City Fiscal Conditions in 2013

The nation’s city finance officers report that the fiscal condition of cities in 2013 is improving, although they are continuing to confront the prolonged effects of the economic downturn. Recovering local and regional economies experiencing slowly improving housing markets and increased consumer spending are strengthening local tax bases and economic outlooks. However, high levels of unemployment, uncertainty about federal and state actions, and long-term pension and health benefit obligations continue to constrain the fiscal outlook for many cities. Cities operate under an annual balanced-budget requirement, which requires that they actively consider adjustments to their fiscal powers - both revenues and expenditures - over the course of the fiscal year.

The National League of Cities’ (NLC) latest annual survey of city finance officers finds that:

- Overall, a majority of city finance officers (72%) report that their cities are better able to meet financial needs in 2013 than in 2012;
- As finance officers look to the close of 2013, they project a small year-over-year increase in general fund revenues measured in inflation-adjusted dollars – the first increase since 2006:
  - Property tax revenues continued to decline in 2012 and are projected to decline in in 2013, reflecting the lagged impact of real estate market declines;
  - Sales tax revenues and local income tax revenues experienced marked increases in 2012, with projections for further growth in 2013;
  - Ending balances increased in 2012 as cities began to rebuild reserves that were used to help weather the aftermath of the Great Recession.
- Factors pressuring city budgets include infrastructure costs, public safety costs, employee-related costs for health care, pensions, wages, and cuts in state and federal aid; and
- Confronted with these pressures and conditions, cities are maintaining local services while continuing to reduce personnel costs for pensions, health care benefits, and employee wages.

The City Fiscal Conditions Survey is a national mail and online survey of finance officers in U.S. cities conducted in the spring-summer of each year. This is the 28th annual edition of the NLC survey, which began in 1986. The financial support of the John D. and Catherine T. MacArthur Foundation, which helped make this year’s survey and report possible, is greatly appreciated.
MEETING FISCAL NEEDS

Overall, the nation’s city finance officers report that their cities are better able to meet financial needs in 2013 than in 2012. In 2013, 72 percent of city finance officers report that their cities are better able to meet fiscal needs than in 2012 (See Figure 1). City finance officers’ comparative assessment of their cities’ fiscal conditions from year to year in 2013 improved significantly from their assessments in both 2012 and 2011, when 57 percent and 43 percent, respectively, said their cities were better able to meet financial needs than in the previous year. The 2013 findings reflect gradually improving economic conditions in many cities after several years of shortfalls and service cuts.

REVENUE AND SPENDING TRENDS

Revenue and spending shifts in 2012 and 2013 paint a mixed fiscal picture for America’s cities. General fund revenues declined in 2012, the sixth straight year-over-year decline going back to 2007. However, a very small increase in general fund revenues is projected for 2013, suggesting that city finance officers are expecting little change in revenues from 2012 to 2013. Similarly, general fund expenditures declined in 2012 and are projected to increase marginally in 2013.

Figure 1: % of Cities “Better Able/Less Able” to Meet Financial Needs

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3 The general fund is the largest and most common fund of all cities, accounting for more than half of city revenues across the municipal sector.
In constant dollars (adjusted to account for inflationary factors in the state-local sector), general fund revenues in 2012 declined -0.9 percent from 2011 revenues, while expenditures declined by -0.2 percent. Looking to the close of 2013, city finance officers project that general fund revenues will increase slightly by 0.1 percent and expenditures will grow by 1.5 percent (See Figure 2).

In comparison to previous periods, the past twelve years have been marked primarily by challenging city fiscal conditions. Recessions in 2001 and 2008-09 were followed by lackluster economic recoveries. City revenue collections typically lag economic transitions. The revenue and expenditure projections of city finance officers for 2013 point to continuing slow recovery. While conditions are no longer deteriorating, the capacity of city budgets remains weakened coming out of the Great Recession. (For more on the lag between economic changes and city revenues, see page 11)

**TAX REVENUES**

The fiscal condition of individual cities varies greatly depending on differences in local tax structure and revenue reliance. While nearly all cities have access to a local property tax, more than half are also reliant upon local sales taxes, and some cities (fewer than 10% nationally) are reliant upon local income or wage taxes. Understanding the differing performance of these tax sources and the connections to broader economic conditions helps explain the forces behind declining city revenues.

**Property Taxes.** Local property tax revenues are driven primarily by the value of residential and commercial property, with property tax bills determined by local governments’ assessment of the value of property. Property tax collections lag the real estate market because local assessment practices take time to catch up with changes. As a result, current property tax bills and property tax collections typically reflect values of property anywhere from 18 months to several years prior to their collection.

The effects of the downturn in the real estate market in recent years continue to be evident in city property tax revenues in 2012-13. Property tax revenues in 2012 dropped by -0.4 percent compared with 2011 levels in constant dollars – the third straight year-over-year...
year decline in property tax revenues. Property tax collections for 2013 are projected to decline, albeit only slightly, by -0.2 percent. However, improving housing markets in many parts of the country suggest an improving outlook beyond 2013 (See Figure 3).

**Sales Taxes.** Changes in economic conditions are also reflected in city sales tax collections. When consumer confidence is high, people spend more on taxable goods and services, and city governments with sales-tax authority reap the benefits through increases in sales tax collections. For much of the past decade, consumer spending was also fueled by a strong real estate market that provided additional wealth to homeowners. The struggling economy and the declining real estate market reduced consumer confidence, resulting in less consumer spending and declining sales tax revenues. However, in 2012 as the national economy started to recover and consumer confidence returned, city sales tax receipts increased over previous year receipts by a robust 6.2 percent, similar to growth levels seen prior to the recession. Sales tax receipts are projected to increase again in 2013, although at a slower rate than in 2012, reflecting ongoing caution about the pace of economic recovery and consumer confidence.

**Income Taxes.** City income tax receipts have either been fairly flat or declined for most of the past decade in constant dollars. Local income tax revenues are driven primarily by income and wages (not by capital gains). The lack of growth in these revenues suggests that economic recovery following the 2001 recession was, as many economists have noted, characterized by a lack of growth in jobs, salaries and wages. However, with economic conditions improving again in 2012-13, city finance officers reported year-over-year growth of 4.4 percent for 2012 and are projecting growth of 2.3 percent for 2013.
Looking to 2014 and beyond, all indications point to improving conditions for city budgets, with national economic indicators pointing to continued slow growth. External factors, however, could easily undermine cautiously optimistic projections, including most notably the possibility of federal budget cuts.

**FACTORS INFLUENCING CITY BUDGETS**

A number of factors combine to determine the revenue performance, spending levels and overall fiscal condition of cities. Each year, the survey presents city finance directors with a list of factors that affect city budgets. Respondents are asked whether each of the factors increased or decreased from the previous year and whether the change is having a positive or negative influence on the city’s overall fiscal picture. Leading the list of factors that finance officers say have increased over the previous year are health benefit costs (84%) and pension costs (80%). Infrastructure (79%) and public safety (69%) demands were most often noted as having increased among specific service arenas. Increases in prices, or costs of services, were also noted by the majority of city finance officers (81%). Leading factors that city finance officers report as having decreased are levels of federal aid (49%) and state aid (48%). In a shift from prior years, more city finance officers report increases in the local tax base (51%) and the overall health of the local economy (66%) (See Figure 4).

When asked about the positive or negative impact of each factor on city finances in 2013, at least seven in ten city finance officers cited health benefit costs (80%), pension costs (75%), and infrastructure demands (73%) as negatively effecting city budgets. Positive impacts cited include the health of the local economy (65%) and the local tax base (47%). (See Figure 5)

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6 The factors include: infrastructure needs/costs, public safety needs/costs, human service needs/costs, wages, pension costs, health benefit costs, prices and service costs, federal aid, state aid, federal mandates, state mandates, city population, city tax base and the health of the local economy.
RESEARCH BRIEF ON AMERICA’S CITIES

REVENUE ACTIONS AND SPENDING CUTS

City finance officers were also asked about specific revenue and spending actions taken in 2013. As has been the case for much of the past two decades, regardless of the state of national, regional, or local economies, the most common action taken to boost city revenues has been to increase the amount of fees charged for services. Two in five (39%) city finance officers report that their city has raised fee levels. Approximately one in four cities increased the number of fees that are applied to city services (22%), and one in five (19%) cities increased the local property tax in 2013. Since the mid-1990’s, irrespective of economic conditions, the percentage of city finance officers reporting increases in property taxes in any given year has been reported at about this same level, reflecting state- and voter-imposed restrictions on local property tax authority as well as the political challenges of raising property tax rates. Increases in sales, income or other taxes are even less common, as continued to be the case in 2013 (See Figure 6).

When asked about expenditure actions taken in 2013, the most common response was reducing the size of the municipal workforce (32%). Three of five (62%) cities report increases in public safety expenditures (See Figure 7).

The 2010-2013 surveys also asked about specific types of personnel-related cuts enacted (See Figure 8). In 2013, the most common cut so far was a hiring freeze (38%). At least one in five cities reduced health care benefits (24%) or pension benefits (22%). However, the percentage of city finance officers reporting personnel-related cuts in 2013 is lower than in 2012 in all categories except pension benefits.

Many cities used some combination of these types of actions in an effort to reduce personnel costs. The combination of these personnel-related cuts has resulted in a significant reduction in personnel costs, as illustrated in Figure 8.

Figure 6: City Revenue Actions in 2013

Figure 7: City Expenditure Actions in 2013

Figure 8: Personnel-Related Cuts in 2013
in the size of local government workforces. The U.S. Bureau of Labor Statistics’ latest national unemployment numbers, as of August 2013, revealed that total local government employment in the U.S., including municipal government employment, is more than 500,000 jobs below the August 2008 level7 (See Figure 9).

State budgets have also been confronted with several years of shortfalls and constraints. In many cases, states have been reducing aid and transfers to city governments. NLC’s 2013 survey asked city finance officers about the types of state actions they’ve encountered since 2010, including cuts in general aid (39%), cuts in state-shared and/or state-collected revenues (37%), revocation or reduction of reimbursement programs or other transfers (26%), cuts in funding for services that cities and other local governments deliver on behalf of state governments (21%) and transfer of state program responsibility (18%). Amid the politics of state budget-balancing, sometimes state actions have also been taken that serve to reduce or limit local authority (21%).

This mix of state actions to balance state budgets adds to the cyclical economic pressures that cities and other local governments are confronting. Looking across state and local actions in response to fiscal stress reveals the pro-cyclical nature of state-local fiscal actions – during economic downturns the decisions that state and local leaders make to balance budgets often exacerbate the effects of the downturn for other levels of government, for employment, and for the quality of life and well-being of individuals and communities.

**ENDING BALANCES**

One way that cities prepare for economic downturns is to maintain adequate levels of general fund ending balances. Ending balances are similar to reserves, or what might be thought of as cities’ equivalents to “rainy day funds,” in that they provide a financial cushion for cities in the event of a fiscal downturn or the need for an unforeseen outlay. Unlike

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7 Bureau of Labor Statistics (BLS) seasonally adjusted data released for August 2013 show 14,084,000 local government employees, compared to 14,587,000 employees for August 2008, a difference of 503,000 positions. http://data.bls.gov/pdq/SurveyOutputServlet
states’ reserves, or “rainy day funds,” there is no trigger mechanism—such as an increase in unemployment—to force release of the funds; instead, reserves are available for spending at any time or for saving for a specific purpose.

City ending balances, which are transferred forward to the next fiscal year in most cases, are maintained for many reasons. For example, cities build up healthy balances in anticipation of unpredictable events such as natural disasters and economic downturns. But ending balances are also built up deliberately, much like a personal savings account, to set aside funds for planned events such as construction of capital projects. Bond underwriters also look at reserves as an indicator of fiscal responsibility, which can increase credit ratings and decrease the costs of city debt, thereby saving the city money in annual debt service costs. Finally, as federal and state aid to cities has become a smaller proportion of city revenues over time, cities have become more self-reliant and are much more likely to set aside funds for emergencies or other purposes.

Prior to the recession, as city finances experienced sustained growth, city ending balances as a percentage of general fund expenditures reached an historical high—since the NLC survey was first administered—of 25 percent. However, as economic conditions made balancing city budgets more difficult, ending balances were increasingly utilized to fill the gap (See Figure 10). In 2012, city finance officers projected ending balances to decline to 12.7 percent of expenditures. Actual ending balances often register at higher levels than projected ending balances. For 2012, final ending balances were reported at 21.5 percent of expenditures, suggesting that cities were once again turning to rebuilding these balances as they emerge from the downturn. Looking to 2013, city finance officers project ending balances at 20.1 percent of expenditures.

![Figure 10: Ending Balances as a Percentage of Expenditures (General Fund)](image-url)
BEYOND 2013

The reports and projections from the nation’s city finance officers reveal a picture of a gradually improving economy and parallel improving city fiscal conditions. However, the pace and scope of the economic recovery to date is not sufficient to help cities recover from a deep and sustained economic downturn. While projections for final 2013 revenues and expenditures show that city fiscal conditions are no longer declining, those projections also suggest that cities are confronting little growth in the near future. Positive indicators, including growth in local sales tax and income tax revenues, are offset by stagnant receipts from real estate taxes as cities continue to register the lagged effects of depressed housing markets. Beyond 2013, a number of factors will be key to the fiscal conditions of cities:

- Strengthening real estate markets (although regional markets will vary considerably) will help cities turn the corner from property tax revenue decline to growth, but the effects will be spread out over several years;
- Other economic conditions – improving consumer confidence, employment, and wages – will weigh heavily on future city sales tax receipts and income tax revenues;
- Two of the factors that city finance officers report as having the largest negative impact on their ability to meet needs are employee- and retiree-related costs for health care coverage and pensions. Pension and health care costs will persist as a challenge to city budgets for years to come;
- Confronting a gradual economic recovery following a deep recession, cities are likely to continue to operate with reduced workforces and service levels, and city leaders will likely continue to be cautious about making significant infrastructure investments;
- Cities’ fiscal conditions remain vulnerable to external policy shifts in the face of a gradual and tenuous economic recovery, including cuts in federal spending and threats to global, national, and regional-local economic conditions from political stasis on issues including the federal budget and U.S. debt ceiling; and
- Because cities are required to balance their budgets on an annual basis, cities will continue to assess and adjust the appropriate package of fiscal policy actions for the purpose of providing services, investing in infrastructure, and meeting the health, safety and welfare requirements of their residents, taxpayers, workers and visitors.

ABOUT THE SURVEY

The City Fiscal Conditions Survey is a national mail and email survey of finance officers in U.S. cities conducted annually from April to June. Surveys were mailed and emailed to city finance officers for a sample of 1,140 cities, asking for their assessments of fiscal status, actions taken, and factors affecting their fiscal conditions. Budget and finance data were also requested in the survey from all cities with the exception of the 100 largest cities by population. Budget and finance data from those cities were collected directly from on-line city budget documents. In total, the 2013 data are drawn from 350 cities, for a response rate of 31 percent. The data allow for generalizations about the fiscal condition of cities.
Throughout the report, the data are occasionally compared for cities with different tax structures and population sizes. The response rates for these categories are provided in the table below.

<table>
<thead>
<tr>
<th>Categories</th>
<th>Survey Responses</th>
<th>%</th>
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<tr>
<td>TOTAL</td>
<td>350</td>
<td>100.0%</td>
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<tr>
<td>Population</td>
<td></td>
<td></td>
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<tr>
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<td>60</td>
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<td>10,000-49,999</td>
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<td>19.1%</td>
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The number and scope of governmental functions influence both revenues and expenditures. For example, many Northeastern cities are responsible not only for general government functions but also for public education. Some cities are required by their states to assume more social welfare responsibilities than other cities. Some assume traditional county functions.

Cities also vary according to their revenue-generating authority. Some states, notably Kentucky, Michigan, Ohio and Pennsylvania, allow their cities to tax earnings and income. Other cities, notably those in Colorado, Louisiana, New Mexico and Oklahoma, depend heavily on sales tax revenues. Moreover, state laws may require cities to account for funds in a manner that varies from state to state. Therefore, much of the statistical data presented here must also be understood within the context of cross-state variation in tax authority, functional responsibility and state laws. City taxing authority, functional responsibility and accounting systems vary across the states.8

When we report on fiscal data such as general fund revenues and expenditures, we are referring to all responding cities’ aggregated fiscal data included in the survey. As a consequence, the data are influenced by the relatively larger cities that have larger budgets and that deliver services to a preponderance of the nation’s cities’ residents. When asking for fiscal data, we ask city finance officers to provide information about the fiscal year for which they have most recently closed the books (and therefore have verified the final numbers), which we generally refer to as FY 2012, the year prior (FY 2011) and the budgeted (estimated) amounts for the current fiscal year (FY 2013).

When we report on non-fiscal data (such as finance officers’ assessment of their ability to meet fiscal needs, fiscal actions taken or factors affecting their budgets), we are referring to percentages of responses to a particular question on a one-response-per-city basis. Thus, the contribution of each city’s response to these questions is weighted equally.

About the National League of Cities

The National League of Cities is the nation’s oldest and largest organization devoted to strengthening and promoting cities as centers of opportunity, leadership and governance. NLC is a resource and advocate for more than 1,700 member cities and the 49 state municipal leagues, representing 19,000 cities and towns and more than 218 million Americans. Through its City Solutions and Applied Research, NLC provides research and analysis on key topics and trends important to cities, creative solutions to improve the quality of life in communities, inspiration and ideas for local officials to use in tackling tough issues and opportunities for city leaders to connect with peers, share experiences and learn about innovative approaches in cities.

The Lag Between Economic & City Fiscal Conditions

We often refer to the lag between changes in the economic cycle and the impact on city fiscal conditions.

What does this mean? The lag refers to the gap between when economic conditions change and when those conditions have an impact on reported city revenue collections. In fact, cities likely feel the impacts of changing economic conditions sooner. However, because reporting of city fiscal conditions occurs, in most cases, on an annual basis, whether through annual budget reporting or NLC’s annual survey, those impacts tend to not become evident until some point after the changes have started to occur.

How long is the lag? The lag is typically anywhere from 18 months to several years, and it is related in large part to the timing of property tax collections. Property tax bills represent the value of the property in some previous year, when the last assessment of the value of the property was conducted. A downturn in real estate prices may not be noticed for one to several years after the downturn began, because property tax assessment cycles vary across jurisdictions: some reassess property annually, while others reassess every few years. Consequently, property tax collections, as reflected in property tax assessments, lag economic changes (both positive and negative) by some period of time. Sales and income tax collections also exhibit lags due to collection and administration issues, but typically no more than a few months.

Figure 2 shows year-to-year change in city general fund revenues and expenditures and includes markers for the official U.S. recessions from 1991, 2001 and 2008-2010, with low points, or “troughs,” occurring in March 1991, November 2001 and June 2009, respectively, according to the National Bureau of Economic Research (NBER). Comparing the dates of the recessions to the low point of city revenue and expenditures as reported in NLC’s annual survey (typically conducted between April and June of every year), the low point for city revenues and expenditures after the 1991 recession occurred in 1993, approximately two years after the trough of the U.S. economic recession (March 1991 to March 1993). After the 2001 recession, the low point for city revenues and expenditures occurred in 2003, approximately 18 months after the trough of the U.S. economic recession (November 2001-April 2003). Our reporting on this lag is dependent upon when the annual NLC survey is conducted, meaning that there is some degree of error in the length of the lag – for instance, had the survey been conducted in November of 1992, rather than April of 1993, we might have seen the effects of changing economic conditions earlier. Nevertheless, the evidence suggests that the effects of changing economic conditions tend to take 18-24 months to be reflected in city budgets.