues to show signs of improvement, albeit with slower growth than was observed in 2013. The statewide median sales price in 2014 was up 5.3 percent over the last year, after rising just over 13 percent in 2013.[8] An increase in median sales price was seen in all regions across the state except for the Upper Minnesota Valley Region, located in southwestern Minnesota, where the median sales price fell almost 8 percent. The share of closed sales attributed to foreclosures or short sales fell 39.6 percent to 14.4 percent in 2014. Strength in the real estate market no doubt influences city tax bases. 2014 marks the first time since 2010 that total market value in cities overall increased.[9] Due to lags in the assessment calendar, it has taken several years for real estate gains to show up in tax base data.

Observation

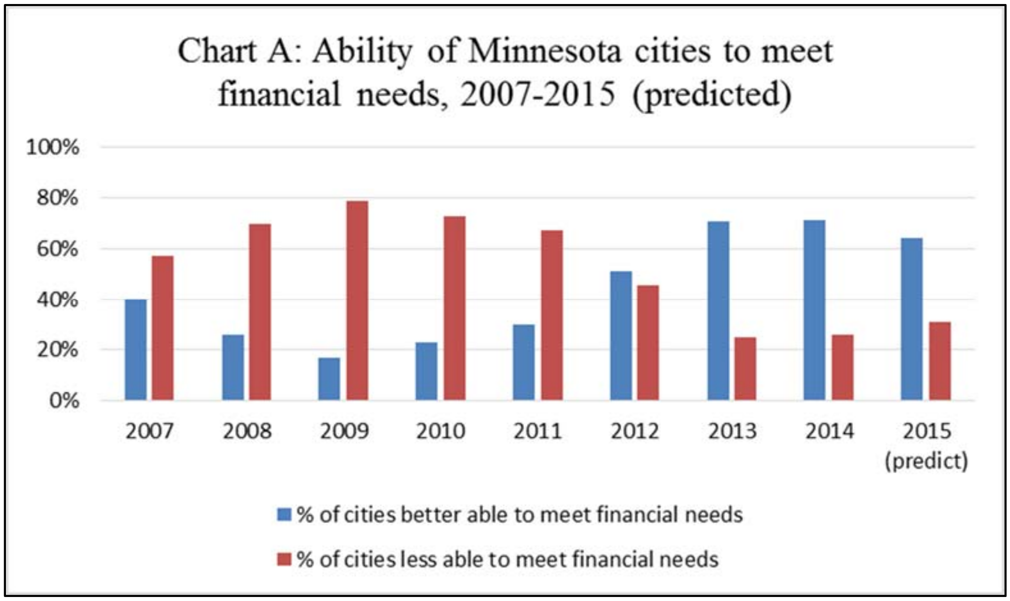
Share of cities better able to meet needs holds steady compared to last year

- The proportion of cities that reported an improved ability to meet needs in 2014 is 71 percent for the second year in a row.
- Looking ahead, 64 percent of cities foresee an improvement in conditions for 2015.

[5] "Budget & Economic Forecast: February 2015." Minnesota Management and Budget, February 2015.
[6] "State and National Employment and Unemployment," Department of Employment and Economic Development (DEED), February 2015.
[7] "Job Vacancies." DEED, February 2015.
[8] "Annual Report on the Minnesota Housing Market: 2014." Minnesota Association of Realtors, January 2015.
[9] "2014 Property Tax Report." *Minnesota Cities* magazine, September-October 2014.

Historic trends

- The share of cities identifying an improvement in conditions increased each year from 2003 to 2006, when just over half of cities reported an easier time meeting needs.[10]
- During the economic crisis and recession this share fell annually to a low of just 17 percent in 2009 (see Chart A).
- The share indicating a better ability to meet needs then began to increase annually until 2013 and has now held steady at 71 percent for two years in a row.



Questions raised

Does "better able" means conditions are good in a particular city?

While "better able" does not always mean that a city's circumstances are good, many cities are likely facing milder conditions now. After several years of meeting needs in a down economy, cities may be better able to meet needs with fewer resources. Cities may also have scaled back their activities, doing less, providing fewer services than in past years, or providing them more efficiently. Challenges that were difficult to address when they first arose may no longer present as large a challenge to overcome as cities have found strategies that work for their community. Some challenges, like widespread foreclosures, may have actually lessened. Additionally, the strategies cities took to address budget challenges in recent years may have positioned them well to more easily meet needs now.

How may have legislative changes influenced a city's ability to meet needs?

As discussed earlier, the 2013 Legislature made changes to the LGA program formula that was intended to reduce year-to-year volatility in a city's distribution. It also increased the total

[10] When considering historic trends it must be remembered that the pool of cities responding to the survey changes annually. Among the cities responding annually since 2008, 66 percent reported more favorable conditions in 2013. This share climbed ever so slightly to 69 percent in 2014 and then falls to 61 percent when looking ahead to 2015.

appropriation for 2014, 2015, and beyond. No city received a reduction in aid in 2014. The conversion from MVHC to the HMVE program, made in 2011, likely lessened budgeting challenges for cities as city levies are no longer partially funded by state reimbursement. The recent legislation exempting cities from paying sales tax may have also contributed to more favorable conditions in many cities.

Are the trends similar in cities outside of Minnesota?
The most recent fiscal conditions survey conducted by the National League of Cities (NLC) suggests that cities across the county have adjusted and adapted to be better able to meet needs than in the past.[11] The share reporting improved conditions in 2014, 80 percent, is the largest in the 29-year history of the survey. Just under three-quarters of cities nationwide reported improved conditions in 2013.

Observation

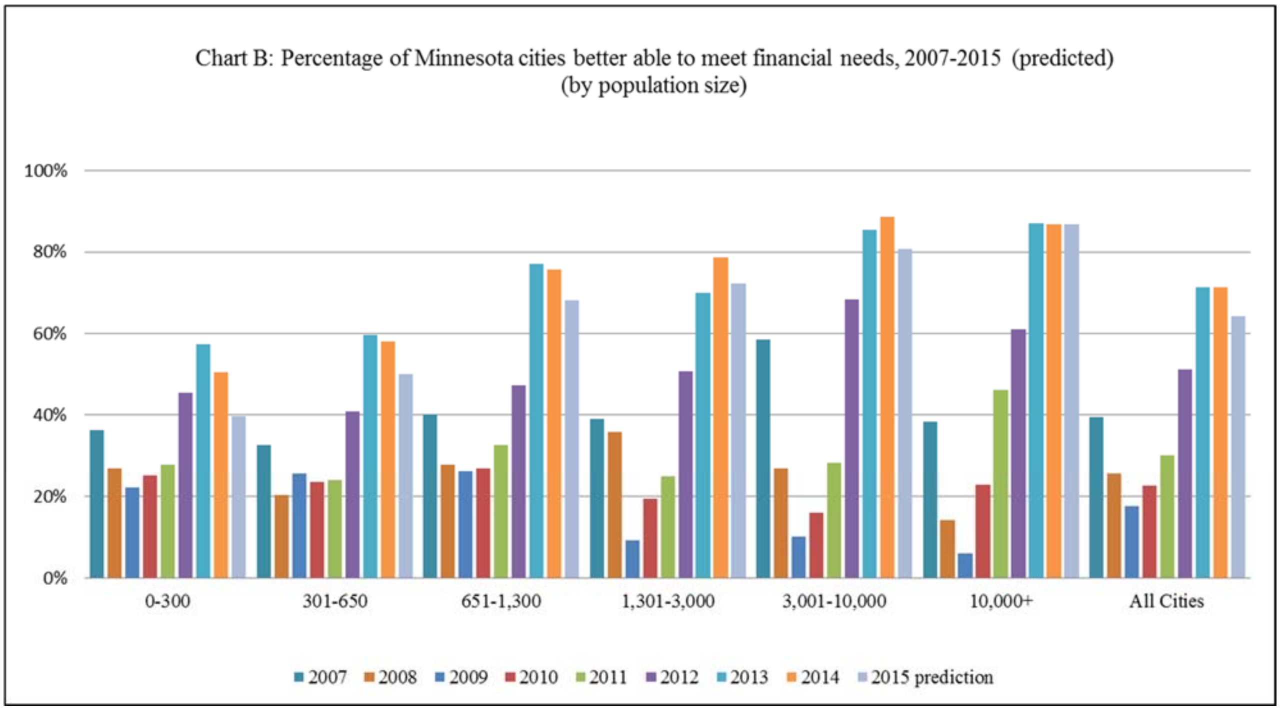
Trends by population size follow pattern of cities overall, with little or no change over 2013 in the shares reporting an improved ability to meet needs

- Like cities as a whole, the share of cities over 10,000 in population reporting improved conditions is unchanged from 2013, holding steady at 87 percent (see Chart B).
- The shares of cities reporting improved conditions in the three smallest population size categories fell slightly from the shares doing so in 2013. However, none of these shares fell below 50 percent.
- The share of cities reporting more favorable conditions increased slightly for cities with populations between 1,301 and 3,000 and those with populations between 3,001 and 10,000. As in recent years, the share of cities facing improved conditions generally increases as population size increases.
- Among the largest cities, the share predicting an easier time meeting needs in 2015 remains at 87 percent, the same share that reported improved conditions in both 2013 and 2014.
- The proportion predicting improved conditions in 2015 decreases as population size decreases, with just 40 percent of cities under 300 foreseeing better circumstances.

[11] Pagano, Michael A. and Christina McFarland. "Research Brief on America's Cities: City Fiscal Conditions in 2014," National League of Cities, October 2014. The 29th annual survey was conducted in the spring of 2014.

Historic trends

- As in recent years, the share of cities reporting improved conditions generally increases as population size increases.



Observation

Regional trends show some differences, but overall little change reported in the shares facing improved conditions

- Metro cities were more likely to report an improvement in conditions than were Greater Minnesota cities (86 percent vs. 68 percent). This gap widens a bit when looking to 2015, with 88 percent of metro cities and just 59 percent of Greater Minnesota cities predicting improvement in conditions in 2015.
- Likewise, cities classified as metropolitan statistical areas (MSAs) were more likely to report an improved ability to meet needs than those that are not MSAs (80 percent vs. 64 percent).[12] Knowing that population is a component in MSA status, it is not surprising that cities that are part of an MSA are more likely to report improved conditions.
- Looking to 2015, the share predicting more favorable conditions falls among both MSA and non-MSA cities.

[12] A metropolitan statistical area (MSA) is defined by the U.S. Census Bureau as a geographical area containing at least one urbanized area of at least 50,000 inhabitants, plus adjacent territory that has a high degree of social and economic integration with the core as measured by commuting ties. The area consists of one or more counties. As of the 2010 Census, there are eight MSAs that include at least one Minnesota county: Duluth, Fargo, Grand Forks, La Crosse-Onalaska, Mankato-North Mankato, Minneapolis-St. Paul-Bloomington, Rochester, and St. Cloud.

- Across the state, six regions showed an increase over 2013 in the proportion of cities reporting an easier time meeting needs. This share declined in the other seven regions.
- The greatest increase was in the Southwest Central region, which went from 42 percent of cities identifying an improved environment in 2013 to 67 percent in 2014.
- All regions along the southern border of the state and, with the exception of the seven-county metro region, all regions along the eastern border reported a decline in the share of cities facing more favorable conditions. However, at least half of cities in each region reported improved conditions in 2014.
- The seven-county metro region is the only region to show an increase in this share when looking to 2015. This observation may be related to the fact that, as a group, the largest cities were the only population size category to not show a decline in this share for 2015.
- The North Central region holds steady, with 76 percent of cities forecasting improved conditions in 2015.
- Cities in the Southwest region may be especially pessimistic about the coming year, with just 39 percent of cities predicting more favorable conditions. In no other region does this share fall below 50 percent.

Historic trends

- Trends by MSA status are similar to those observed for cities overall. The shares reporting improved conditions fell until 2009 (see Table A).
- The share reporting an improved ability to meet needs fell from 2013 among non-MSA cities.

Table A: Percentage of Minnesota cities better able to meet needs

	2007	2008	2009	2010	2011	2012	2013	2014	2015 (predicted)
MSA cities	46%	24%	15%	25%	35%	57%	78%	80%	74%
All Cities	40%	26%	17%	23%	30%	51%	71%	71%	64%
Non-MSA cities	34%	27%	20%	21%	26%	47%	66%	64%	56%

- While all regions across the state showed an increase in the proportion of cities reporting an improved ability to meet needs last year, this year the picture is mixed. Just six regions showed an increase in this share over 2013 (see Figure 1).
- When looking ahead to next year, most regions show a similar pattern to that of cities overall, with the share predicting an easier time meeting needs in 2015 falling (see Figure 2).

Figure 1: Percentage of cities better able to meet needs in 2013/2014 (by region)

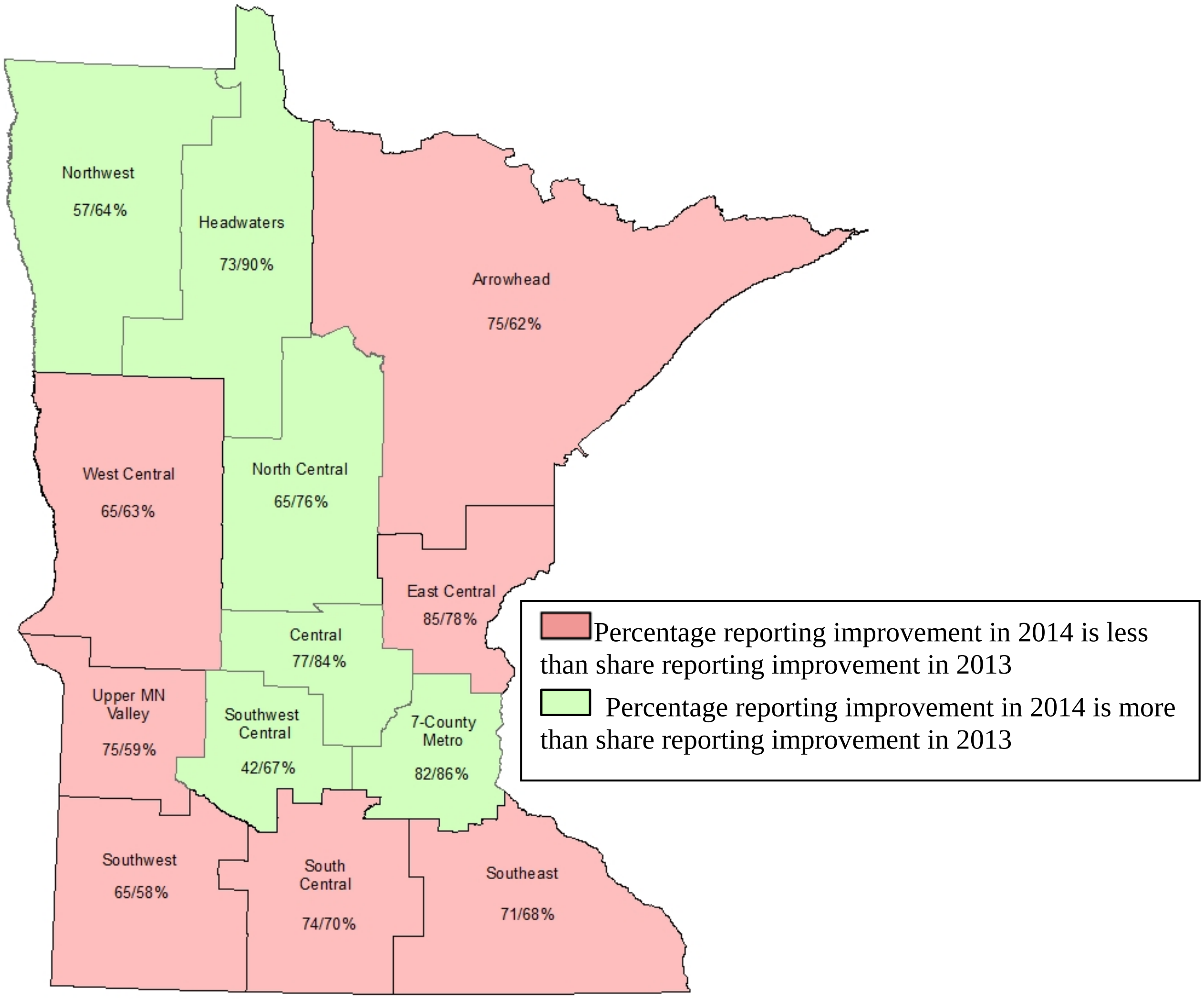
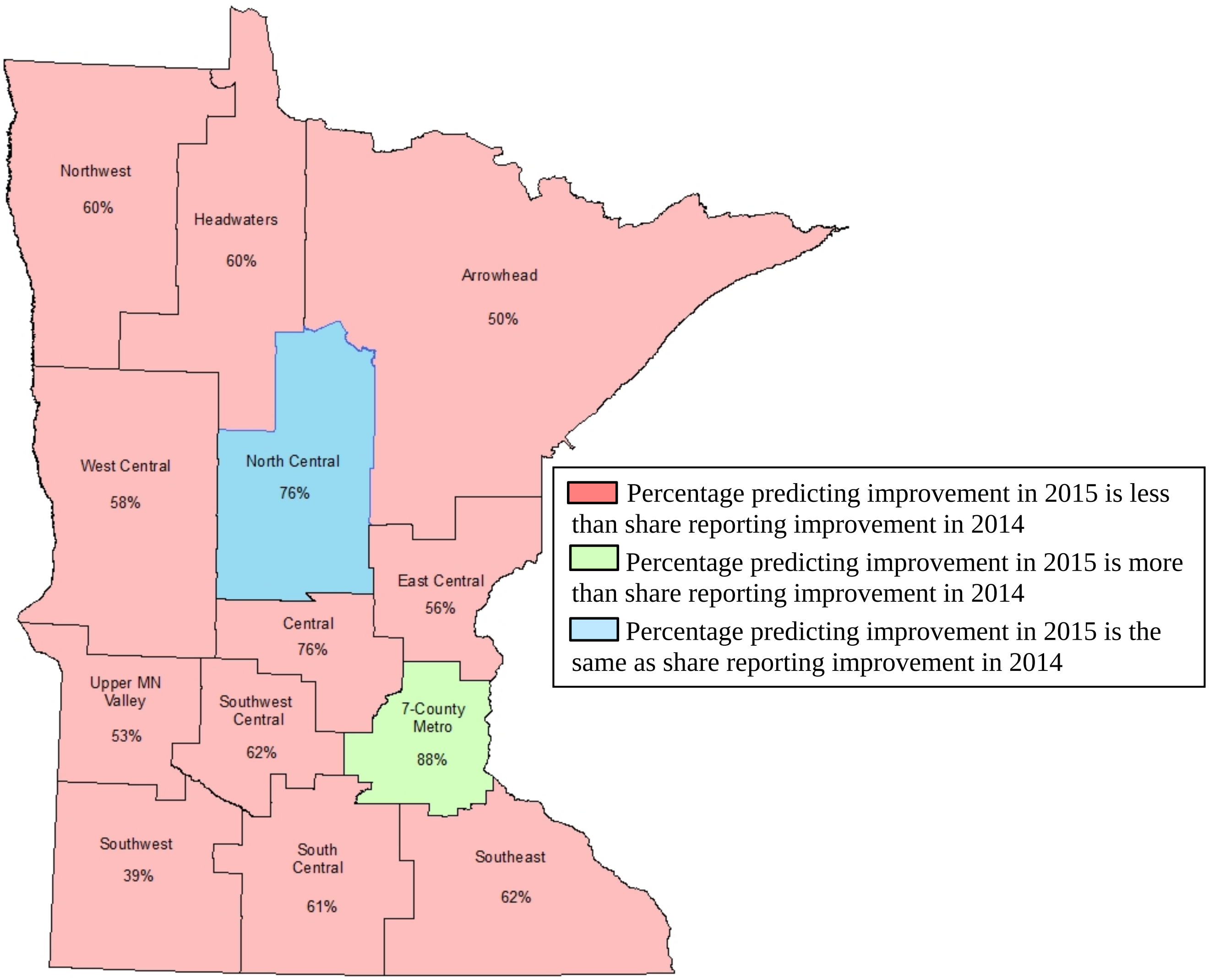


Figure 2: Percentage of cities predicting improved conditions for 2015 (by region)

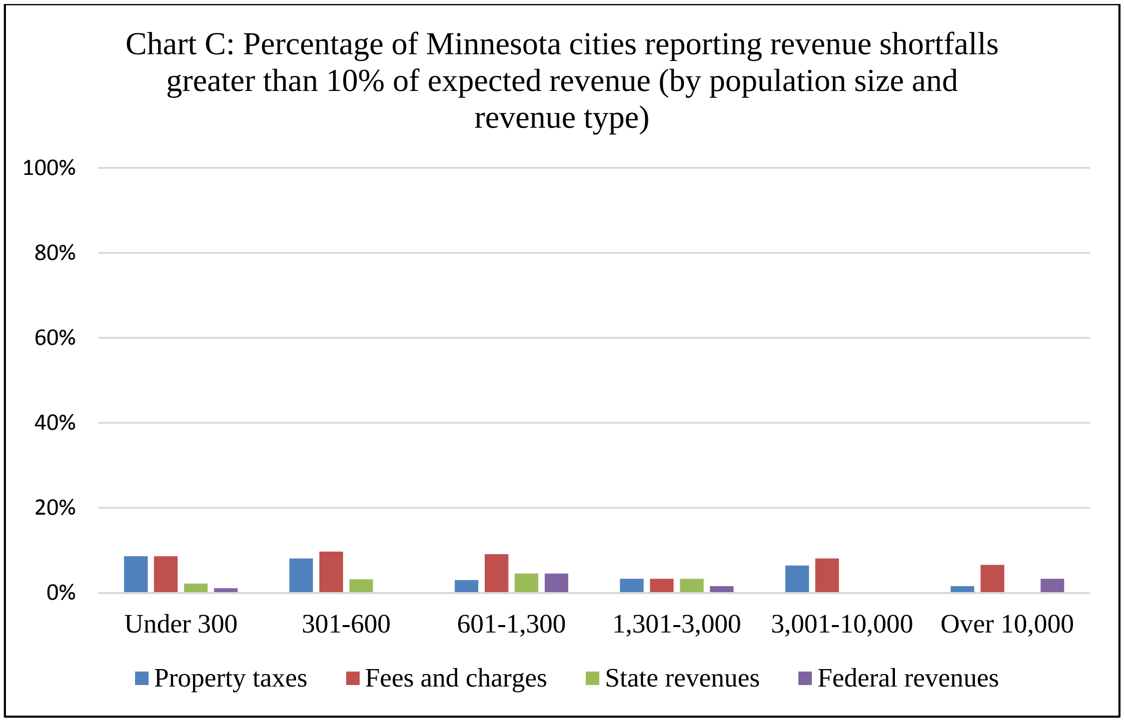


Observation

Smaller shares of cities reported shortfalls in main revenue categories for fourth year in a row.

- Following the trend first observed in 2011, the share of cities reporting a shortfall in expected revenues in 2014 fell or stayed the same when compared to the prior year for each revenue source.
- The share of cities reporting a shortfall in property taxes is the smallest since 2004.
- The shares of cities reporting shortfalls in state and federal revenues are the smallest yet.
- Both the smallest and largest population size cities were least likely to report a property tax shortfall (30 percent). Cities with populations between 1,301 and 3,000 were most likely to do so, with 44 percent indicating a shortfall.
- Like last year, the share reporting a significant shortfall of 10 percent or more of expected property tax revenues was much smaller than the share reporting a shortfall of less than 10

percent (5 percent vs. 30 percent). Smaller cities were more likely to report significant property tax shortfalls than larger cities (see Chart C).



- Location was not a large factor in the likelihood of a city reporting any shortfall in property taxes (33 percent among cities in the seven-county metro area vs. 36 percent of Greater Minnesota cities). Cities in Greater Minnesota were more likely to identify significant shortfalls than were metro area cities (6 percent vs. 1 percent).
- 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 10 percent of cities.
- Looking at location, cities in Greater Minnesota were more likely than metro area cities to report any shortfall in fee revenue (30 percent vs. 16 percent).
- Similarly, significant shortfalls in fees were more likely among Greater Minnesota cities (8 percent vs. 4 percent of metro cities).
- These trends hold true when looking at shortfalls in state and federal revenues, with larger shares of Greater Minnesota cities reporting both any and significant shortfalls in state and federal revenues.

Historic trends

- Except for state revenues, the largest share for each revenue source was seen during the Great Recession (see Table B). During the year leading up to and during the recession, the share of cities reporting shortfalls generally increased each year. Since 2011 these shares have declined, suggesting that cities have made adjustments in how they budget.

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%
2014	36%	28%	11%	6%

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

Largest Share | Smallest Share

- While fees and charges are generally used more broadly by larger cities—13 percent of the smallest cities reported not having the authority to collect such revenue—the largest cities were least likely to report a shortfall in this revenue category (15 percent). Historically, survey results have shown larger shares of the bigger cities reporting significant shortfalls in fee revenue. However, this is the third year in a row in which this trend has not been observed.

Questions raised

What are some of the reasons why cities might report a shortage in revenues?

There are many reasons that cities are less likely to report a shortage. First, cities may have adjusted expectations for revenues in recent years. Challenges that arose during the Great Recession likely led many cities to anticipate less revenue. Foreclosures, unemployment, and a slow economy may all have contributed to revenue shortfalls. During the first part of recovery, cities may have been accustomed to receiving less revenue in some categories. Now, a strengthening economy, improving housing market, and declines in foreclosures and unemployment may help cities avoid revenue shortfalls.

Legislative changes may also mean that some cities are actually receiving more revenue in some categories. Legislative changes may also influence expectations for revenues. Changes made to the LGA program for 2014 and beyond that improve the stability of city distributions likely contribute to the fact that just 11 percent of cities reported a shortfall in state revenues. The downward trend in the proportion reporting shortages in property taxes may be related to the conversion to the homestead market value exclusion program several years ago. Prior to the switch, cities may have included reductions to the market value homestead credit reimbursement in property tax shortfalls.

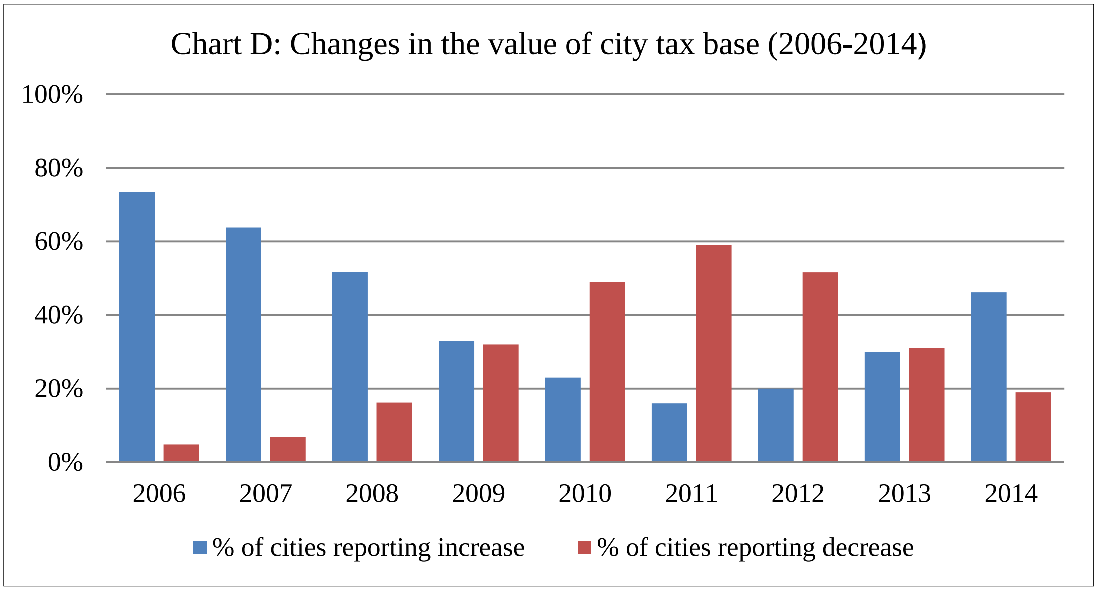
Observation

Changes in most budget factors similar to those reported in 2013; some positive shifts observed

- While shifts in the share of cities reporting change for many budget factors are small, many of these are in a positive direction, meaning less of a budget burden for cities. However, the fact that the mix of responding cities changes each year must be kept in mind when comparing these shifts between years.
- For the third year in a row, the share of cities reporting an increase in the value of the tax base grew. The share reporting a drop in tax base value fell to just under 20 percent.
- The share of cities reporting an increase in the service needs of new development rose to 25 percent from just 20 percent in 2013. This suggests that new development continues to increase.
- Shifts in the shares of cities reporting changes in the health of the local economy can be characterized as very positive. One-third of cities now report an increase in local economic health, up from 23 percent in 2013.The shares reporting no change or a decline are roughly the same as last year, suggesting that if the economy is not healthier, at least it is likely not getting worse.
- Further supporting the notion of a stabilizing economy is the fact that the shares reporting changes in prices, inflation, and the cost of living are very similar to those reported last year. A big difference in the shares reporting an increase or a decrease would suggest big changes in the larger economy, which influences a city's ability to meet needs.
- The top budget factors identified by the most cities as having increased in 2014 were:
    - Cost of employee wages and salaries.
    - Prices, cost of living, and inflation.
    - Infrastructure needs.
    - Cost of employee health benefits.
    - Cost of employee pensions and value of the tax base (tie).

Historic trends

- Beginning in 2006, the share of cities reporting an increase in tax base fell yearly while the share reporting a decrease grew until more than half of cities reported a drop in tax base value in 2011 (see Chart D). This trend reversed in 2012 and continued again this year. The share reporting an increase is now greater than the share reporting a decrease (46 percent vs. 19 percent).



- Since 2009 there has been little change in the factors that the largest shares of cities have identified as increasing.
- Most of the leading factors identified by Minnesota cities as increasing from fiscal year 2013 were also the top factors identified by city officials nationwide in the recent NLC survey. Larger shares of cities across the nation identified increases in each factor than did cities in Minnesota.

Questions raised

What might be behind the trend of larger shares of cities reporting growth in the value of the property tax base?

The housing crisis and subsequent slow recovery held down growth in the value of the property tax base in many cities for several years. Gains in the residential real estate market began in 2012 when the median sales price increased just under 10 percent over the prior year. Increases have again been seen in the last two years, another sign of a stabilizing and even strengthening economy. Because of the data lag in the assessment calendar—values for taxes payable in 2014 were determined in January 2013—it has taken time for this growth to be felt by the city tax base. 2014 marks the first time since 2008 that both residential and total city market value have increased. Of course, residential property is just one category of the tax base. Changes in these other types—multi-family, commercial, agricultural, and other—also influence the tax base. Each of these categories also saw growth for taxes payable in 2014.

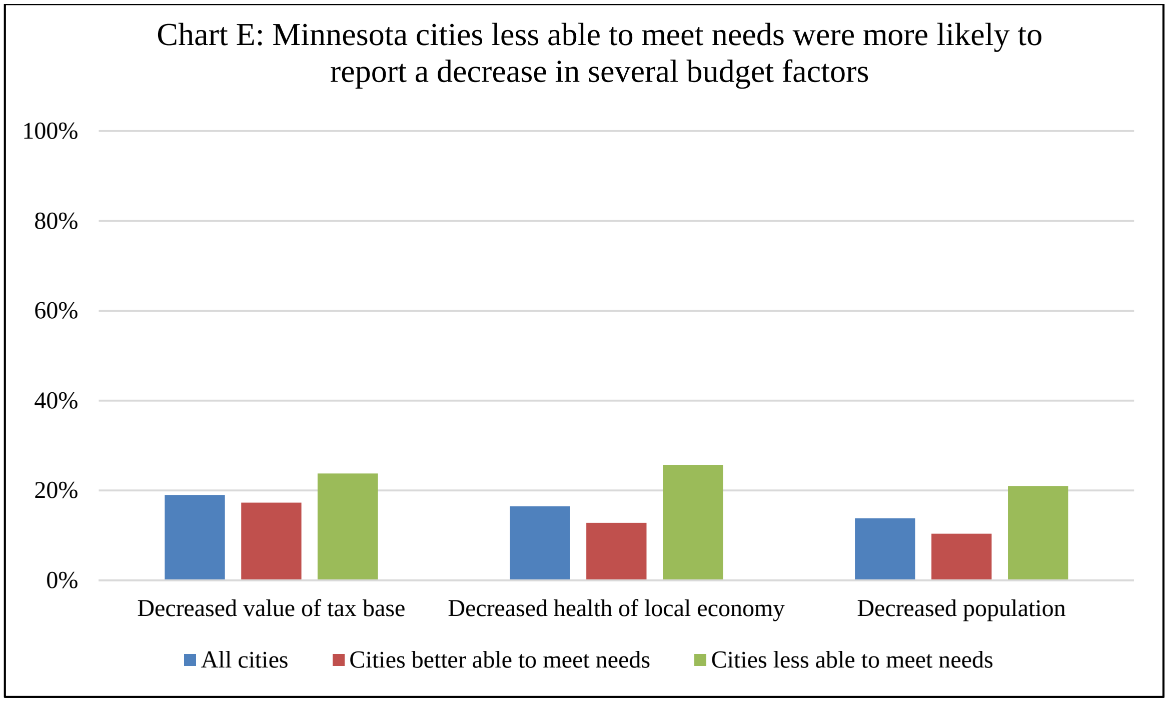
Observation

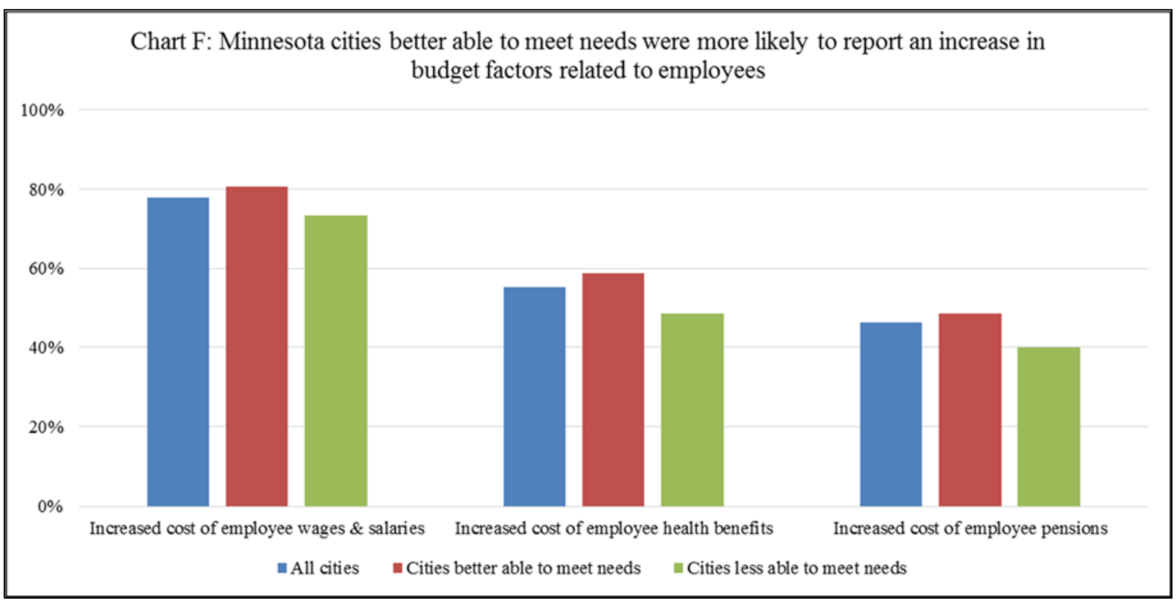
Changes in budget factors are related to a city's ability to meet fiscal needs

- Changes in some budget factors that may lead to budget challenges were more likely among cities less able to meet needs.
- Cities less able to meet needs were more likely to report a decrease in the value of the tax base, health of the local economy, and population than cities better able to meet needs in

2014 (see Chart E). These cities are mostly located in Greater Minnesota and have populations under 1,300. Given the uniqueness of individual cities, while a decrease in a factor may pose a challenge to one city, a different city may not be challenged by a similar decrease.

- Cities who identified as "better able" were more likely to report increases in the factors related to employees (see Chart F).





Questions raised

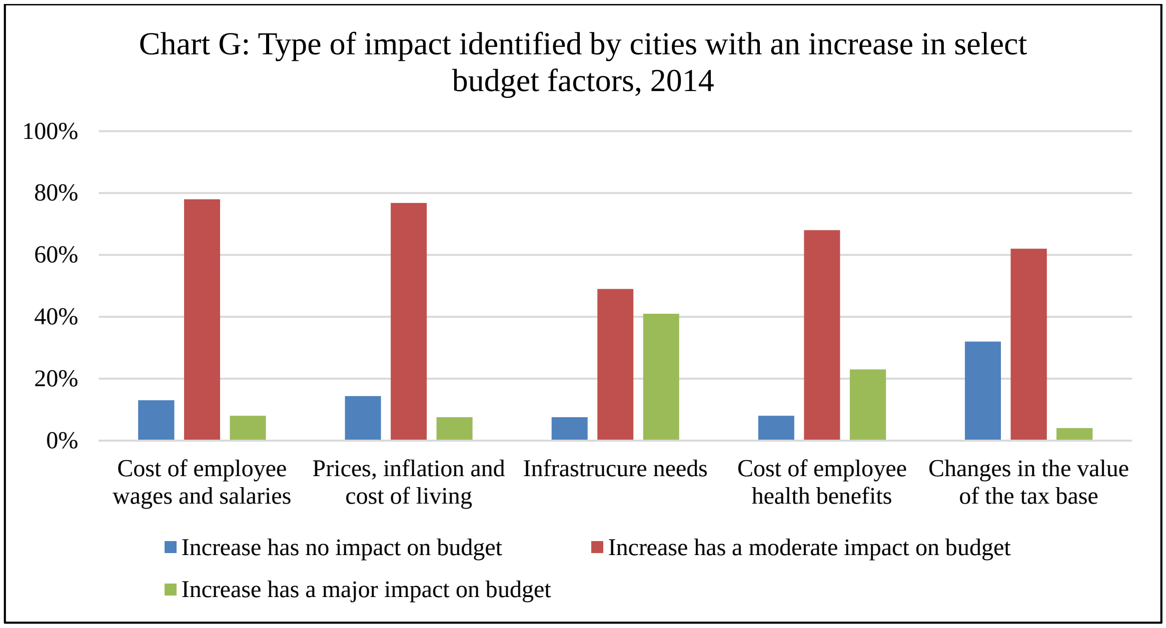
Why might cities identified as "better able" be more likely to report increases in factors related to employees? Wouldn't these increases put stress on the budget?

A city facing more favorable conditions may be able to fill positions that have been left vacant and catch up on employee wage increases that were postponed during more difficult years. Looked at in this way, increases in these factors may be more indicative of a city doing better than of a budget burden or fiscal challenge that may contribute to a city being less able to meet needs.

Observation

Little changes in the share of cities reporting budget impacts due to changes in budget factors

- Besides being asked how each budget factor changed compared with the prior year, cities were asked about the impact of those changes on their 2014 budget. The survey does not ask whether the impact felt is positive or negative.
- The share of cities reporting at least a moderate impact on their budget shifted slightly for each factor from the share doing so in 2013. This share increased for 13 factors and declined for five factors in 2014.
- The greatest change is in the share reporting at least a moderate budget impact due to changes in the cost of employee pensions (36 percent in 2013 vs. 43 percent in 2014).
- The top factors identified as having at least a moderate impact on cities' budgets in 2014 were:
  - Employee wages and salaries.
  - Prices, inflation, and cost of living.
  - Infrastructure needs.
  - Cost of employee health benefits.
  - Value of the tax base.
- The share of cities identifying an impact increased over last year—some very slightly so—for each of these top factors.
- For most of these budget factors, the share of cities reporting a moderate impact is much greater than the share reporting a major impact (see Chart G). However, this difference is much smaller among cities identifying an increase in infrastructure needs.



Questions raised

How does a city's ability to meet fiscal needs relate to how it experiences change in budget factors?

Not only is a city's ability to meet fiscal challenges affected by the mix of specific challenges it faces, but also by whether and how great an impact budget factors actually have on the city. For most budget factors, the share of cities reporting no impact on the budget was greater among those cities that identified as being better able to meet needs in 2014. The reverse was true for the share of cities reporting no impact due to changes in the tax base, cost of employee pensions, and cost of employee health benefits. For these factors, the share reporting no change was slightly smaller among "better able" cities. Cities that reported being better able to meet needs in 2013 were just as or slightly more likely to indicate a major impact from changes in most budget factors.

Observation

Just over nine in 10 cities report using at least one budget strategy in 2014; average number of strategies used was up slightly over 2013

- Each year cities are asked to identify the strategies used in the current fiscal year in preparation for the next. The vast majority of cities, 93 percent, reported using at least one strategy in 2014.
- The average number of strategies used by a city was 2.11, up slightly from 2013 (2.06 strategies on average). Over three-quarters of cities reported employing between one and three strategies in 2014. Exactly one-third of cities reported using just one strategy (see Table C).

Table C: Number of budget-balancing actions employed by Minnesota cities in 2014

	Implemented in 2014
Average number of strategies per city	2.12
1 - 3 strategies	78%
4 - 6 strategies	13%
7 - 9 strategies	2%
No reported strategies	7%

- The budget-balancing strategies cities are asked about can generally be grouped into broad categories. Increases in property taxes and fees, charges, and licenses make up the “revenue increases” category. The “spending decreases” category encompasses cuts in infrastructure, public safety, and other spending as well as reductions to the overall growth grate of spending. Actions comprising the “increasing efficiencies” grouping includes increases to productivity levels, contracting out or privatizing, and inter-local agreements.
- The portion of cities taking action in the revenue increases category increased over last year. The share that reported taking action in all other categories fell or stayed the same compared with 2013.
- Among the cities reporting an increase in revenue in 2014, 6 percent increased fees, charges, and license revenue only; 59 percent increased tax revenue only; and 35 percent increased both kinds of revenue.
- The share of cities that reported spending decreases dipped slightly in 2014 to the smallest share reported (11 percent, the same size as in 2006).
- The proportion of cities reporting an increase in taxes rose in 2014 to 69 percent. This is the largest share since 2007.
- Just under one-third of cities reported making human resource-related changes as a way to address fiscal challenges in 2014. Like many of the other strategies, repeated use may not be sustainable without severe impacts on service levels.

Historic trends

- Following the trend seen over the last several years, the share reporting between 1 and 3 strategies grew over 2013. Just over half of cities reported using between 1 and 3 strategies in 2010 while more than three-quarters of cities did so in 2014.
- Table D provides a historic look at the trends in the broad revenue categories, with the year or, in some cases, years with the highest and lowest reported shares highlighted.
- Most revenue categories experienced little or no change in 2014 when compared with the prior year. The share of cities reporting revenue increases rose from 61 percent in 2013 to 73 percent in 2014, the largest share since 2008.

Table D: Budget-balancing actions taken by Minnesota cities (2003-2014)

	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%
FY2014	73%	11%	23%	7%	4%	25%

Largest Share	Smallest Share

- Table E shows trends in specific budget-balancing actions taken by cities. Most action categories experienced little or no change in 2014 when compared with the prior year. The share reporting an increase in taxes increased from 49 percent in 2013 to 69 percent in 2014.

Table E: Specific budget-balancing actions taken by Minnesota cities (2007-2014)

	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 interlocal 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%
FY2014	69%	30%	3%	5%	3%	4%	8%

- During the recession and recovery more than half of cities reported making human resource-related changes as a way to address challenges. This share has trended downward with just 32 percent reporting taking at least one HR-related action in 2014 (see Table F).

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

	2009	2010	2011	2012	2013	2014
Reduced workforce	26%	25%	20%	16%	8%	7%
Cut or maintained wage levels	65%	63%	48%	39%	28%	24%
Increased use of furloughs	6%	3%	1%	1%	0%	0%
Reduced employee benefits	11%	9%	8%	6%	4%	5%
Made at least one HR action	74%	70%	61%	51%	38%	32%

- The recent NLC fiscal conditions survey also asked cities about actions taken to address budget challenges.[13] Trends for cities nationwide in the HR-related actions are similar to those observed in Minnesota. On last year's NLC survey, 38 percent reported implementing a hiring freeze. This year 33 percent reported increasing the size of the workforce. For the first time since 2008, this share is larger than the share decreasing the size of the workforce (18 percent).
- The most common revenue-related actions reported by cities throughout the country were increases to the levels of fees (43 percent), increases to the property tax rate (22 percent), and increases to the number of fees (18 percent). These shares are similar to those reported on last year's survey.

Questions raised

What factors affect how cities respond to fiscal challenges?

Cities respond to fiscal challenges in various ways. How a particular city addresses a challenge is dependent on several factors. The specific fiscal challenge or combination of challenges facing the city along with its local tax base, resident needs and preferences, services provided, local policies and ordinances, past actions, state laws and mandates, and revenue-raising opportunities all inform the response. Of course not every strategy is available or appropriate for each city and, over time, cities may need to adjust the strategy or strategies used in order to continue meeting needs most effectively.

How has the economic recession changed how cities approach budgeting?

During the economic recession and recovery, cities have had to adjust how they budget. The period of annual cuts to LGA payments led some cities to begin using state aid payments for one-time expenditures rather than relying on them for ongoing or operating costs. Years of little spending increases or flat property tax levies may mean some cities need to make increases in order to meet needs or continue providing the same level of service. Other cities may find themselves able to do things now that they were unable to several years ago such as fill employee vacancies or implement wage increases.

[13] The list of actions cities were presented with differed from that on the Minnesota survey. The options available to cities nationwide vary depending on state and local laws.

What might be some of the reasons behind the higher percentage of cities reporting revenue increases?

There are many reasons why cities may need to increase revenues. Some cities may be better positioned now to reverse changes made during the recession. Many cities reduced the workforce or kept positions open during the recession. Very small shares of cities reported increasing the workforce during those years, with just 2 percent doing so in 2008. This year, just 7 percent cut or left positions vacant while 16 percent increased the size of the workforce. Similarly, some cities are beginning to increase wages again after several years of freezes or even cuts. Just over 70 percent of cities reported increasing wages in 2014 compared with just under one-third of cities in 2009.

During the recession many cities chose to delay infrastructure improvements, new projects, and major purchases. Some cities may be increasing revenue in order to take on some of these delayed projects and purchases. Other cities may be restoring services that were cut or reduced during the recession. For example, some cities that reduced library hours several years ago are now adding additional hours.

The share of cities that reported reducing spending is the lowest ever reported. Does this mean that cities are spending more?

While fewer cities reported making spending reductions, this does not mean that the inverse is true—that cities are spending more. In fact, 72 percent of cities reported holding levels steady in at least one of the spending categories. Just 21 percent of cities reported increases in all of the spending categories. Decreasing spending year after year may not be possible in all areas without negatively affecting service levels. Spending increases may be needed in order to maintain service levels or avoid additional costs down the road. For example, when infrastructure improvements are repeatedly delayed, costs may increase as conditions continue to deteriorate. Cities may choose to spend at a particular time in order to take advantage of low interest rates or other efficiencies. Other cities may be better able to make purchases or improvements now after years of maintaining spending levels. Additionally, some cost increases may be out of the control of cities.

Why might cities choose a particular strategy in regard to taxes?

Of the cities reporting an increase in taxes, just 17 percent increased taxes significantly while 83 percent identified a slight increase. Some cities may choose to implement slight increases each year with the intent of avoiding a significant increase in one year. A significant increase in taxes may be due to an unforeseen need for more revenue such as a natural disaster or a major unexpected infrastructure project. The reasons for any tax increase are many. Cities may need to increase tax levels due to past action (i.e., years of little or no change), planned projects or expenditures, service level expectations and demands, or cost increases beyond their control. One-quarter of cities held taxes steady for the coming year while 3 percent reported a decrease in tax levels. This share is down from 12 percent last year. A city may be unable to sustain multiple years of tax decreases without negatively influencing service levels or compromising long-term fiscal health.

Except for the change in the share increasing taxes, many of the shares reported in Table E are similar to last year. Why might this be?
The different mix of cities responding to this year's survey may be partially responsible. This lack of significant change may also provide additional support of the idea that cities are adjusting to conditions that arose during the recession and recovery. Some cities may have found a mix of strategies that allows them to continue meeting the needs of their community. For most strategies, the share reporting a significant change is very small. The share indicating a significant increase in infrastructure spending is one exception to this trend. The share doing so is the same size as the share reporting a slight increase in infrastructure spending, 28 percent. Many cities delayed infrastructure projects during the recession and may face higher project costs now.

Just 8 percent of cities reported increasing inter-local agreements this year. Are cities partnering less than in past years?
While the proportion of cities indicating an increase in the number or scope of inter-local agreements is at an all-time low, it does not mean that cities are not working cooperatively. Many of these agreements have been in place for many years. The League maintains a database of known cooperative agreements. Over half of cities have at least one example of a partnership with another city, county, or school district in the database. As in the past several years, less than 1 percent of cities reported a decrease in this category. Just under three-quarters reported making no changes to the number or scope of such agreements. This again supports the idea that cities have adjusted to the challenges that arose during the recession and may have found successful strategies. Of course it may not always make sense for cities to partner when the relationship would not result in reduced cost or improved service delivery outcomes. Cities may need to adjust cooperative agreements as needs and preferences change.

Summary points

Ability to meet needs

The share of cities reporting being better able to meet financial needs during the last fiscal year held steady in 2014 at 71 percent. This share was first reported last year and is the largest ever reported. 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.

The shares of cities reporting improved conditions in the three smallest population size categories fell slightly from shares doing so in 2013. However, none of these shares dipped below 50 percent of cities. These shares increased or held steady for the larger population size categories. As in the past, metro cities were more likely to report an easier time meeting needs in the prior fiscal year than were cities in Greater Minnesota.

Revenue shortfalls

The share of cities reporting a shortfall in each of the main budget categories fell for the fourth year in a row. The share of cities reporting a shortfall in property taxes continues to fall. Just over one-third reported a shortfall in property tax revenue in 2014, the smallest since 2004.

Changes in budget factors

A city's ability to meet fiscal needs is influenced by changes in a wide variety of budget factors. Little change was observed in many budget factors when compared to 2013. The share reporting an increase in the value of the tax base rose from 30 percent in 2013 to 46 percent in 2014. This is the first time since 2009 that the share reporting an increase in tax base value is greater than the share reporting a decrease (19 percent).

Impact of changes in budget factors

One of the influences on a city's ability to meet fiscal needs is the level of impact that changes in budget factors have on the city. The top factors identified by cities as having at least a moderate budget impact in 2014 were employee wages and salaries; prices, inflation, and cost of living; infrastructure needs; cost of employee health benefits; and value of the tax base.

Budget-balancing strategies

A city's response to fiscal challenges is dependent on multiple factors. Cities were asked to report on the strategies taken in 2014 in preparation for 2015. The vast majority of cities reported undertaking at least one strategy. The portion of cities taking action in many categories changed very little from 2013. The average number of strategies undertaken by an individual city increased slightly.