

Cities, Services & Funding: Broader Thinking, Better Solutions

The Projected Future of City Budgets through 2025

Key Findings from the Projection:

- Cities of every size, in every region, will be broke by 2015 if no policy changes are made.
- By the year 2025, cities overall would see a deficit of 35 percent of city revenues.
- Fundamental changes are needed in city services and funding in order for these projections to be avoided.

Key Findings

from the projection

- Projecting city revenue and expenditure trends into the future reveals that all types of Minnesota cities—cities of every size, in every region—will be broke by the year 2015 if no policy changes are made. And in many kinds of communities, this is a reality today as revenues fall short of what cities need to provide services.
- Cities overall would see a deficit of 35 percent of city revenues by the year 2025.
- For this projection of the future to be avoided, fundamental changes are needed in the way that city services are funded.

Cities of all types will be in the red by 2015

All types of cities in all regions of the state will be unable to pay the bills within the next five years if they continue on their current financial path. Looking out as far as 2025 reveals that cities overall would still be in the red if policy changes are not enacted.

Put another way, by the time babies born this year are in first grade cities of all population and tax base sizes, in all parts of the state, would be in the red if historical revenue and expenditure trends continue.

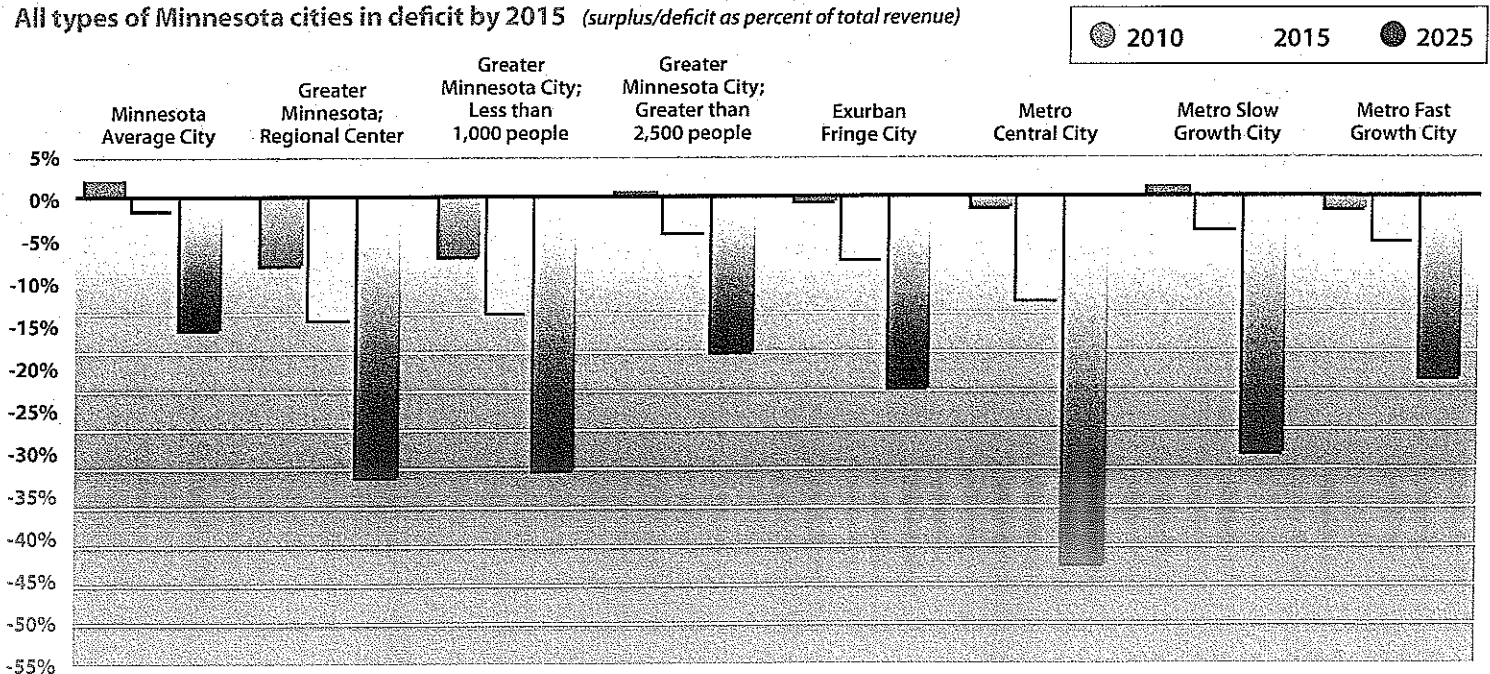
The League of Minnesota Cities contracted with researchers at the Hubert H. Humphrey Institute of Public Affairs at the University of Minnesota to carry out an analysis of city budgets. This analysis is a foundational piece of the new effort titled: "Cities, Services & Funding: Broader Thinking, Better Solutions"—an initiative currently underway by the League to spur public dialogue about the future among the city community, the public, the media, and policymakers.

The chart below shows when different kinds of cities will be in a deficit if revenue and expenditure trends continue without intervening policy changes and what portion of city revenues those deficits will represent.

The fact is that this projection of the future cannot be allowed to happen in real life.

By law, cities must balance their budgets. City officials will therefore have no choice but to enact more of the painful decisions they are already making today—primarily, cutting services and raising property taxes—to avoid this massive deficit. And unlike the state or federal government, cities do not have another level of government to shift the problem to—their options for resolving a deficit of this magnitude are much more limited and will affect local residents and businesses directly.

All types of Minnesota cities in deficit by 2015 (surplus/deficit as percent of total revenue)



Tough choices ahead

These findings are staggering—that cities of all kinds will fall into a deficit within the next five years and be unable to provide the level of services residents and businesses have come to expect. In other words, it won't matter where a city is, how big or small its population, what its tax base composition is, what its local economy looks like, or what its unique mix of revenue sources is—all types of cities end up in the red if nothing changes.

If cities reach the point where they are unable to pay the bills, agonizing choices would have to be made that would impact the day to day lives of Minnesota families, businesses, and communities across the state. Cities would become very different places in which to live, work, and play.

Why this analysis was done, and why it's so important

Cities that rely on local government aid (LGA) and other state programs have experienced dramatic cuts since 2003, and with a \$6 billion state deficit looming, the prospect of restoring that funding looks grim, to say the least.

All cities—regardless of the level of LGA they receive—are facing growing community pressure for expanded services and lower taxes. Population trends, such as the aging of the Baby Boom generation, are raising the expectations for many services. Yet at the same time, city councils are reluctant to raise property tax levies or fees because they know Minnesotans are dealing with a

To illustrate, in a deficit situation as severe as projected, cities as a group would have to eliminate a wide range of services or double property tax levies. For senior citizens across the state, those service cuts could mean no access to a library or a senior center. For children and families, there could be no baseball fields, hockey rinks or swimming pools for after-school and summer recreation. For homeowners, property values could decline as sidewalks and streets crumble into a maze of cracks and potholes. This isn't hyperbole—it's simply the continuation of the slow path of degradation Minnesotans have been seeing for the past seven years.

tough economy and are increasingly on fixed incomes.

In response to this current situation, the League asked the Humphrey Institute to calculate a projection of what the future would look like if nothing changes—if no property tax levies were raised, LGA funding was essentially flat, and services remained at current levels. The Humphrey Institute projection confirms that the future is not sustainable given the current financial trends and historic relationship between the state and cities. The time has come to find a *new* state-local financial relationship.

We need broader thinking and better solutions

The League believes that the time has come for bold action: a complete rethinking of the services cities provide and how to pay for those services. To find better solutions for the people of Minnesota, a broader conversation must begin now—in cities of every size in every corner of the state.

Broader thinking is needed—where more Minnesotans are involved in the conversation and the conversation is about more than the current ways of doing things.

The solutions aren't obvious. We need more than just those who are typically involved in public policy to be thinking and talking about cities, services and funding in order to ensure that what we know and love about our communities will be there in the future.

To this end, the League plans to get Minnesotans of all walks of life, in all regions of the state, thinking and talking about what the future holds for their communities. The plan is to hold a variety of community conversations throughout Minnesota over the course of 2010 and 2011. The League has already begun to collect citizen perspectives through its new blog site: www.outsidethebox.org. The thoughts gathered from citizens will form the basis for policy proposals and, hopefully, legislative action.

The League is confident that the collective thinking of Minnesotans throughout the state will lead policymakers toward better solutions for our communities.

Methodology

Research staff at the Humphrey Institute performed two main tasks as part of the analysis: projection of overall city revenues and expenditures through the year 2025 and interviews with city officials across the state. The researchers relied primarily on city revenue and expenditure data from the Office of the State Auditor's annual city finances reports. The most recent data from the OSA is for city budget year 2008. LMC provided historical data from the Department of Revenue on local government aid, market value homestead credit reimbursement and property tax levies. The researchers looked at 11 years worth of historical city revenue and expenditure data as well as data on property taxes, and state aids and credits.

Based on those historical trends and assuming current policies continue unchanged, they projected that total city revenues will increase at an annual rate of 3.7 percent between 2010 and 2025 and that total city expenditures will grow at an annual rate of 5.5 percent in that time period. That projection is the status quo outcome if no policy changes are enacted between now and then. Cities are facing and will continue to face several cost pressures that are beyond local control such as the price of fuel, rising health care costs, foreclosures, and changing demographics. The researchers calculated the overall city surplus or deficit at various points in the future as a percentage of total city revenues.

The researchers also projected revenues and expenditures for eight different profiles of cities. The projections for these profiles serve to demonstrate the extent to which the problem of expenditures outstripping revenues spreads to cities of all kinds (see Appendix for revenue and expenditure figures for all profiles).

continued

The profiles are based on demographic and geographical characteristics and are as follows:

- Minnesota average city: profile built for city with average population (excluding Minneapolis and St. Paul)
- Minnesota central city: average of Minneapolis and St. Paul
- Greater Minnesota regional cities: cities outside the seven-country metro area that serve as regional hubs (e.g., Albert Lea, Mankato)
- Greater Minnesota cities under 1,000
- Greater Minnesota cities greater than 2,500 (excluding regional centers) (e.g., Olivia, Two Harbors)
- Exurban fringe cities: cities essentially part of metropolitan area but lying just outside seven-county boundaries (e.g., Elk River, Rockford)
- Metro slow growth cities: 14 cities that have not grown over last 28 years (e.g., Edina, West St. Paul)
- Metro fast growth cities: 73 metro cities that have seen population growth over 100 percent in last 28 years (e.g., Apple Valley, Lakeville)

To better understand what these projections might mean for individual cities in terms of the kinds of decisions local leaders would face, interviews were conducted with city officials representing each profile city. Cities belonging to each profile were randomly selected as interview candidates. Researchers contacted the chief administrative officer of as many of them as possible during the study period. A total of 36 interviews was conducted. City officials described potential cuts to parks, libraries, housing, and capital projects. Many stressed that service levels would decline. Of top concern among the various pressures on cities budgets

are the aging of the population, energy costs, and falling property values.

Assumptions Used in Projections

The analysis was performed in January and February of 2010. The analysis is static, meaning that the starting point for the projection is a snapshot in time in terms of input data available. In order to project out into the future, several assumptions were used. The key assumptions were as follows:

- Property tax rates remain flat, meaning any growth in property tax revenues comes from tax base increases. This assumption removes policy decisions that cannot be predicted regarding the size of a city levy from the analysis.
- Inflation was set at 2 percent as suggested in the Minnesota Budget Trends Study Commission final report. That commission examined state budget trends in order to project surpluses or deficits in the future.
- LGA was reduced by \$50 million for 2010 from the \$434 million remaining after the \$102 million cut the Governor made in the now-ratified unallotments. LGA is then held flat through 2025. *[Note: The \$50 million reduction is slightly worse than what actually transpired in the 2010 legislative session (an additional cut of \$7.8 million). There are serious concerns, however, about the future availability of LGA given the state's ongoing budget deficit problems.]*
- MVHC reimbursements were reduced 11.5 percent in 2010. This reduction is in addition to the \$26 million cut to the program made by the Governor in the now-ratified unallotments. MVHC is then held flat through 2025.

[Note: The actual outcome of the 2010 session was a much larger cut to the reimbursement payments for 2010 of \$45 million and then a return to the post-ratified unallotment level of roughly \$56 million.]

The projections assume that cities maintain sufficient reserves to comply with the State Auditor's position on fund balances. Those reserves serve to meet cash flow needs between cities' two main influxes of revenue each year and in case of unexpected expenditures such as dealing with natural disasters. The assumptions used in assembling the projections reflect information available at the time. For example, the final outcome for city LGA and MVHC payments was not yet known during the study period. Thus, the assumption that 2010 LGA would be reduced by \$50 million following the Governor's unallotment reductions represents the best possible guess at the time. Since the analysis was performed, several key events have occurred that represent changes in cities' financial picture. An important one is that the large reduction (\$50 million) to LGA that is assumed for 2010 did not occur. Instead of a \$50 million decrease from the post-ratified unallotment level of \$434 million, \$7.8 million was cut. On the other hand, a much larger reduction from MVHC reimbursement than was included in the projections did occur. The 2010 legislature reduced the reimbursement payments by almost \$45 million. If those two changes were reflected in a revised projection, the 2010 deficit amount would grow for cities overall and for each of the different city profiles developed in the analysis. The timing of when different kinds of cities would fall into deficit remains largely the same.

APPENDIX — City Profiles: Revenue and Expenditures through 2025

	2007	2008	2009	2010	2015	2020	2025
Minnesota Average City Surplus/(Deficit) in \$'s							
Total Revenues	5,847,369	6,011,870	6,054,109	6,120,786	7,401,401	8,871,288	10,820,948
Total Expenditures	5,453,187	5,566,812	5,792,211	5,974,612	7,509,269	9,655,563	12,655,607
Total Surplus/(Deficit)	394,182	445,058	261,897	146,174	(107,868)	(784,275)	(1,834,659)
Minnesota Metro Central City Surplus/(Deficit) in \$'s							
Total Revenues	766,163,027	795,302,404	805,963,653	806,655,535	965,673,616	1,152,822,869	1,397,057,453
Total Expenditures	722,437,012	738,666,147	777,566,709	817,552,784	1,093,404,406	1,494,453,286	2,056,802,151
Total Surplus/(Deficit)	43,726,016	56,636,257	28,396,943	(10,897,249)	(127,730,790)	(341,630,417)	(659,744,698)
Greater Minnesota Regional Surplus/(Deficit) in \$'s							
Total Revenues	27,463,564	27,887,156	28,025,214	27,894,954	33,885,355	40,901,083	50,487,761
Total Expenditures	25,621,547	27,875,680	29,153,107	30,282,672	39,206,578	51,652,601	68,667,175
Total Surplus/(Deficit)	1,842,017	11,476	(1,127,892)	(2,387,718)	(5,321,222)	(10,751,518)	(18,179,413)
Greater Minnesota Cities Less than 1,000 people Surplus/(Deficit) in \$'s							
Total Revenues	486,647	423,680	428,381	421,029	503,541	601,405	733,535
Total Expenditures	478,678	418,202	436,421	452,504	578,248	753,254	990,600
Total Surplus/(Deficit)	7,969	5,477	(8,040)	(31,474)	(74,708)	(151,849)	(257,065)
Greater Minnesota Cities Greater than 2,500 people Surplus/(Deficit) in \$'s							
Total Revenues	11,962,618	12,902,758	12,938,025	13,009,920	15,876,189	19,297,776	23,919,937
Total Expenditures	11,865,787	11,915,562	12,449,301	12,910,728	16,606,221	21,728,376	28,696,700
Total Surplus/(Deficit)	96,831	987,196	488,724	99,193	(730,032)	(2,430,600)	(4,776,763)
Exurban Fringe Surplus/(Deficit) in \$'s							
Total Revenues	1,759,918	1,889,682	1,918,779	1,918,186	2,269,259	2,724,372	3,334,294
Total Expenditures	1,594,963	1,783,802	1,857,523	1,923,490	2,451,022	3,175,956	4,151,465
Total Surplus/(Deficit)	164,955	105,880	61,256	(5,304)	(181,763)	(451,584)	(817,172)
Metro Slow Growth Surplus/(Deficit) in \$'s							
Total Revenues	21,979,742	20,287,852	20,146,489	20,805,475	25,702,162	30,390,176	36,319,204
Total Expenditures	17,972,510	18,844,717	19,694,105	20,499,383	26,730,122	35,769,335	48,296,977
Total Surplus/(Deficit)	4,007,232	1,443,134	452,382	306,092	(1,027,960)	(5,379,159)	(11,977,774)
Metro Fast Growth Surplus/(Deficit) in \$'s							
Total Revenues	25,891,001	23,452,399	23,616,203	24,559,953	30,353,892	36,643,352	44,824,243
Total Expenditures	24,404,452	25,413,887	24,018,015	24,921,095	32,057,793	41,899,270	55,261,954
Total Surplus/(Deficit)	1,486,549	(1,961,487)	(401,812)	(361,141)	(1,703,901)	(5,255,918)	(10,437,711)



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