Municipal Finance: Conditions, Local Responses, and Outlook for the Future

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Strengthening Neighborhoods in Weak Markets
Federal Reserve Bank of St. Louis
September 24, 2008
Topics to cover

- City fiscal conditions
- Housing finance and foreclosures – local impacts and responses
- Revenue structure and spatialization
- The outlook for the future
Percentage of Cities "Better Able/Less Able" to Meet Needs in Current Fiscal Year

- Less able
- Better able
Percentage of Cities “Better Able/Less Able” to meet needs next year than in current year.
Percentage of Cities "Better Able/Less Able" to Meet Financial Needs in FY 2008, by Tax Authority

- Property Tax Cities: 25% Better Able, 75% Less Able
- Income Tax Cities: 48% Better Able, 52% Less Able
- Sales Tax Cities: 40% Better Able, 60% Less Able
Percentage of Cities "Better Able/Less Able" To Meet Financial Needs in FY 2008, by Region

- Western Cities: -74% Less Able, 26% Better Able
- Southern Cities: -53% Less Able, 47% Better Able
- Midwest Cities: -67% Less Able, 33% Better Able
- Northeast Cities: -61% Less Able, 39% Better Able
Factors Negatively Impacting City Budgets
(% of city finance officers listing factor)

- Prices/Inflation – 91%
- Employee wages – 89%
- Employee health benefits – 84%
- Infrastructure needs – 78%
- Public safety needs – 78%
- Employee pension costs – 77%
<table>
<thead>
<tr>
<th>Revenue Actions</th>
<th>Expenditure Actions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase fees – 49%</td>
<td>Increase pub. safety – 73%</td>
</tr>
<tr>
<td>Increase # of fees – 28%</td>
<td>Increase infrastructure &amp; capital – 52%</td>
</tr>
<tr>
<td>Increase property tax rate – 24%</td>
<td>Increase operations – 42%</td>
</tr>
<tr>
<td>Decrease property tax rate – 24%</td>
<td>Increase productivity – 37%</td>
</tr>
<tr>
<td>Increase level of impact fees – 23%</td>
<td>Increase human serv – 35%</td>
</tr>
<tr>
<td></td>
<td>Increase workforce – 33%</td>
</tr>
<tr>
<td></td>
<td>Decrease operations – 23%</td>
</tr>
<tr>
<td></td>
<td>Decrease workforce – 22%</td>
</tr>
</tbody>
</table>
### State Aid to Municipalities and to Other Local Governments

<table>
<thead>
<tr>
<th>Year</th>
<th>State Aid as Percentage of General Municipal Revenue</th>
<th>State Aid as Percentage of General Local Government Revenue, Excluding Municipalities</th>
<th>State Aid to Municipalities ($Millions)</th>
<th>State Aid to Local Governments, Excluding Municipalities ($Millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1971-1972</td>
<td>24.1%</td>
<td>38.0%</td>
<td>$8,434</td>
<td>$26,709</td>
</tr>
<tr>
<td>1976-1977</td>
<td>23.2%</td>
<td>39.0%</td>
<td>$14,093</td>
<td>$46,184</td>
</tr>
<tr>
<td>1981-1982</td>
<td>20.8%</td>
<td>40.2%</td>
<td>$19,003</td>
<td>$76,360</td>
</tr>
<tr>
<td>1986-1987</td>
<td>20.2%</td>
<td>39.3%</td>
<td>$26,420</td>
<td>$110,449</td>
</tr>
<tr>
<td>1996-1997</td>
<td>20.7%</td>
<td>40.5%</td>
<td>$45,932</td>
<td>$212,303</td>
</tr>
<tr>
<td>2001-02</td>
<td>21.9%</td>
<td>39.9%</td>
<td>$62,405</td>
<td>$293,137</td>
</tr>
</tbody>
</table>
Projected state budget gap in FYs 2009-10

Metropolitan Area Housing Price Decline 6/07 – 6/08

Source, State Budget Gaps: Center on Budget and Policy Priorities, September 2008
Source, Metropolitan Area Housing Prices: Standard and Poor’s/Case-Shiller Home Price Index, June 2008
Topics to cover

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- The outlook for the future
NLC Survey of Local Officials – Impact of Housing Finance & Foreclosures

## Local Response & Collaboration (% of city officials)

<table>
<thead>
<tr>
<th>Local Response</th>
<th>Collaboration</th>
</tr>
</thead>
<tbody>
<tr>
<td>■ Adjust budget/decrease spending – 18%</td>
<td>■ Non-profit/civic – 59%</td>
</tr>
<tr>
<td>■ Increase temp. assistance – 17%</td>
<td>■ State government – 35%</td>
</tr>
<tr>
<td>■ Increase property oversight/code enf. – 11%</td>
<td>■ Other local govt – 34%</td>
</tr>
<tr>
<td>■ Build internal capacity – 6%</td>
<td>■ Banks/mortgage comp. – 32%</td>
</tr>
<tr>
<td></td>
<td>■ Churches – 29%</td>
</tr>
<tr>
<td></td>
<td>■ Neighborhood assoc. – 26%</td>
</tr>
<tr>
<td></td>
<td>■ Federal govt – 26%</td>
</tr>
<tr>
<td></td>
<td>■ Other private – 18%</td>
</tr>
</tbody>
</table>

City Practices

- **Steps to help families on brink of foreclosure**
  - Counseling on pre- and post-loan programs
  - Coalitions and partnerships (Louisville, Seattle, many others)
  - City help lines (Baltimore & Chicago)
  - Emergency (trust) fund/stabilization loan programs (Seattle, Louisville, Chicago, New Bedford, San Antonio, Boston)

- **Foreclosures & vacant properties**
  - Mapping foreclosure and at-risk properties/borrowers
  - Upkeep, maintenance, and revitalization (Boston, Sacramento, many others)
  - Foreclosures to workforce housing (Charlotte, Cleveland, Denver, Montgomery County, MD, Fairfax County, VA, many others)
  - Purchase (or seized) & resale, land banks (Flint, Syracuse)

- **Mortgage industry**
  - Education and collaboration
  - Requiring lenders to register foreclosed properties with city and retain property management company (Chula Vista)
  - Lawsuits (Baltimore, Cleveland, Buffalo, Worcester)
Gap areas where cities need help…

- Funding for loan/stabilizations programs
- Mapping & tracking foreclosure activity
- Establish programs to help lower-capacity jurisdictions
- Coordinate and facilitate cross-jurisdictional responses
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a Income or sales tax for selected cities. b Cities can levy a local income tax, but no locality currently does so. c A local income tax under certain circumstances. d Sales tax only; cities can levy a property tax for debt-retirement purposes only. e Cities can impose the equivalent of a business income tax. f Sales taxes for selected cities and/or restricted use only.
Municipal Revenue Reliance by State
Cities’ strategic behavior to maximize individual and community well-being derives from three principal imperatives of municipalities in a federal system:

First, because cities must pursue policies that augment or, at a minimum, maintain the economic vitality of the community, policy officials are induced to use land to its highest and best use.
Incorporated Places in Maricopa County

Peoria’s Progressive Annexation

Phoenix

Tempe
Second, because cities must pursue policies that minimize social disruption and protect property values, policy officials are encouraged to assemble, zone, and dedicate land for the purpose of simulating natural barriers and protecting property values.
Fences and Canals in Tempe
Third, because cities must pursue policies that enhance their fiscal condition, policy officials are motivated to consider development options that either maximize revenues or minimize costs.
Figure 1: The Revenue-Generating, Social Value, and Development Value Importance of Vacant Land in Three-Dimensional Space

A 3-Dimensional Model of Strategic Behavior

Source: Ann O’M. Bowman and Michael A. Pagano
Terra Incognita: Vacant Land and Urban Strategies
Red Cube Land
## Vacant Land and Cities’ General Taxing Authority

<table>
<thead>
<tr>
<th></th>
<th>General Tax Authority</th>
<th>N</th>
<th>Mean</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Vacant Land as a Percentage of Total Land Area</strong></td>
<td>Diversified (Sales or Income or Sales and Income)</td>
<td>106</td>
<td>0.175</td>
</tr>
<tr>
<td></td>
<td>Property Tax Only</td>
<td>38</td>
<td>0.142</td>
</tr>
<tr>
<td><strong>Number of Abandoned Structures per 1000 Population</strong></td>
<td>Diversified (Sales or income or Sales and Income)</td>
<td>98</td>
<td>2.227</td>
</tr>
<tr>
<td></td>
<td>Property Tax Only</td>
<td>32</td>
<td>0.895</td>
</tr>
</tbody>
</table>
Spatialization of Revenue Structures

Why promote development or a certain type of development at a particular location?

Given a choice, parcels will be identified for development that maximize revenues or minimize costs. The ‘mini-max incentive’ embedded within the context of a city’s revenue structure manifests itself spatially in the design, land-use designations and development patterns of the city, or the spatialization of revenue structure.
STRATEGIC BEHAVIOR OF PROPERTY-TAX CITIES

Property-tax cities think strategically about development based on the market value of the development and on the possibility of shifting service-delivery costs to other jurisdictions (fiscal externalities).
Sales-tax cities think strategically about development based on their mental constructs of “shopping sheds” and on which market transactions are taxable.
Land Use in Chandler
Figure 2b: Idealized Urban Form of Sales Tax Cities (with expansion capacity)
STRATEGIC BEHAVIOR OF INCOME-TAX CITIES

Income-tax cities think strategically about development based on their assessment of the income growth potential of the individual or firm.
STRATEGIC BEHAVIOR OF SITE-VALUE TAX CITIES

Site-value-tax cities think strategically about development based on the possibility of shifting service-delivery costs to other jurisdictions (fiscal externalities).
Policy Questions?

1. Sprawl and transportation.

Low density growth is caused by numerous factors (e.g., transportation and land costs), but might sprawl also be encouraged because of cities’ pursuit of revenues. For example, if sprawl is an outgrowth of sales-tax cities’ demand for resources, would a different revenue mix curb or diminish sprawl?
Do revenue structures influence cooperative behavior among local governments? What immediate gains to a municipality with undeveloped land near it would cooperation with a neighboring municipality generate? Unless forced by the state to adopt a cooperative face, the revenue logic of cities, especially sales-tax cities, might discourage cooperation.
3. **Revenue Structures and Land Use.**

If land use/zoning follows the logic of spatialization of revenue structures, how could zoning and land use change with the introduction of a different revenue system?
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Outlook for the Future

- City tax bases and revenue will continue to decline through 2011
  - Real estate market will be slow to recover
  - Consumer spending and wages also down
- Inflationary/cost pressures will continue
  - Energy-related and employee costs
- Unlikely aid from federal and state levels
- Cities will tap into ending balances/reserves
- Public concern will limit options
For more information…

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