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NATIONAL LEAGUE of CITIES
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CITY FISCAL CONDITIONS 2015

30th Anniversary

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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.

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30TH ANNIVERSARY PREFACE

In the mid-1970s, the Joint Economic Committee of the U.S. Congress (JEC) commissioned regular reports to inform Congress about the fiscal shifts and changes among America's municipalities. Called "Trends in the Fiscal Condition of Cities," this and similar reports were useful for researchers and even more useful for municipalities to understand how well their fiscal systems were performing and to explain the factors that affected their changing fiscal conditions. Policy officials, public interest groups (including the National League of Cities), policy analysts and the general public awaited the report to inform trends, concerns, issues of national interest and the like. In the mid-1980s, however, the JEC stopped commissioning the reports.

NLC decided to step up and replicate the study as accurately as possible, but with considerable modifications. Rather than limiting the scope of the research, NLC expanded it by sending paper surveys in 1986 to all NLC member cities; after 1989 the survey was sent to all cities with populations over 50,000 and a sample of cities with populations between 10,000 and 50,000. NLC also increased the frequency of the effort by moving from a biennial report to an annual report. Since 1986, NLC's annual City Fiscal Conditions report has been prepared by analysts working with NLC and released to the world of policy officials, public interest groups, policy analysts and the general public. The NLC survey's focus, however, was narrower than the JEC's in that the JEC reported on total city revenues and expenditures for 75 cities, which would include enterprise funds, capital funds, special funds, and others, while the NLC survey focused only on the General Fund. The General Fund provides funding to cities' general operations and constitutes more than 55 percent of total city spending. The changes in General Fund revenues also tend to reflect the changing economic and fiscal environment within which cities operate.

Consequently, NLC's City Fiscal Conditions report is an analysis of cities' General Funds, which provides a dynamic view of city fiscal conditions.

The survey designers have experimented with a series of questions over the last three decades, including specific questions on employment, public safety expenditures, capital outlays, changes in state aid, and other contemporary considerations. In the mid-1990s, the question on General Fund revenues and expenditures was expanded to include a 'source of revenues' question, allowing the report to track over time the changes in property, sales and income tax receipts by U.S. cities. This additional piece of financial data has helped provide a more accurate and nuanced picture of city fiscal condition because it recognizes the variation in general tax reliance among U.S. cities. Although nearly all cities levy a property tax, some 15 percent of US cities are authorized to levy an income/payroll tax, and 55 percent tax retail sales. The resulting tax-reliance, then, varies from city to city – an important addition to the annual report.

Over the last decade, the survey administration has transitioned from a mailed paper survey to the electronic medium and from collecting financial data from only the mailed survey to downloading Comprehensive Annual Financial Reports (CAFRs) from city websites for 100 large cities.

This research report represents the 30th annual contribution by the National League of Cities to the nation's understanding of cities' fiscal conditions.

EXECUTIVE SUMMARY

This year marks the 30th edition of the City Fiscal Conditions survey of city finance officers. Based on the rich historical data accumulated over three business cycles, this year's report provides an important retrospective and comparative analysis of fiscal impacts resulting from the 1990, 2001 and 2007 recessions, in addition to our annual analysis of current fiscal conditions.

In 2015, the fiscal condition of U.S. cities continues to show modest improvement. City finance officers are more optimistic than ever, driven largely by an expansion of General Fund revenues. These recent gains, however, have not been substantial enough to restore the revenue declines of the six years prior. When compared to the 1990 and 2001 recessions, it is clear that the fiscal impacts of the 2007 recession are much more substantial, both in terms of depth and duration.

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 30th annual edition of the NLC survey, which began in 1986.

Other key findings from National League of Cities' annual survey of city finance officers include:

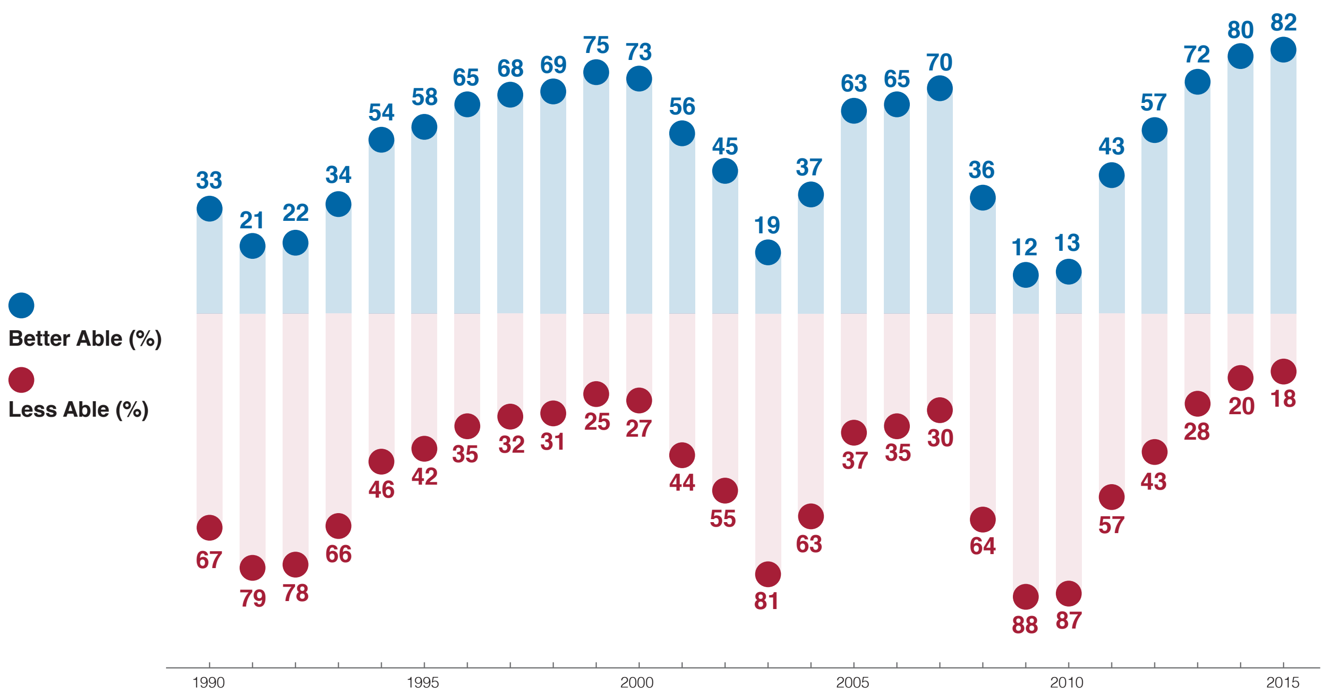
- General Fund revenues registered their first post-recession gains in 2013, with consecutive but slower growth since. Revenues increased 1.3 percent in 2014 and are anticipated to grow .31 percent in 2015. Expenditures increased 1.5 percent in 2014, with continued growth anticipated into 2015.
- Property tax revenues increased a sizable 2.4 percent in 2014, with growth of 1.2 percent expected in 2015.
- Growth in sales tax revenues reached a post-recession high of 6.2 percent in 2012, registered 5.9 percent growth in 2013, 3.1 percent in 2014, and is expected to grow 2.3 percent in 2015.
- Income tax revenues have been the most volatile tax source during the recovery period. Growth reached a post-recession high in 2012, with a 4.4 percent increase over 2011. Cities experienced 3.6 percent year-over-year growth of income taxes in 2013, followed by a dip of -1.7 percent in 2014, and an anticipated return to growth in 2015 with 3.6 percent gains.
- Ending balances are anticipated to reach a 30 year high in 2015, budgeted at 25.2 percent of General Fund expenditures. Ending balances reached a post-recession low in 2010 at 16.5 percent of expenditures, but have grown consistently, standing at 22.8 percent in 2014.
- Infrastructure needs (48 percent), pensions (38 percent) and health care benefits (36 percent) are factors that are most constraining city budgets in 2015. Those having the most positive influences are the value of the city tax base (70 percent), health of the local economy (63 percent) and gas and oil prices (24 percent).

The capacity of city budgets remains weakened coming out of the Great Recession. As a result, evidence suggests that cities are more fiscally conservative than in recent years and are cautiously preparing for the next economic downturn. City fiscal conditions have proven remarkably resilient over the past three decades, but longer-term fiscal sustainability will depend not only on cities' ability to balance their budgets annually, but also to manage infrastructure and employee-related costs and volatilities such as gas and oil prices, interest rates and state aid.

MEETING FISCAL NEEDS

City finance officers are confident that cities are in a better fiscal position this year than last.[1] Eighty-two percent of city finance officers report that their cities are better able to meet the financial needs of their communities in 2015 than in 2014 (**see Figure 1**).[2] This level of optimism amongst finance officers is the highest since the inception of the survey and reflective of widespread, incremental improvements amidst an on-going slow and long recovery.

FIGURE 1: Percent of Cities "Better Able/Less Able" to Meet Financial Needs

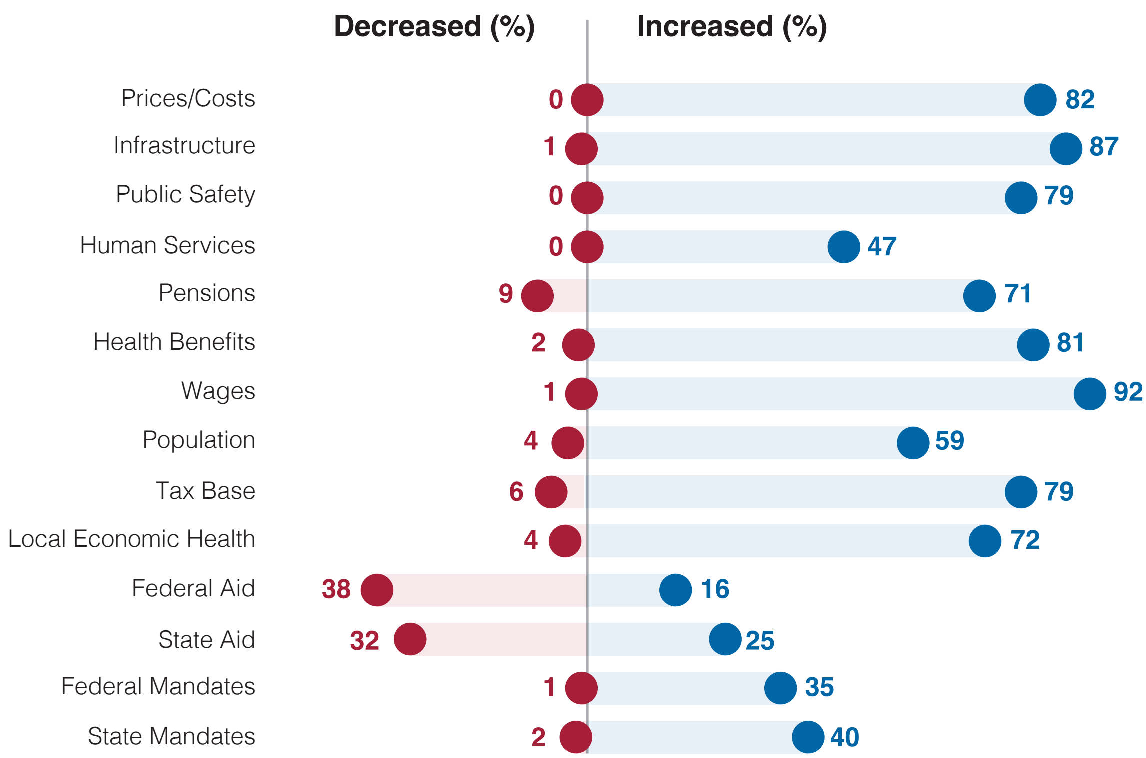


A number of factors combine to impact the ability of cities to meet their fiscal needs. Each year, the survey presents city finance directors with a list of factors that determine revenue performance, spending levels and overall fiscal condition of cities.[3] Respondents are asked whether each of these factors increased or decreased from the previous year and which factors had the most positive and negative influence on the city's overall fiscal picture. Given the recent decline in gas and oil prices, we added "gas and oil prices" to the list of factors this year.

Gas and oil prices (62 percent), federal aid (38 percent) and state aid (32 percent) are the most widely reported budgetary factors that have declined over the past year (**see Figure 2**). Employee wages and salaries (92 percent), infrastructure needs (87 percent) and prices, or costs of services (82 percent) are factors that have increased in the greatest number of cities (**see Figure 3**).

1 The use of "cities" or "city" in this report refers to municipal corporations.
2 All references to specific years are for the fiscal years as defined by the individual cities. 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 2014, the year prior (FY 2013) and the budgeted (estimated) amounts for the current fiscal year (FY 2015).
3 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, the health of the local economy, and gas and oil prices.

FIGURE 2: Change in Selected Factors



When asked about the most impactful factors on their budgets, the value of the local tax base (70 percent), health of the local economy (63 percent) and gas and oil prices (24 percent) have the greatest positive influences. The decreased cost to fuel fleets, among other energy-related expenses, is having significant positive impacts on many local budgets. For cities with energy-based economies, however, the prospect may not be as optimistic. In some cities, the energy-boom has led to substantial wear and tear on infrastructure and service demands that are outpacing revenues.[4]

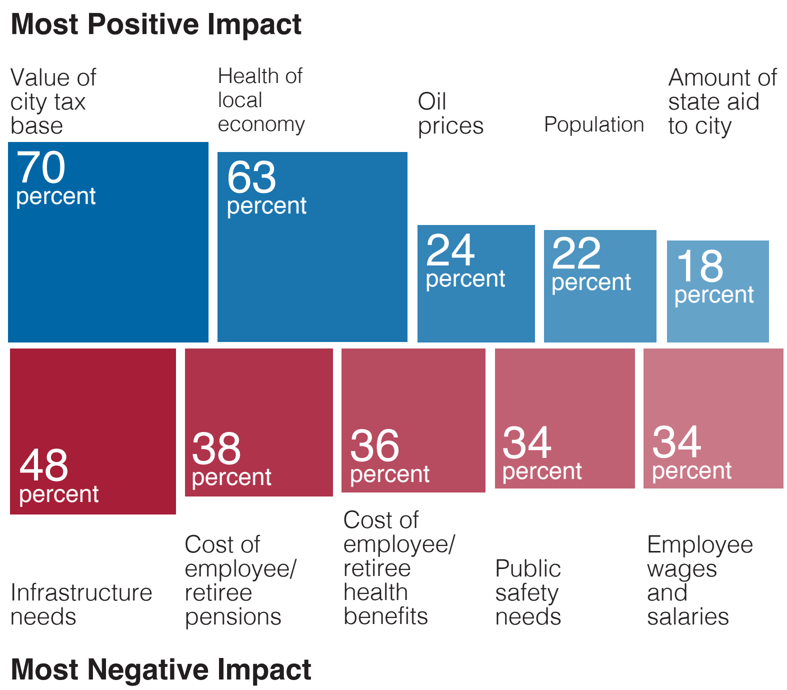
> **“THIS LEVEL OF OPTIMISM AMONGST FINANCE OFFICERS IS THE HIGHEST SINCE THE INCEPTION OF THE SURVEY.**

4 The Oil Boom Hasn't Helped North Dakota Cities by Sean Cockerham for Tribune News Service in Governing Magazine, September 10, 2015 (http://www.governing.com/topics/transportation-infrastructure/the-oil-boom-hasnt-helped-north-dakota-cities.html).

Infrastructure needs (48 percent), pension costs (38 percent) and health benefit costs (36 percent) are weighing most negatively on city budgets (**see Figure 3**). Unfortunately, these are also factors that are likely to persist and worsen absent heavy investment.

For example, without a steady funding stream from other levels of government, cities have gained responsibility not only for maintaining existing infrastructure, but resolving the backlog of infrastructure needs and adequately providing new infrastructure for future economic growth. Infrastructure projects are paid for with locally-generated revenue, state and federal aid, and municipal bonds (debt). Although the municipal bond market is strong, it has been fueled primarily by refunding instead of new debt.[5] Cities are taking advantage of low interest rates to decrease the cost of existing debt but have been reluctant to take on new, long-term expenditures. This is evidence that cities are carefully approaching their budgets. Lack of new investment, however, combined with constrained local revenues and cuts in state and federal aid are concerning for the state of infrastructure financing.

FIGURE 3: Most Positive and Negative Factors



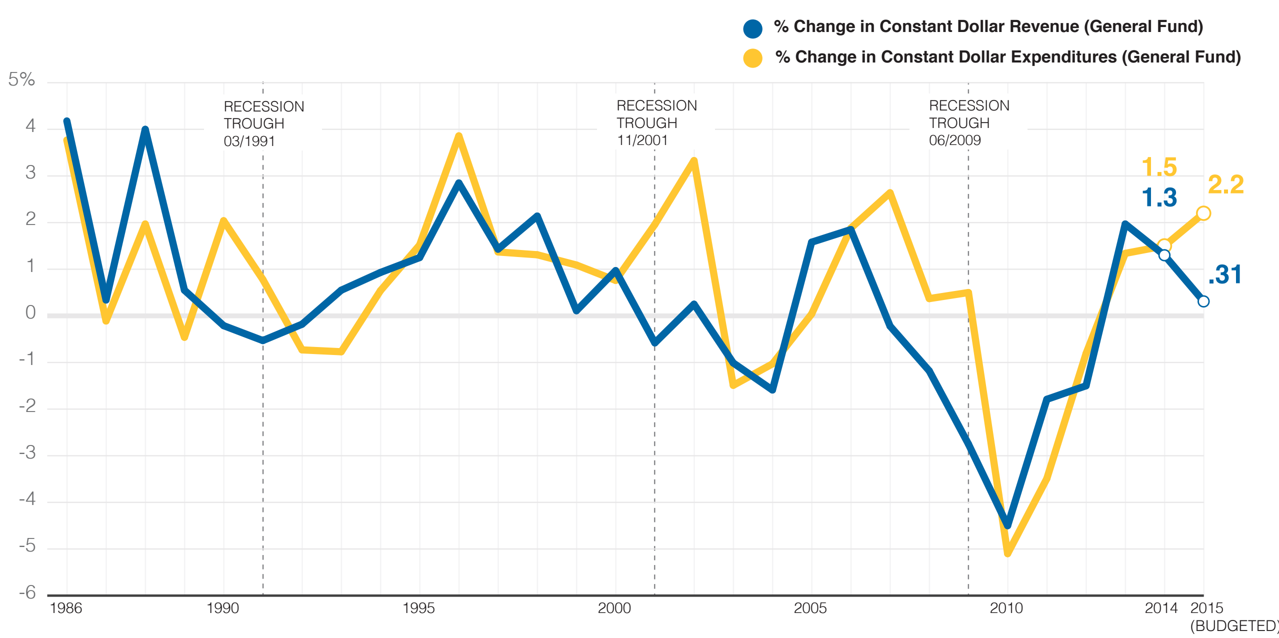
5 Mid-Year 2015 Market Review by Natalie Cohen and Roy Eappen, Wells Fargo Securities, June 2015.

REVENUE AND SPENDING TRENDS

Each year we ask city finance officers to provide information about the portion of their city's budget referred to as the General Fund. General Fund revenues are derived from property and other taxes, user fees and shared revenues. Given these sources, trends in General Fund revenues tend to reflect the changing economic and fiscal environment within which cities operate. Additionally, the General Fund provides funding to cities' general operations and constitutes more than 55 percent of total city spending. General Fund expenditures are mostly discretionary and can be allocated to services as city leaders see fit, such as police, fire, trash pick-up and economic development.

In constant dollars (adjusted to account for inflationary factors in the state-local sector), revenues grew 1.3 percent in 2014 over 2013 (**see figure 4**).[6] Revenues are expected to continue to grow, but slow to a pace of .31 percent in 2015. This will be the third year of consecutive revenue growth.[7] Expenditures experienced growth in 2014 as well, increasing 1.5 percent over 2013. Looking to close 2015, city spending levels are projected to grow by 2.2 percent.

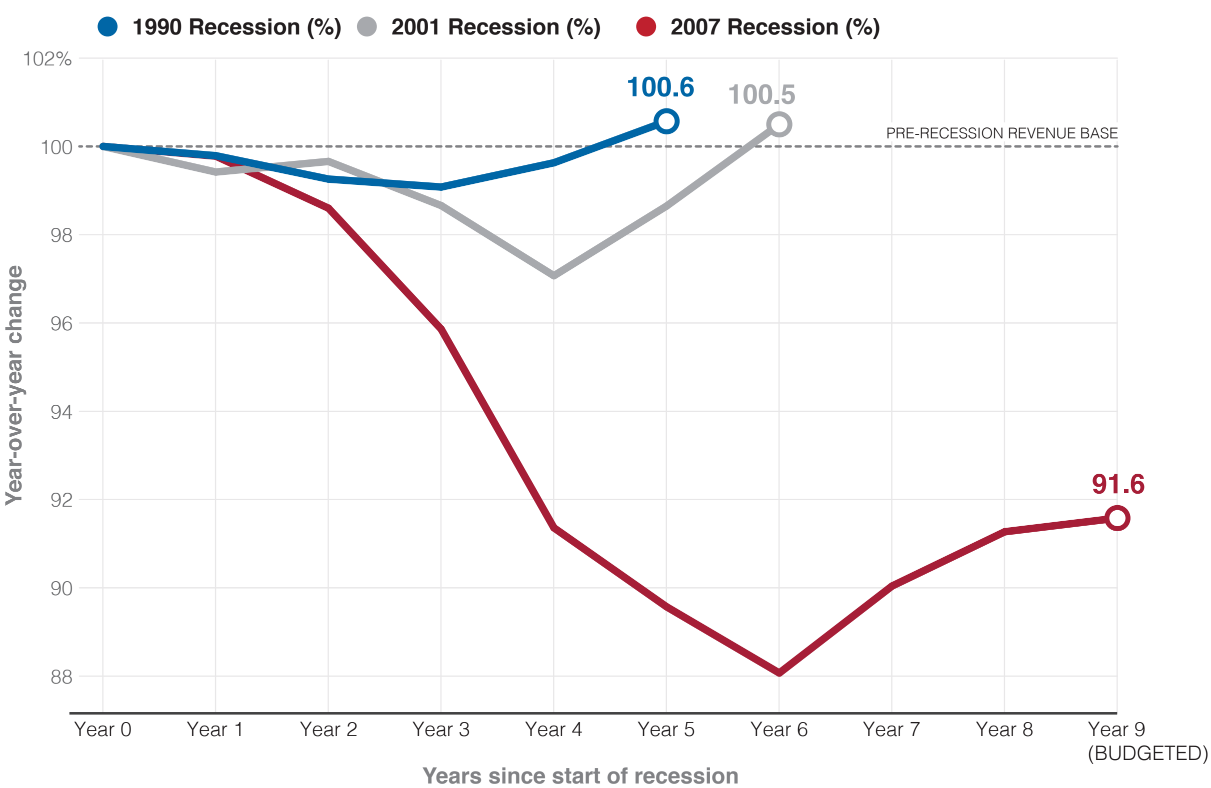
FIGURE 4: Year-to-Year Change in General Fund Revenue and Expenditures



6 "Constant dollars" refers to inflation-adjusted dollars. Constant dollars are a more accurate source of comparison over time because the dollars are adjusted to account for differences in the costs of state and local government. To calculate constant dollars, we adjust current dollars using the U.S. Bureau of Economic Analysis (BEA) National Income and Product Account (NIPA) estimate for inflation in the state and local government sector. Importantly, inflation between 2014 and 2015 is essentially zero.
7 It is typical for revenue estimates for the current year (i.e. FY2015) to be conservative and for expenditure estimates to be greater than revenue estimates.

Taking a closer look at revenue behavior during the current business cycle, city budgets have registered positive revenue growth since 2013. Despite this recent growth, revenues have not yet reached pre-recession levels (**see Figure 5**). After the start of the recession in 2007, cities faced six consecutive years of revenue decline. Recent growth has not restored these substantial losses. As of 2015, almost eight years after the start of the recession, cities are operating at only 91.6 percent of 2006 revenues.[8] If growth continues at its current pace, revenues will not reach pre-recession levels for several years.

FIGURE 5: General Fund Revenue Recovery during Recent Recessions



When compared to the 1990 and 2001 recessions, it becomes clear that the fiscal impacts from the most recent recession are much more substantial, both in terms of depth and duration. During the 1990 recession, cities experienced three years of decline, restoring to pre-recession revenue levels in less than two years. During the 2001 recession, cities experienced revenue decline and volatility for four years, but fully recovered in two.

8 This estimate is calculated from the cumulative year-over-year decline/growth in constant dollar General Fund revenues for each recession, with the year prior to the start of each recession (1989, 2000, 2006) as the base year (i.e. Year 0 in figure 5).

TAX REVENUES

Understanding the performance of key tax sources and their connections to broader economic conditions helps explain the forces behind city revenue behavior during the business cycles discussed previously. The fiscal condition of individual cities varies depending on local tax structure and revenue reliance.[9] 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 percent nationally) are reliant upon local income or wage taxes.

FIGURE 6: Year-to-Year Change in General Tax Receipts

Property Taxes. Local property tax revenues are driven by the value of residential and commercial property, with property tax bills determined by local governments' assessment of the value of property. Property tax revenues are considered more inelastic or less responsive to economic changes since it typically takes deeper, longer-term economic shifts to impact housing values.

Additionally, property tax collections lag the real estate market because local assessment practices require that cities wait to estimate the value of land and property until the property is exchanged on the market. 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 (for more on the lag between economic changes and city revenues, see page 18).

9 For more information on variation in local and state tax structures, see Cities and State Fiscal Structure (NLC 2015) at http://www.nlc.org/find-city-solutions/city-solutions-and-applied-research/finance/cities-and-state-fiscal-structure.

Due to this lag, the sharp drop in the real estate market that set the recession into motion did not hit property tax rolls until 2010. Cities faced several years of declining property tax revenues following 2010, even though real estate markets across the country had already begun to stabilize.

Property tax revenues registered their first, albeit modest, gains in 2013. In 2014 property tax receipts increased 2.4 percent, the largest post-recession year-over-year growth. Growth is anticipated to continue in 2015 for the third consecutive year, but slow to 1.2 percent (**see Figure 6**).

Sales Taxes. Sales taxes are considered more elastic than property taxes because consumer sales are generally quicker to respond to economic shifts. 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 many years prior to the recent recession, consumer spending was fueled by a strong real estate market that provided additional wealth to homeowners. The struggling economy and declining real estate market reduced consumer wealth and confidence, resulting in less consumer spending and declining sales tax revenue.

Consumer spending has improved driven by marginal improvements in the economy. Recently, drops in energy prices have also impacted consumer spending, freeing up spending for other goods and services.[10] Still, lack of strong growth in the broader economy and unpredictable recovery, along with harsh winters, have resulted in less than stellar growth in consumer spending.

Growth in sales tax revenues reached a post-recession high of 6.2 percent in 2012. Sales taxes have registered positive gains every year since, but the pace of growth has steadily slowed. Sales tax receipts registered 5.9 percent growth in 2013, 3.1 percent in 2014, and are anticipated to grow by 2.3 percent in 2015.

> **“ DURING THE MOST RECENT RECESSION, IN AN UNCHARACTERISTIC MOVE, ALL THREE TAX SOURCES DECLINED TOGETHER.**

Income Taxes. Local income tax revenues are driven primarily by income and wages (not by capital gains). Like sales taxes, income taxes are a more elastic source of revenue because personal incomes respond more quickly to local economic circumstances.

The current recovery period has been marked by slow employment and wage growth, widening income inequality, and expansion of low-wage, part-time work and some high-wage jobs with a notable lack of growth in middle income employment. These troubling trends have direct impacts not only on workers, but on city tax rolls, which have registered volatile income tax receipts in recent years.

After strong growth in 2012 and 2013, income tax receipts registered a decline in 2014 of -1.7 percent. For 2015, income tax revenues are projected to rebound and grow by 3.6 percent.

10 Falling Crude Prices Impact on the U.S. Economy, Chicago Tribune, March 14, 2015 (http://www.chicagotribune.com/suburbs/daily-southtown/opinion/ct-sta-varjavand-column-st-0315-20150313-story.html).

A mix of revenue sources is needed to provide municipalities with stability to buffer against economic downturns, and to allow them to capture revenue growth during periods of economic expansion. Notably, in previous downturns, due to the lag in property tax assessments and collections, sales and income tax receipts moved in the opposite direction of property tax revenues, providing that buffer.

During the most recent recession, in an uncharacteristic move, all three tax sources declined together, creating what continues to be an extraordinarily prolonged and uncertain period for local government finances. The decline in property, sales and income tax receipts together is largely a function of the severity of the decline in the real estate market and the instability of the economy.

ENDING BALANCES

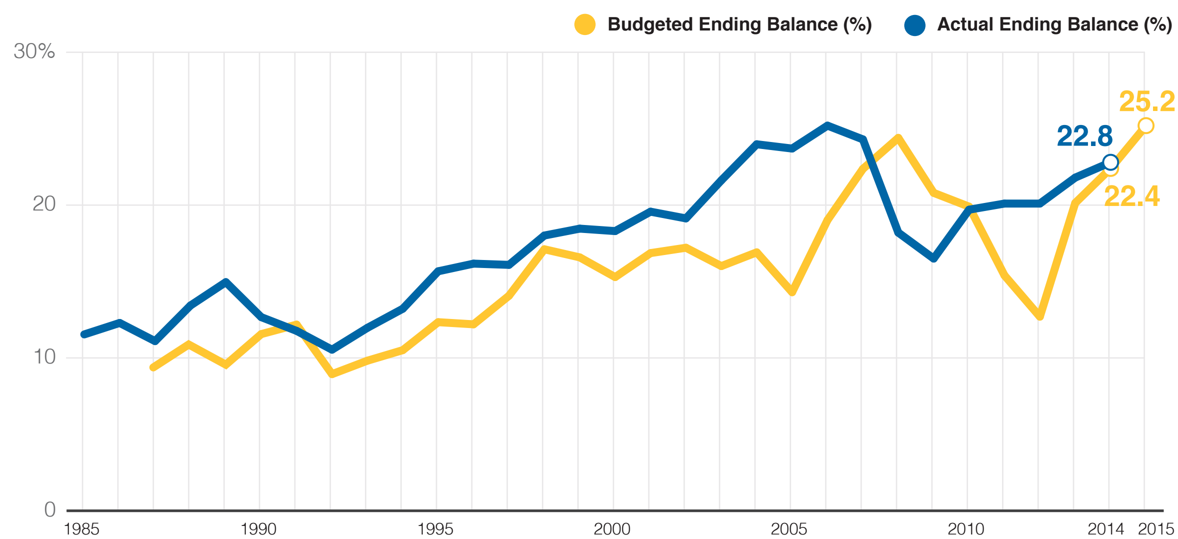
One way that cities prepare for economic downturns is to maintain adequate levels of General Fund ending balances. Ending balances are similar to reserves, or what might be thought of as cities' equivalents to "rainy day funds," in that they provide a financial cushion for cities in the event of a fiscal 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, 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** 7).[11]

FIGURE 7: Ending Balances as a Percentage of General Fund Expenditures



11 The Government Finance Officers' Association (2009) recommends that cities maintain an ending balance, at a minimum, of no less than one to two months of regular general fund operating expenditures (http://www.gfoa.org/determining-appropriate-level-unrestricted-fund-balance-general-fund).

Ending balances reached a post-recession low in 2010 at 16.5 percent of General Fund expenditures. Since that time, ending balances have grown steadily. In 2014, ending balances were 22.8 percent of expenditures and budgeted at 25.2 percent for 2015. Importantly, actual ending balances often register at higher levels than projected ending balances so we anticipate even stronger growth this year, making 2015 a banner year for ending balances. The solid growth of ending balances signals cities' desire to be more prepared for future fiscal downturns and recognition that key tax revenues, along with state and federal aid, have become less reliable.

"THE SOLID GROWTH OF ENDING BALANCES SIGNALS CITIES' DESIRE TO BE MORE PREPARED FOR FUTURE FISCAL DOWNTURNS...

FISCAL POLICY ACTIONS

Most cities are required to balance their budgets on an annual basis. This means that they are actively adjusting revenues and expenditures throughout the year. To better understand these fiscal policy responses, we asked city finance officers about specific revenue and spending actions taken in 2015.

FIGURE 8: City Revenue Actions

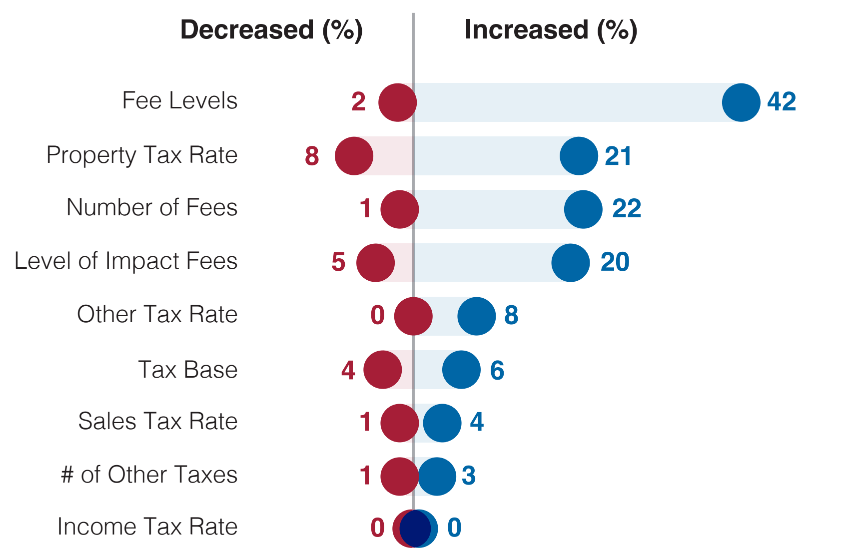
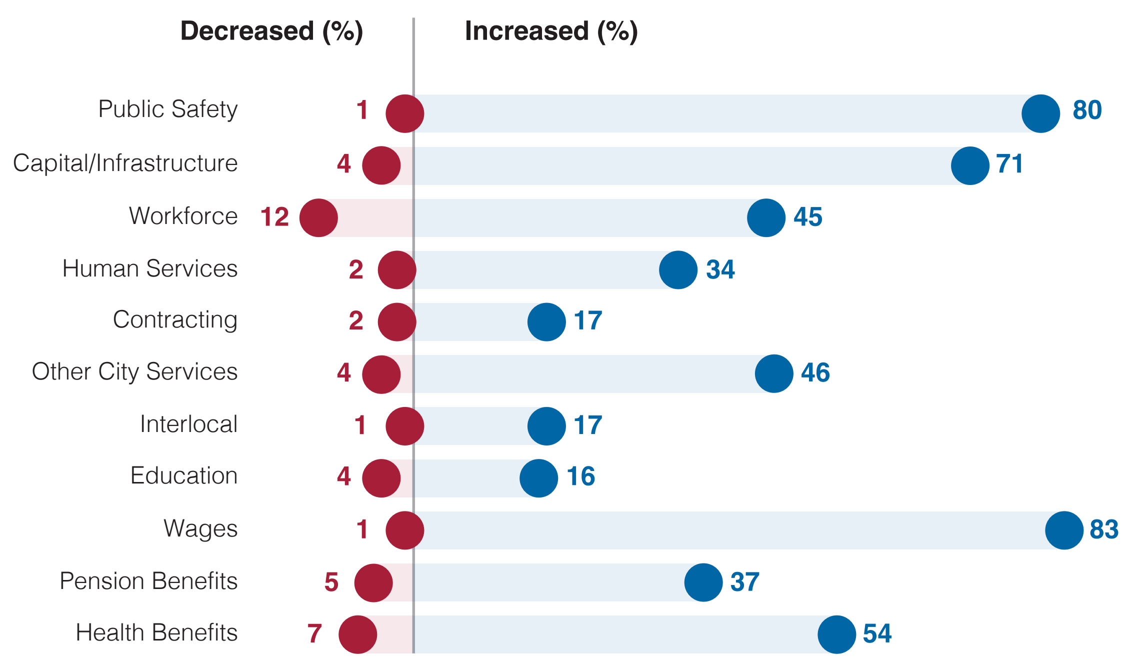


FIGURE 9: City Spending Actions



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 fees charged for services. Two in five (42 percent) city finance officers report that their city has raised fee levels (**see Figure 8**). Approximately one in five cities increased the number of fees that are applied to city services (22 percent).

Twenty-one percent of cities increased the local property tax in 2015. 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 2015.

When asked about expenditure actions taken in 2015, most cities increased employee wages (83 percent), public safety expenditures (80 percent) and infrastructure spending (71 percent) (**see Figure 9**). During the recession, spending on employee wages, both wage levels and total municipal employment, declined sharply. Given the role of city staff in service provision, notably public safety, reinvestments in these critical areas are an important sign of service restoration.

The strong majority of cities also report increased spending on infrastructure. Spending levels, however, have not returned to pre-recession levels and are likely insufficient to resolve the backlong of infrastructure needs.[12]

12 Municipal Bonds and Infrastructure Development – Past, Present, and Future by Justin Marlowe, University of Wisconsin. Prepared for International City/County Management Association and Government Finance Officers Association, 2015 (http://icma.org/en/icma/knowledge_network/documents/kn/Document/307554/Municipal_Bonds_and_Infrastructure_Development__Past_Present_and_Future).

CONCLUSION

City fiscal conditions continue to improve, but remain weakened nearly eight years after the start of the Great Recession. As fiscal year 2015 draws to a close, revenues have experienced three consecutive years of growth. This is an indication that city budgets are stabilizing, however revenue bases are still below pre-recession levels. Growth is slow and fiscal challenges are likely to continue due to rising spending demands.

Beyond 2015, a number of questions remain that will determine the fiscal sustainability of cities into the future:

Will recovery of General Fund revenues come too late?

Based on the recent pace of growth, it is quite possible that revenues will not fully recover before the next recession hits. Economists predict that the U.S. will see the next downturn somewhere around 2018.[13] Based on conservative estimates of one percent revenue growth, and holding all other conditions constant, revenues would not return to pre-recession levels until 2024. Using more generous estimates of two percent growth (General Fund revenues have rarely grown larger than two percent in recent history), revenues would hit pre-recession levels in 2020. In either scenario, it is probable that city revenues will not return to their previous levels before the next recession. Cities are aware of their precarious revenue situation, evidenced by their growing ending balances.

What is the fiscal condition of states, and its impact on cities?

The fiscal outlook for states varies widely, but most states are experiencing slow growth in revenues, coupled with new and expanding expenditures, including Medicaid. As a result, many states have reported budget shortfalls for the upcoming fiscal year.[14] This has been, and will continue to be, a challenge for cities because often the decisions that states make to balance budgets exacerbate negative fiscal and economic conditions in cities. Specific state actions that directly impact the fiscal stability of cities include cuts in general aid, cuts in state-shared and/or state collected revenues, revocation or reduction of reimbursement programs or other transfers, cuts in funding for services that cities and other local governments deliver on behalf of state governments, transfer of state program responsibility, and reductions or limits to local taxing authority.

What is the longer-term impact of the drop in gas and oil prices on city budgets?

As large consumers of energy, the recent decline in gas and oil prices has meant positive budgetary impacts for many U.S. cities. However, it is likely that these prices are volatile and will fluctuate in the coming months. Based on this volatility, longer-term fiscal impacts will be decided by whether cities budget future energy expenditures based on current low prices and whether they allocate short-term savings to pay for long-term fixed costs (i.e., personnel). Oil is also a key ingredient in materials used to repair roads, having the residual benefit of making infrastructure improvements less costly. This, combined with low interest rates, suggests an ideal environment for cities to take on new debt to tackle extensive infrastructure repair and replacement backlog.

13 Based on a September 2015 Bloomberg news survey of 31 economists (http://www.bloomberg.com/news/articles/2015-09-11/here-s-when-economists-expect-to-see-the-next-u-s-recession).
14 Donald J. Boyd and Lucy Dadayan. The Blinken Report: The Economy Recovers While State Finances Lag. The Rockefeller Institute of Government, June 2015 (http://www.rockinst.org/pdf/government_finance/2015-06-23-Blinken_Report_Two.pdf).

What is the outlook for infrastructure financing?

That the nation faces a massive infrastructure deficit is no longer news. Research clearly demonstrates that underfunding maintenance has reached critical proportions, and estimates of the backlog in infrastructure investment tops $3 trillion. Half of America's cities identified 'infrastructure' as one of the three most challenging issues confronting municipalities today, and that figure has been high for over 20 years. Although borrowing costs are quite low for most municipalities, the repayment schedule often means that debt repayment competes with basic operating needs of a city. The long-term economic and community growth potentials of cities could be compromised should cities, and other partners, not address the infrastructure crisis soon.

How big is the pension crisis, sector wide?

Public pension funding ratios registered their first post-recession improvements in 2014, and the outlook for the next several years suggests steady improvement unless plans experience lower than assumed asset returns.[15] Many cities have already made adjustments to their investment-return assumptions since the recession, which bodes well for future sustainability.[16] Beyond this, the pension challenges for cities are multifaceted and unique based on their underlying economy, tax capacity, state fiscal health and availability of policy choices. For example, Chicago has a very diverse and robust underlying economy and the tax capacity to address some issues. The major problem for Chicago is that the state of Illinois is cash-strapped, so any resource transfer from the state is unlikely. The Court also has forced the state and the city to address its financial problems but not to solve them on the backs of pensioners. As a result, the City of Chicago is exploring a property tax increase to help meet pension obligations.

These factors, along with another downturn likely within the next few years, portend more challenging times ahead for city budgets. Budgeting in this environment has been, and will continue to be, an ongoing process of revenue and expenditure choices that affect services, public employee welfare, and conditions for future economic growth. Although uncertainty marks the fiscal landscape, city leaders have learned how to cope with limited fiscal tools and revenue capacity and may be even more prepared for the next downturn given the build-up of ending balances. However, simply because they are able to manage under difficult circumstances does not mean that it will be easy, or without consequence. The choices cities are making involve tradeoffs, and it has become evident that investments critical to our nation's prosperity are at stake. In the years ahead, as cities continue to navigate their roles as fiscal stewards, stronger state and Federal partnerships will be critical to enable the fiscal choices that will allow cities to grow, innovate, and propel our economy forward.

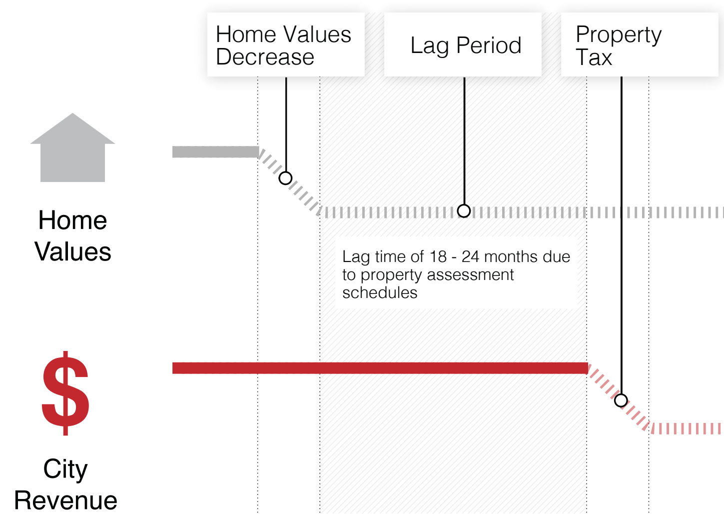
15 Alicia H. Munnell and Jean-Pierre Aubry. The Funding of State and Local Pensions: 2014-2018. Center for Retirement Research at Boston College, June 2015 (http://crr.bc.edu/briefs/the-funding-of-state-and-local-pensions-2014-2018/).
16 State and Local Fiscal Facts: 2015 (http://icma.org/en/icma/priorities/public_policy/resources/fact_sheets).

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.

Lag Between Economic and City Fiscal Conditions



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 4 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 2007, 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.

APPENDIX I

ABOUT THE SURVEY

Categories	Survey Responses	%
TOTAL	363	100
Population		
>300,000	58	16
100,000-299,999	125	34
50,000-99,999	103	28
10,000-49,999	77	22
Tax Authority		
Property	101	28
Sales & Property	233	64
Income & Property	29	8

The City Fiscal Conditions Survey is a national mail and email survey of finance officers in U.S. cities conducted annually from May to July. Surveys were mailed and emailed to city finance officers for a sample of 1,003 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 100 large cities. Budget and finance data from those cities were collected directly from on-line city budget documents. In total, the 2015 data are drawn from 363 cities, for a response rate of 36.2 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.

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.[17]

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 2014, the year prior (FY 2013) and the budgeted (estimated) amounts for the current fiscal year (FY 2015).

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 weighed equally.

17 For more information on variation in local and state tax structures, see Cities and State Fiscal Structure (NLC 2015) at http://www.nlc.org/find-city-solutions/city-solutions-and-applied-research/finance/cities-and-state-fiscal-structure

APPENDIX II: DATA TABLES

FIGURE 4: Year-to-Year Change in General Fund Revenue and Expenditures

Change in Constant Dollar Revenue (General Fund), Percent

1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
4.18%	0.34%	4%	0.55%	-0.21%	-0.53%	-0.18%	0.55%	0.93%	1.25%	2.85%	1.43%	2.14%	0.11%	0.97%
2001	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
-0.58%	0.25%	-1.01%	-1.59%	1.58%	1.85%	-0.22%	-1.18%	-2.75%	-4.50%	-1.79%	-1.50%	1.97%	1.30%	0.31%

Change in Constant Dollar Expenditures (General Fund), Percent

1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
3.77%	-0.11%	1.97%	-0.46%	2.04%	0.78%	-0.73%	-0.77%	0.54%	1.52%	3.86%	1.37%	1.31%	1.09%	0.76%
2001	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
1.96%	3.33%	-1.49%	-1.03%	0.04%	1.88%	2.64%	0.37%	0.50%	-5.10%	-3.49%	-0.81%	1.34%	1.50%	2.20%

FIGURE 5: General Fund Revenue Recovery during Recent Recessions

1990 Recession

Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9
0	-0.21%	-0.74%	-0.92%	-0.37%	0.57%				

2001 Recession

Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9
0	-0.58%	-0.34%	-1.34%	-2.93%	-1.35%	0.50%			

2007 Recession

Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9
0	-0.22%	-1.40%	-4.14%	-8.64%	-10.43%	-11.93%	-9.96%	-8.73%	-8.42%

FIGURE 6: Year-to-Year Change in General Tax Receipts

Sales Tax, Percent

1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
3.6%	3.4%	6.0%	2.4%	2.8%	-5.3%	-3.4%	-3.2%	1.0%	0.5%	3.0%	-0.3%	2.3%	-6.6%	-8.4%
2011	**2012**	**2013**	**2014**	**2015**										
1.6%	6.2%	5.9%	3.1%	2.3%										

Income Tax, Percent

1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
-0.1%	1.2%	4.2%	0.9%	-0.1%	-0.2%	-5.1%	-4.7%	-2.3%	-1.1%	2.3%	-2.5%	2.2%	1.3%	-1.0%
2011	**2012**	**2013**	**2014**	**2015**										
-2.5%	4.4%	3.6%	-1.7%	3.6%										

Property Tax, Percent

1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
1.3%	2.0%	1.5%	1.4%	1.0%	2.0%	4.4%	0.6%	3.3%	2.2%	4.0%	6.3%	6.2%	4.2%	-2.0%
2011	**2012**	**2013**	**2014**	**2015**										
-3.9%	-0.4%	0.8%	2.4%	1.2%										

APPENDIX II: DATA TABLES

FIGURE 7: Ending Balances as a Percentage of Expenditure (General Fund).

Actual Ending Balance, Percent

1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
11.54	12.29	11.10	13.43	14.96	12.67	11.77	10.54	11.97	13.22	15.67	16.17	16.09	18.01	18.46	18.30
2001	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	
19.57	19.13	19.13	21.62	23.98	23.70	25.20	24.30	18.20	16.50	19.70	20.10	21.80	22.80	NA	

Budgeted Ending Balance, Percent

1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
NA	NA	9.02	10.31	9.56	11.56	12.18	8.94	9.82	10.51	12.34	12.20	14.07	17.11	16.58	15.29
2001	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	
16.86	17.21	16.01	16.91	14.30	19.02	22.37	24.40	20.80	19.90	15.40	12.70	20.14	22.40	25.20	

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