ABOUT THE NATIONAL LEAGUE OF CITIES

The National League of Cities (NLC) is the nation’s leading advocacy organization devoted to strengthening and promoting cities as centers of opportunity, leadership and governance. Through its membership and partnerships with state municipal leagues, NLC serves as a resource and advocate for more than 19,000 cities and towns and more than 218 million Americans. NLC’s Center for City Solutions and Applied Research 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.

ABOUT THE AUTHORS

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ACKNOWLEDGEMENTS

Special thanks to Brooks Rainwater, Center Director of the Center for City Solutions and Applied Research at NLC, who contributed to the report and served as a key advisor to the project. The authors would like to acknowledge the respondents to this year’s fiscal survey. The commitment of these cities’ finance officers to the project is greatly appreciated. The authors are also grateful to Shu Wang and Ayman Bari, doctoral students in the Department of Public Administration at UIC, for their assistance in collecting general fund data on the nation’s largest 100 cities, and Micah Farver, NLC research assistant, for survey and research support.

The financial support of the John D. and Catherine T. MacArthur Foundation helped make this year’s survey and report possible, and is greatly appreciated.
City Fiscal Conditions in 2014

In 2014, the nation’s city finance officers report that fiscal conditions are improving as the Great Recession recedes. However, local fiscal health has not yet fully returned to prerecession levels as economic activity clambers back from the downturn. While tax revenues continue to improve, increases in service costs, long-term infrastructure needs, employee wages, and pension and health care obligations, along with decreased levels of state and federal aid, continue to constrain the fiscal outlook.

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

1. More city finance officers report improved conditions this year than in the 29-year history of the survey, with 80 percent reporting that their cities are better able to meet fiscal needs than in 2013.

2. For the first time since 2008, more cities are increasing rather than decreasing the size of municipal workforces.

3. As finance officers look to the close of 2014, general fund revenues are projected to stagnate and expenditures are projected to slightly increase.
   - Property tax revenue is anticipated to increase in 2014 at a rate of 1.6 percent; the first positive growth in five years.
   - Sales tax and income tax revenues continue to show positive rates of increase in 2013, but are projected to slow in 2014.
   - Ending balances are nearing prerecession highs, but are still below 2006 levels; 2014 ending balances are projected to be 22.4 percent of expenditures.

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. Overall, increases in ending balances and tax collections, along with gradual economic recovery and the centrality of cities in our nation’s economy, bode well for future fiscal growth although full recovery remains to be seen.

What is the City Fiscal Conditions Survey?
The City Fiscal Conditions Survey is a national mail and online survey of finance officers in U.S. cities conducted in the spring and summer of each year. This is the 29th annual edition of the NLC survey, which began in 1986.

1 All references to specific years are for fiscal years as defined by the individual cities. The use of “cities” or “city” in this report refers to municipal corporations.
MEETING FISCAL NEEDS

In 2014, 80 percent of city finance officers report that their cities are better able to meet fiscal needs than in 2013 (see Figure 1). More city finance officers report improved conditions this year than in the history of the survey. Although this finding reflects improvements in fiscal health, optimism is relative to the broad impact of the recent recession in cities nationwide.


REVENUE AND SPENDING TRENDS

Revenue and spending trends in 2013 and 2014 point to a continued weak fiscal recovery. For the first time since 2006, general fund revenues registered an increase in 2013. However, city finance officers project revenue to remain flat in 2014, suggesting that fiscal recovery has not yet stabilized. General fund expenditures increased in 2013 and are projected to increase again in 2014.

In constant dollars (adjusted to account for inflationary factors in the state-local sector), general fund revenues in 2013 increased 2.8 percent from 2012 revenues, and expenditures increased by 2.2 percent. Looking to the close of 2014, general fund revenues are projected to decrease slightly by 0.5 percent. City finance officers project expenditures will grow by 1 percent (see Figure 2).

In comparison to previous periods, the recent recession is marked by a prolonged and uncertain recovery for local government finances. Although it is typical for city revenue collections to lag economic transitions,
revenue collections over the past few years reflect a longer lag and a substantially deeper impact. There is good news for city finances in 2013, but it is clear that 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 10).

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 about 15 percent 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 driving 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 property value. 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.

Despite more stable real estate markets in most parts of the country, property tax revenues remained fairly flat, decreasing 0.4 percent in 2013 compared with 2012 in constant dollars. The first anticipated increase in property tax collections is projected for 2014 at a rate of 1.6 percent over 2013 (see Figure 3).

4 According to the Tax Foundation, about 15 percent of municipalities in the U.S. have access to the income tax. Given that two-thirds of the income taxing jurisdictions are in Pennsylvania and that Pennsylvania has a low income tax rate, the contribution of income tax to total local own-source revenues for the municipal sector is only about 10 percent. http://taxfoundation.org/article/local-income-taxes-city-and-county-level-income-and-wage-taxes-continue-wane
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. 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.

With stabilizing housing and employment markets, consumer confidence has been on the upswing in recent years. As a result, city sales tax receipts in 2013 increased over 2012’s receipts by 4.6 percent. City finance officers project sales tax revenue growth at a pace of 3.6 percent for 2014.

Income Taxes. Local income tax revenues are driven primarily by income and wages (not by capital gains). With employment improving in 2013-14, city finance officers reported year-over-year growth of 4.3 percent for 2013. For 2014, income tax revenues are projected to remain fairly flat with 0.6 percent growth.

Looking to 2015 and beyond, local sources of revenue will likely continue their slow growth as the economy recovers. However, the projected lack of growth in 2014 general fund revenues indicates that external factors are at play and have the potential to undermine finance officers’ cautiously optimistic outlook.

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.

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7 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.
and which factors had the most positive and negative influence on the city’s overall fiscal picture.

Leading the list of factors that city finance officers say have decreased are federal aid (41 percent) and state aid (30 percent). Leading the list of factors that finance officers say have increased over the previous year are infrastructure demands (84 percent), prices or costs of services (84 percent) and employee wages and salaries (84 percent) (see Figure 4).

More than two-thirds of city officials cite the change in the tax base (69 percent) and health of local economy (68 percent) as having a positive budgetary impact, while over 70 percent say that changes in prices/inflation (77 percent), wages (77 percent), infrastructure (76 percent), health benefits (75 percent) and pensions (73 percent) have had a negative budgetary impact (see Figure 5).

When asked about the most impactful factors on their budgets, health of the local economy (81 percent) and value of the local tax base (73 percent) lead the pack as having the greatest positive influences (see Figure 6). Infrastructure needs (52 percent), health benefit costs (51 percent) and pension costs (47 percent) weigh most negatively on city budgets. Although gradual economic recovery is stabilizing local budgets, these negative factors represent demands on local budgets that are likely to persist and hold back local budgets from full recovery for years to come.
REVENUE ACTIONS AND SPENDING CUTS

City finance officers were also asked about specific revenue and spending actions taken in 2014. 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, the same approach for much of the past two decades. Two in five (43 percent) city finance officers report that their city has raised fee levels. Approximately one in five (18 percent) cities increased the number of fees that are applied to city services and the local property tax (22 percent) in 2014.

Since the mid-1990s, 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 2014 (see Figure 7).

When asked about expenditure actions taken in 2014, the most common responses were increasing employee wages (76 percent), public safety expenditures (69 percent) and infrastructure spending (62 percent) (see Figure 8).

Throughout the recessionary period, many cities used some combination of personnel and workforce-related cuts, including hiring freezes, layoffs and reducing health benefits, in an effort to reduce costs. This year, with budgets stabilizing, one in three cities (33 percent) report increasing the size of the municipal workforce.
For the first time since 2008, more cities are increasing rather than decreasing the size of their municipal workforce (see Figure 9). The U.S. Bureau of Labor Statistics (BLS) reports that local governments are adding jobs at a faster pace than their counterparts in state and federal government and are responsible for most of the gain in government employment.\(^8\)

Despite these improvements, however, the combination of personnel-related cuts over the past several years has resulted in a significant reduction in the size of local government workforces. The latest national unemployment numbers (August 2014) revealed that total local government employment in the U.S. is still about 500,000 jobs below the August 2008 level.\(^9\)

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9 Bureau of Labor Statistics (BLS) seasonally adjusted data released for July 2014 show 14,124,000 local government employees, compared to 14,587,000 employees for August 2008, a difference of 463,000 positions [http://www.bls.gov/news.release/empsit.t17.htm].
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. However, unlike 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, ending balances as a percentage of general fund expenditures reached a historical high—since this survey was first administered—of 25.2 percent. However, as economic conditions made balancing city budgets more difficult, ending balances were increasingly utilized to fill the gap (see Figure 10). In 2013, city finance officers projected ending balances to increase to 20.1 percent of expenditures. Actual ending balances often register at higher levels than projected ending balances. For 2013, final ending balances were reported at 21.8 percent of expenditures, suggesting that cities were once again turning to rebuilding these balances as they emerge from the downturn. Looking to 2014, city finance officers project ending balances at 22.4 percent of expenditures.

FIGURE 10: Ending Balances as a Percentage of Expenditures (General Fund).
BEYOND 2014

The nation’s city finance officers report that fiscal conditions are strengthening. The economic downturn was so deep and the length of the recovery so drawn out that full recovery is still on the horizon. Projections for the 2014 general fund reveal flat revenue growth in 2013, and a small increase in expenditures. Positive indicators can be seen with increased property, sales and income tax collections. These are tempered, however, by increases in the costs of services, ongoing pension and healthcare costs and long term infrastructure needs, as well as decreased levels of state and federal aid.

Beyond 2014, a number of additional factors will be key to the fiscal condition of cities:

- Although national employment has been on the rise, the fast growth of low wage jobs will impact local economies and subsequent tax receipts and service needs for years to come;

- The real estate market has strengthened significantly in recent years, and new housing starts are projected to increase with anticipated positive gains in property tax revenues. Other real estate market trends, including increased numbers of renters and stronger housing rebounds in larger metropolitan areas, could signal impending changing patterns in property tax collections;

- Internet commerce and the emergence of disruptive, Internet-based businesses underscore the imperative to better align local fiscal structures with broader economy activity; and

- Cities’ fiscal conditions remain vulnerable to external policy shifts, with continued federal and state cuts to aid, global instability and ongoing political challenges affecting economic outputs central to long-term fiscal health.

Cities are required to balance their budgets annually, and 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 from 1,000 cities with populations greater than 10,000, 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 2014 data are drawn from 354 cities, for a response rate of 35 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 above.

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.

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 2013, the year prior (FY 2012) and the budgeted (estimated) amounts for the current fiscal year (FY 2014).

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.

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–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.
### FIGURE 2: Year-to-Year Change in General Fund Revenues and Expenditures (Constant Dollars).

**Change in Constant Dollar Revenue (General Fund), Percent**

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**Change in Constant Dollar Expenditures (General Fund), Percent**

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### FIGURE 3: Year-to-Date Change in General Fund Tax Receipts (Constant Dollars).

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**Income Tax, Percent**

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**Property Tax, Percent**

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### FIGURE 9: Percent Increasing/Decreasing Size of the Municipal Workforce.

**Increased, Percent**

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**Decreased, Percent**

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### FIGURE 10: Ending Balances as a Percentage of Expenditure (General Fund).

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