

RESEARCH BRIEF

on America's Cities

CHRISTOPHER W. HOENE

City Budget Shortfalls and Responses: Projections for 2010-2012

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While the nation's economy may be approaching the late stages of the worst economic downturn since the Great Depression, local government budget tightening and spending cuts over the next several years could well impose a significant drag on the nation's economic recovery. Cities face layoffs, canceled contracts with small businesses and vendors, reduced services and sizable budget shortfalls for 2009 that are expected to grow much more severe and widespread from 2010 to 2012.¹ With the pace of recovery still sluggish, the consequences of the recession will be playing out in America's cities and towns, on Main Street and in the lives of families for years to come.²

This report provides projections about municipal budget shortfalls over the next three years and reviews city leaders' responses to those conditions. Among the findings:

- The municipal sector will likely face a fiscal shortfall of between \$56 billion and \$83 billion from 2010-2012, driven by declining tax revenues, ongoing service demands and cuts in state revenues;
- The low point for city fiscal conditions typically follows the low point of an economic downturn by at least two years, indicating that the low point for cities will come sometime in 2011; and
- City leaders are responding with layoffs, furloughs and payroll reductions; delaying and canceling capital infrastructure projects; and cutting city services.

THE MUNICIPAL SECTOR SHORTFALL

The municipal sector – as if all city budgets were totaled together – likely faces a combined, estimated shortfall of anywhere from \$56 billion to \$83 billion from 2010-2012. The range of the projected shortfall is wide because of the number of factors that can potentially affect municipal bottom lines. Chief among these is the impact of the economic recession on municipal revenue collections. In 2009, city finance officers surveyed by NLC reported that sales tax and income tax collections were declining, but property tax collections were relatively flat.³ Nationwide, housing values are down 9.5 percent since 2007, which eventually will translate into residential property tax revenue declines for cities – the brunt of which will hit in 2010, 2011 and 2012. More recently, the commercial property market also has been affected by economic conditions, which will result in declines in commercial property tax collections. At the same time, ongoing and increased demands from residents for municipal services and increasing municipal costs will make it difficult for city leaders to offset revenue shortfalls through spending cuts alone. Revenue declines and spending pressures will conspire to produce municipal budget shortfalls that will have to be filled through increases in fees for services, laying off workers or cutting back their hours, delaying and canceling capital infrastructure projects and drawing down municipal reserves.

For 2009, based on NLC's survey of city finance officers, cities faced an estimated budget shortfall of nearly 3 percent of total general fund budgets. Applying a similar shortfall estimate to each year of the next three years results in a combined, projected shortfall of \$35 billion for 2010-2012. However, based on previous recessions, it is highly likely that cities will face larger shortfalls in 2010, 2011 and 2012 than they experienced in 2009. A 4 percent shortfall over the 2010-2012 period would total \$46 billion, while a 5 percent shortfall over the period would total \$53 billion (see Table 1).

1 All references to specific years are for fiscal years as defined by the individual cities.

2 The use of "municipal," "municipalities," "cities" or "city" in this report refers to municipal corporations.

3 Christopher W. Hoene and Michael A. Pagano, *City Fiscal Conditions in 2009*, National League of Cities, September 2009, http://www.nlc.org/ASSETS/29BFCBD454A442E9BF89645017277767/CityFiscalConditions_09.pdf.

Christopher W. Hoene, Ph.D.

Director, Center for Research and Innovation, National League of Cities, Hoene@NLC.org, (202) 626-3172



Table 1: Projected Municipal Sector Budget Shortfall, 2010-2012 (All \$ in 1,000s)

Total Municipal General Revenues in 2009: \$397,780,262

YEAR	3% SHORTFALL	4% SHORTFALL	5% SHORTFALL
2010	\$ 11,933,408	\$ 15,911,210	\$ 19,889,013
2011	\$ 11,575,406	\$ 15,274,762	\$ 18,894,562
2012	\$ 11,228,143	\$ 14,663,772	\$ 14,359,867
Total	\$ 34,736,957	\$ 45,849,744	\$ 53,143,443

CUTS IN STATE AID AND TRANSFERS

The other major factor that will influence municipal sector shortfalls from 2010-2012 will be actions state governments take in response to their own budget shortfalls. The Center on Budget and Policy Priorities estimates state budget gaps of \$190 billion for 2010, \$180 billion for 2011 and \$118 billion for 2012.⁴ The 2010 gap, alone, comprises 28 percent of state budgets for that year. As a means of covering these gaps, many state governments will make cuts in transfers to local governments. Similar actions were taken in response to the 2001 recession, coming mainly in 2003 and 2004. Over that two-year period states reduced total transfers to cities by 9 percent.⁵ In comparison, the current recession is by nearly all measures more severe than the 2001 recession, suggesting that state cuts in transfers to cities will, if anything, be more severe as well. Using a conservative estimate of reductions in state transfers to cities of 10 percent per year from 2010-2012 adds \$21 billion to the shortfall in the municipal sector. If state governments were to make cuts in transfers to cities that more closely approximate their own budget shortfalls, those cuts might come more in the range of 15 percent, adding \$30 billion to the shortfall in the municipal sector (see Table 2).

Table 2: Projected Cuts in State Transfers to Cities, 2010-2012 (All \$ in 1,000s)

Total State Transfer to Cities in 2009: \$78,107,822

FISCAL YEAR	10% SCENARIO	15% SCENARIO
2010	\$7,810,782	\$11,716,173
2011	\$7,029,704	\$9,958,747
2012	\$6,326,734	\$8,464,935
Total	\$21,167,220	\$30,139,856

Using conservative projections of the municipal budget shortfall and state cuts for 2010-2012, the total range is between \$56 billion (a 3 percent municipal budget shortfall and 10 percent reduction in state transfers) and \$83 billion (a 5 percent municipal budget shortfall and 15 percent reduction in state transfers).

CITY SPENDING CUTS AND RESPONSES TO SHORTFALLS

In response to declining economic conditions and the prospect of budget shortfalls, NLC's annual survey of city finance officers revealed that nine in 10 (91 percent) cities reported making spending cuts in 2009, and 82 percent expect to make further cuts in 2010. When asked about the most common responses to prospective shortfalls in 2009, by a wide margin the most common responses were workforce reductions, such as laying off staff, furloughs, and hiring freezes (67 percent), and delaying or cancelling capital infrastructure projects (62 percent) – the types of projects that also result in investment in small businesses and other private sector vendors, as well as generating jobs beyond city government. One in seven cities (14 percent) has already made cuts to public safety services – police, fire, and emergency – a number that will inevitably rise as the municipal budget shortfalls increase (see Figure 1).

4 Iris J. Lav, Nicholas Johnson, and Elizabeth McNichol, "Additional Federal Fiscal Relief Needed to Help States Address Recession's Impact," Center on Budget and Policy Priorities, Nov. 19, 2009, <http://www.cbpp.org/cms/index.cfm?fa=view&id=2988>.

5 Christopher W. Hoene and Michael A. Pagano, "Fend-For-Yourself Federalism: The Effect of Federal and State Deficits on America's Cities," *Government Finance Review*, October 2003.

EXAMPLES OF FISCAL DISTRESS IN CITIES

Augusta, Maine: Mid-year budget shortfall and decreasing budget for next fiscal year, resulting in layoffs, reductions in police and fire overtime and reductions in services.

Baltimore: \$127 million shortfall, likely resulting in a next round of layoffs and furloughs after already having eliminated more than 500 positions.

Bossier City, La.: \$6.5 million deficit in the city's current \$50.3 million budget, resulting in proposed elimination of 117 out of 897 positions, including 80 police and fire positions.

Boston: \$130 million shortfall, resulting in layoffs of more than 500 municipal employees.

Cleveland: \$23 million shortfall, and the city estimates that for every \$1 million about 20 general city employees or 12 police and firefighters would have to be laid off.

Columbia, Mo.: \$4 million budget shortfall in 2009-10, covered through cutbacks in personnel and programs.

Dallas: \$190 million budget shortfall; 637 full-time positions to be eliminated, including 347 layoffs, and cuts to street repairs, libraries and senior services.

Denver: \$120 million shortfall, resulting in layoffs of 80 positions and early retirement of 322 city workers.

Dover, Del.: Budget decrease of \$10.5 million from last year, covered by requiring all city employees to take 12 unpaid furlough days and the deferral of capital improvements.

East Providence, R.I.: Reduced city positions by 55, including 16 in the police department and 28 in the fire department.

Little Rock, Ark.: \$2.8 million shortfall, resulting in \$200,000 cut in police services and \$450,000 cut in fire services.

Los Angeles: \$98 million shortfall in 2009-10, \$408 million in 2010-11, and predicting total shortfall near \$1 billion by 2013; the city has already removed 2,400 positions from the city payroll through early retirement, furloughs and other workforce reductions.

Sacramento, Calif.: General fund revenues declined by \$15 million, resulting in eliminating funding for 387 positions.

San Francisco: \$436 million shortfall and expecting \$80-100 million more due to declining revenue collections and state cuts; mayor asked city departments for 25 percent cuts.

Seattle: \$72 million budget shortfall, resulting in the elimination of 310 positions and the city using \$25.4 million of a \$30.6 million fiscal stabilization ("rainy day") fund.

Springfield, Ill.: \$8.5 to \$12 million shortfall in next fiscal year, which would mean eliminating 136 to 192 positions.

Springfield, Mo.: \$13.7 million in budget cuts, resulting in four positions eliminated and furloughs of 158 employees.

THE NEED FOR FEDERAL INTERVENTION

City governments are important components of the U.S. economy. The local and state sector comprises about one-eighth of GDP and cities make up a significant portion of that sector. Consequently, the fiscal actions taken by cities affect the health of the local and regional economies that drive national economic performance. In the absence of additional federal intervention, a deepening local fiscal crisis could hobble the nation's incipient recovery with more layoffs, furloughs, cancelled infrastructure projects, and reduced services. Estimates

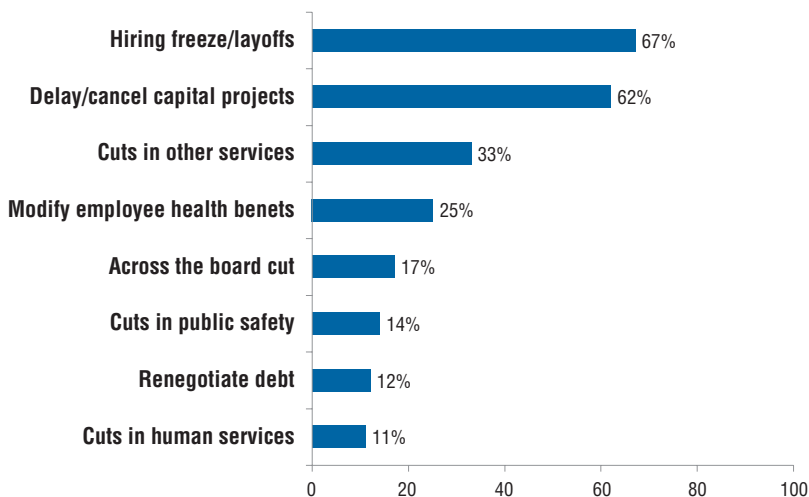


Figure 1: City Spending Cuts in 2009

from Goldman-Sachs for 2010 and the Center and Budget and Policy Priorities for 2011 suggest that cuts in the state and local sector could reduce U.S. Gross Domestic Product (GDP) by 0.6 percent to 0.7 percent for 2010 and 0.9 percent for 2011. The President's Council of Economic Advisors estimates that each percentage point of GDP translates into approximately one million jobs, meaning that state and local sector cuts could cost the economy 600,000-700,000 jobs in 2010 and 900,000 jobs in 2011.⁶ In short, federal investment in a jobs package that helps stabilize city budgets will help cities save and create jobs locally, both city government jobs and private jobs via small businesses and other enterprises that are dependent on public sector investment.

At an event sponsored by NLC and the Brookings Institution Metropolitan Policy Program in November

2009, Philadelphia Mayor Michael Nutter said “Cities are too important to fail.” Federal investment in local jobs and fiscal stabilization will help ensure that actions by cities are helping national economic recovery.

CITY FISCAL CONDITIONS TYPICALLY LAG ECONOMIC CONDITIONS

City fiscal conditions typically lag economic conditions, in much the same way that state fiscal conditions lag economic conditions and the unemployment rate lags overall economic recovery. For city budgets, this lag is typically two years, depending on the factors driving the changes in the economy and the depth of those changes. Current economic indicators suggest that the U.S. economy has recently passed the low point of the current recession, which means that the low point for city fiscal conditions will likely be experienced sometime in 2011. The lag is a function of tax collection and administration issues in cities, particularly for the property tax, which is the most common form of city taxation. 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 registered 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, and many jurisdictions only reassess a portion of all property in any given year. Consequently, property tax collections, as reflected in property tax assessments, lag economic changes (both positive and negative) by varying periods of time, depending on the jurisdiction. Sales and income tax collections also exhibit lags due to collection and administration issues, although the lags are typically shorter.

NOTES ON METHODOLOGY

Projections for the budget shortfall in the municipal sector and cuts in state transfers from 2010-2012 were tabulated using U.S. Census of Governments data for municipal general revenues for fiscal year 2006, projected to 2009 using the U.S. Bureau of Economic Analysis (BEA) National Income and Product Accounts (NIPA) estimates for inflation in the state and local government sector, and estimated for 2010-2012 based on conservative projections that were informed by NLC’s annual survey of *City Fiscal Conditions* and other NLC research.

Some of the data and findings reported here are drawn from NLC’s *City Fiscal Conditions* Survey, a national mail survey of finance officers in U.S. cities. Surveys were mailed to a sample of 1,055 cities, including all cities with populations greater than 50,000 and, using established sampling techniques, to a randomly generated sample of cities with populations between 10,000 and 50,000. The survey was conducted from April to June 2009. The 2009 survey data are drawn from 379 responding cities, for a response rate of 36.0 percent.

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 19,000 cities and towns representing more than 218 million Americans.

Through its Center for Research and Innovation, 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.

⁶ Goldman-Sachs U.S. Economic Analyst, “The State and Local Sector: What a (Fiscal) Drag,” July 10, 2009 and Iris J. Lav, Nicholas Johnson, and Elizabeth McNichol, “Additional Federal Fiscal Relief Needed to Help States Address Recession’s Impact,” Center on Budget and Policy Priorities, November 19, 2009.