THE PEW CHARITABLE TRUSTS

The Local Squeeze

Falling Revenues and Growing Demand for Services Challenge Cities, Counties, and School Districts

JUNE 2012

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This report benefited tremendously from the insights and expertise of three external reviewers. These experts provided feedback and guidance at critical stages in the project. While they have screened the report for accuracy, neither they nor their organizations necessarily endorse its findings or conclusions.

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ACKNOWLEDGMENTS
Valuable research support was provided by the following Pew staff members: Nancy Augustine, Brandon Brockmyer, Jeff Chapman, Maggie Clark, David Draine, Ike Emejuru, Samantha Harvell, Brendan Hill, Melissa Maynard, and Matt McKillop. We also thank the many experts in the field who were so generous with their time, knowledge, and expertise.

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Contents

Executive Summary

While states slowly recover in the wake of the Great Recession, local governments have been hit with a one-two punch: State aid and property taxes, which together account for more than half of local revenues, are dropping simultaneously for the first time since 1980. The blow comes as demand for government services rises, driven by stubborn unemployment rates, population growth, and other factors.

State aid funds nearly a third of local government budgets on average. It fell by $12.6 billion, or 2.6 percent, in fiscal year 2010, the most recent year for which comparative data are available.[1] This trend has continued, with 26 states reporting cuts for fiscal year 2011 and 18 doing so thus far for 2012.[2] Some cities, counties, and school districts are fighting back with lawsuits. Before 2010, state funding was covering a smaller share of localities' growing expenses, falling from 33 percent in 2000 to 30 percent in 2009.

Property taxes, which amount to 29 percent of local government revenues, also are shrinking, reflecting the drop in real estate prices during the recession. In 2010, property tax revenues were $11.9 billion, or 2.5 percent, lower than the year before, the first annual decline since the mid-1990s and the largest in decades. They fell again in 2011, by another 3.1 percent, or $14.6 billion, and are expected to decrease further in 2012 and 2013.[3] This is different from past economic downturns, when home values and property tax revenues remained relatively stable.

DIVING DEEPER: THE AMERICAN CITIES PROJECT

Like all local governments, the nation's largest cities are facing heightened fiscal stress and often have to do more with less to meet residents' needs. In the coming months, Pew's American Cities Project will explore how economic trends, demographic shifts, and changes in service delivery are affecting 30 major cities. The project will help policy makers understand shared challenges and promising approaches.

For more information, visit www.pewstates.org/cities.

Some localities have raised taxes and fees to try to generate more revenues. But most have tackled budget pressures by reducing spending. Policy makers have increased class sizes and shortened school days; cut a wide range of services, from public safety to trash collection; and privatized or consolidated certain functions, such as maintaining parks and handling 911 calls. They also have eliminated public sector jobs, shedding half a million employees, or more than 3 percent of the local government workforce, since September 2008 through layoffs and attrition. Half of those were teachers and other school administrators or staff members.[4]

The local squeeze will be felt for years to come. The nation's ongoing housing crisis and fragile economic recovery, the likelihood of additional cuts in federal and state aid, and greater demand for services all presage a rough road ahead for local governments.

A Drop in Key Revenues

In 2011, Ohio state policy makers cut $36 million from Cleveland's fiscal year 2012 budget, about 7 percent of the city's annual general fund revenues.[5] Cleveland laid off more than 300 employees that year—more than half of them police officers and firefighters—and left another 145 vacant positions unfilled. It also shut down five fire companies. With six trash crews eliminated, residents waited longer to have their refuse and recycling collected.[6]

Meanwhile, the small town of Saline, Michigan has struggled to balance the school district's budget with less state aid, fewer federal grants, and a drop in student enrollment. To close a deficit in fiscal year 2012, the school board dipped into its fund balance, cut 18 teachers, and negotiated union concessions. It was "the most difficult budget year in the last three years" and appears to be "the end of the road," Scot Graden, superintendent of schools, told a reporter for AnnArbor.com in 2011.[7]

On the other side of the country, Stockton, California saw its property tax revenues plummet and its foreclosure rate jump to the second highest in the nation in 2011, just below that of Las Vegas. The city now teeters on the verge of bankruptcy. This is a dramatic change from its boom years, when construction in Stockton tripled between 1997 and 2005 as new residents flocked to Silicon Valley.[8] But when the housing market crashed, state aid also fell. Revenues flowing to Stockton from California's sales and use taxes dropped by more than 30 percent between 2006 and 2010.[9]

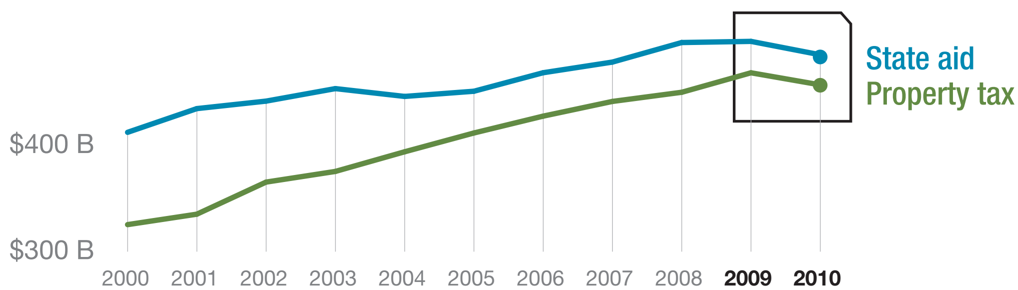
Cities, counties, and school districts across America are struggling with unprecedented challenges that have slowed their recovery from the recession. Many are in a fiscal vise, squeezed on one side by reduced state aid and property tax income—which together make up more than half of local revenues—and growing demand for services on the other. In fiscal year 2010, local governments lost 2.6 percent of their state aid and 2.5 percent of their property tax revenues from the previous year, for a total of $25 billion. The two revenue sources had not declined simultaneously since 1980.[10]

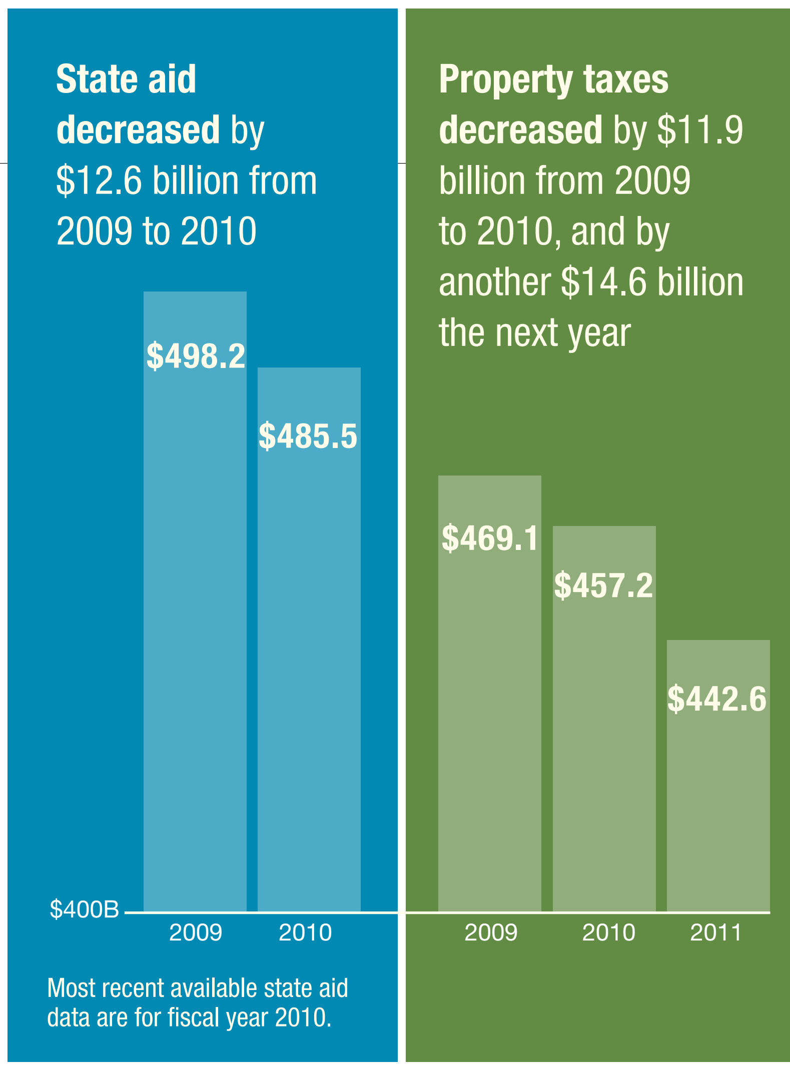
In recent decades, state aid and property taxes most often counterbalanced one

Two major revenue sources drop in 2010

State aid and property taxes, which together account for more than half of local revenues, shrank in the same year for the first time since 1980.

State aid and property taxes: 2000-2010 (in billions of dollars)





SOURCE: Pew Center on the States analysis of the U.S. Census State Government Finance Database and the U.S. Census Quarterly Tax Survey another—one would rise as the other fell, effectively softening the blow. Since 2006, however, the growth of both sources slowed relative to local spending, and then dropped. By 2009, state aid and property taxes together covered a smaller share of local expenditures than at any time since the Census began tracking these funds in 1972.[11]

State Aid

The Great Recession was devastating for states. By late 2009, their tax revenues were 13 percent lower than before the downturn. In the majority of states, this income has crawled back above its 2007 peak level, but growth remains slow.[12] With expenditures continuing to rise, states had to find more than $500 billion to close budget shortfalls between fiscal years 2009 and 2012.[13] While some states raised taxes and used one-time fixes, most closed their gaps with cuts, including in funding to municipalities. Nearly every local budget and service has been affected, including education, libraries, police and fire protection, roads and transportation, health, and housing. "Over the last three or four decades, every time there's been a recession and states have made cuts, those aid programs have taken the hit," said Chris Hoene, director of the Center on Research and Innovation at the National League of Cities.[14]

States fund on average close to a third of local budgets.[15] Many states provide

THE RANGE OF LOCAL GOVERNMENTS

About 90,000 local governments—or localities—operate across the country, including 3,033 counties, 19,492 large and small cities, 16,519 towns, 13,051 school systems, and 37,381 special district governments with narrow responsibilities such as hospitals and fire protection.[16] Each type raises revenue through a particular combination of sources, provides a specific set of services, and has a different degree of authority and autonomy. For instance, some cities have access to multiple revenue sources, including sales, income, and property taxes. School districts, on the other hand, tend to rely heavily on local property taxes and state aid.

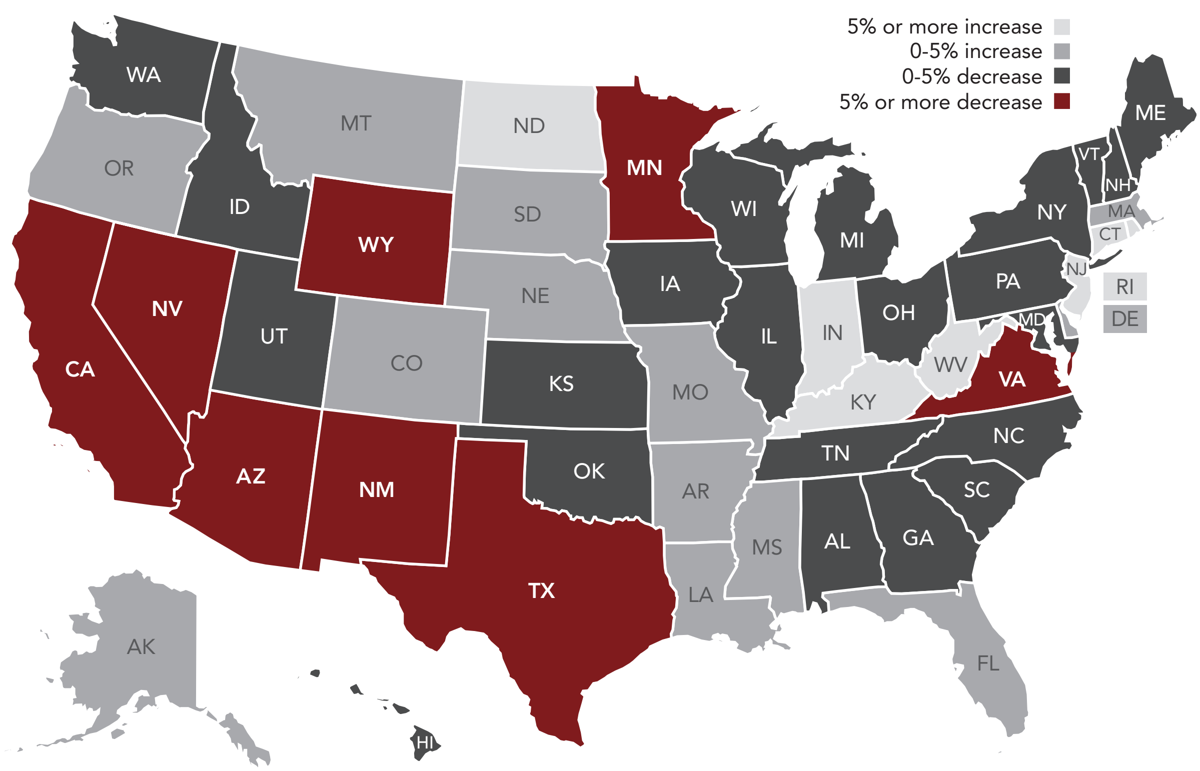
Similarly, responsibilities for delivering services vary by type of government and state. A city will usually exist within a county but have a separate government structure, although the two may cover very similar geographic areas, such as Boston and Suffolk County, or even be formally consolidated, as in Denver and San Francisco. Some states have a direct say in local fiscal decisions, such as controlling which taxes local governments may or may not use to generate revenue, while others take a more hands-off approach.[17]

grants for general operations; in other cases, money is set aside for certain uses, such as road repair. States also sometimes share a portion of tax revenues with cities, counties, and school districts based on factors like population, need, and the community's existing tax burden.

Even with an infusion of federal stimulus funding, state aid overall declined in 2010 by more than $12.6 billion, or 2.6 percent.[18] Cities of all sizes were hit. In Phoenix, for example, Arizona cut $58 million in shared revenue, more than 11 percent; in Wheaton, the seat of Minnesota's least populous county, a loss of just $82,500 amounted to a 12 percent reduction in its aid from the state.[19] Some of the hardest-hit localities have been in the Sunbelt area of the Southwest. In New Mexico, for instance, funding shrank by more than 10 percent, or nearly $500 million. California cut more than $5.7 billion in state support, a 6 percent reduction from the year before. Arizona and Nevada reduced their aid by more than 5 percent. Minnesota, Texas, Virginia, and Wyoming also were among those that made the largest cuts that year.[20]

Elementary and secondary education—traditionally shielded from cuts—is now a common target. In the 2011–2012 school year, 37 states cut aid to local school districts.[21]

Change in State Aid to Localities, 2009 to 2010



SOURCE: Pew Center on the States analysis of the U.S. Census State Government Finance Database

For many localities, state aid was dropping even before the recession. In Florida, for example, it fell by $3 billion, or 14 percent, between 2007 and 2009.[22] Even when these funds were not shrinking, on a national level they were covering a smaller share of local governments' growing expenses, dropping from 33 percent in 2000 to 30 percent in 2009.[23]

More recently, at least 26 states reported they reduced aid to localities for fiscal year 2011 and at least 18 have done so to date for 2012.[24] Nebraska, for instance, canceled all funding to cities and counties in 2011.[25] In Maryland, state aid for local health services declined more than 40 percent, and support for counties and municipalities dropped 60 percent between 2007 and 2012.[26]

Not all states have had to make cuts. Alaska is one of a few that could afford to be generous to localities in recent years because of its severance tax revenue from oil. In fact, Alaska helped municipalities pay down unfunded pension obligations by more than $1.7 billion between fiscal years 2010 and 2013.[27] Even though Connecticut faced a budget gap larger than a quarter of its general fund in 2010, the state increased local aid by more than 10 percent that year, and has not reported cuts since then.[28]

Some policy leaders who believe that cuts will encourage efficiency and force tough spending choices have promoted longer-term changes. For example, after reducing state aid by nearly $500 million for fiscal years 2012 and 2013, Ohio established the Local Government Innovation Program to provide $45 million in competitive grants for localities that enter into shared-service agreements or that centralize certain services.[29] Governor John Kasich (R) said he hopes the financial incentives, along with cuts in state aid, will force Ohio's cities to change the way they do business.

In New Jersey, Governor Chris Christie (R) is taking a hard line on streamlining local governments to save money. He has led the charge for a cap on property taxes, local salary freezes, and regional cooperation. "If the state comes in and says, 'If you share services with the guy next door and you can save a certain amount of money,' and you choose not to do it, then we will reduce municipal aid by that amount," Christie said at a town hall meeting in March 2012.[30]

As state aid decreases, some local governments are reducing their expectations for state aid going forward, but other localities are fighting back. In Texas, for example, more than half of the school districts sued the state for cutting $4.3 billion from school funding in fiscal year 2012. Many of the districts that have not joined the lawsuits say they cannot afford the litigation. The trial is expected to take place in October 2012.[31]

In 2011, the League of Minnesota Cities supported a petition by the attorney general to keep $725 million in appropriated local government assistance despite a state government shutdown that July. The court ruled in favor of the league, but the legislature and governor agreed to reduce the amount by $138 million the day before the funds were distributed.[33]

PROFILE:

PASADENA INDEPENDENT SCHOOL DISTRICT

Pasadena Independent School District is one of hundreds of school systems suing Texas over $4.3 billion in education cuts they believe are unconstitutional. In a community where 80 percent of families live below the poverty line, the school district laid off 340 employees, more than half of them teachers; others were bus drivers, crossing guards, and security personnel. "Everything has been on the chopping block. There's not been a sacred cow," Candace Ahlfinger, an associate superintendent for Pasadena, told NPR.[32]

Federal Aid

Meanwhile, measures to reduce the federal deficit could hurt the portion of state revenues—about a third—that comes from federal grants, an impact likely to be shared with local governments.[34] In particular, if the automatic spending cuts put in place as part of the 2011 Budget Control Act go into effect, grants to states and localities for education programs, low-income housing vouchers, community development, and workforce development programs could be among those affected. On the other hand, according to the Congressional Budget Office, federal deficit reduction could have long-term benefits for state and local budgets by stabilizing the national economy and keeping borrowing costs low.[35]

Property Taxes

With less money from federal and state governments, many localities are relying increasingly on their own revenues. Property taxes currently amount to nearly a third of their total revenues, more than any other locally raised source, especially in small towns and school districts.[36] In 2010, however, collections fell by 2.5 percent nationally, or $11.9 billion. This was the first real decline since 1995 and the largest in three decades.[37] The drop was even greater in 2011, bringing total property tax revenue down by an additional $14.6 billion, or 3.1 percent from its peak.

In previous economic downturns, the property tax was steadier than other major revenue sources, including sales and income taxes, primarily because home prices remained stable in those periods.[38] This time, the housing market collapsed and was a key driver of the Great Recession.

The impact on local budgets, however, was not immediate. Because properties in many communities are not assessed annually, tax collections between 2006 and 2009 were largely shielded from the consequences of plummeting home values.

Home prices fell by almost 20 percent between 2007 and 2011, with some states seeing much sharper declines. In Arizona, for example, values dropped almost 50 percent over that period.[39] These losses led to millions of mortgages going underwater, with unpaid principal balances larger than what the properties are worth. Meanwhile, 1.5 million houses were sold nationally because of default or foreclosure, fueling a downward spiral in prices and reducing the number of homeowners paying local property taxes.[40]

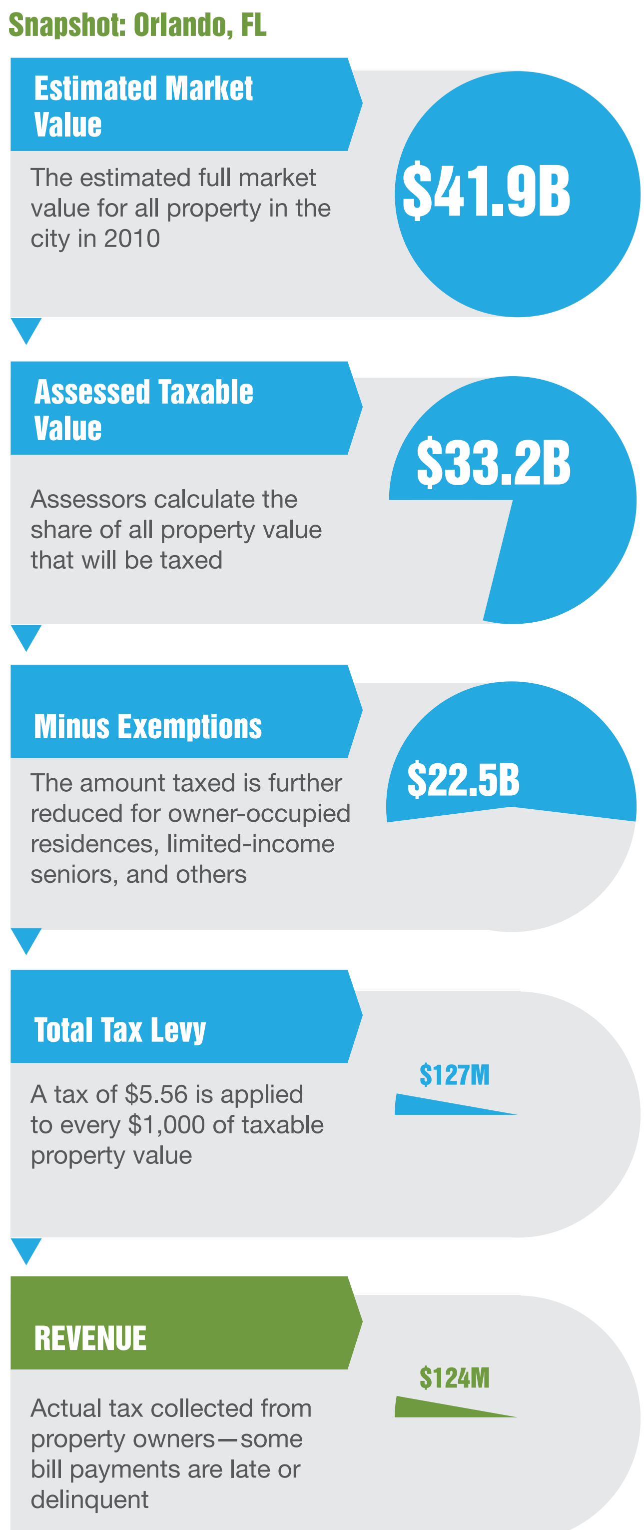
Besides reducing the value of nearby homes and shrinking the tax base, vacant and foreclosed properties can drive up local costs for demolition,

PROFILE:
CLEVELAND

Cleveland had a problem with vacant and abandoned property even before the national housing bubble burst. In 2006, nearly 6 percent—more than 7,000—of the residential properties in the city were vacant. As a result, Cleveland lost $30 million in property tax revenue that year. It also collected less money from building permits and found it more difficult to issue bonds, because it borrows against its assessed property values. These problems have only intensified; by 2010, the vacancy rate had risen to more than 19 percent.[41]

There are other related costs. Fires broke out in vacant and abandoned properties much more often than in occupied homes, costing the city about $5,000 per incident. In addition to maintaining these properties, Cleveland spent more than $9 million over two years to demolish close to 1,000 properties that were beyond repair.[42]

How is the Property Tax Calculated?



SOURCE: Pew Center on the States analysis of City of Orlando Comprehensive Financial Report, Fiscal Year 2010

legal proceedings, and public safety.[43] In Baltimore, Detroit, and Chicago, the money required to demolish significant numbers of vacant and abandoned properties is eating up more of city budgets than they can afford, according to officials. Federal funds that have helped localities address these problems in the past also are beginning to shrink or expire.[44]

Lags in assessments, along with additional foreclosures and the sheer magnitude of the drop in home values, will likely prolong the time it takes for revenues to recover. Moody's Analytics predicts that average property tax revenues will decrease by another 1 percent during 2012.[45] The hardest-hit states—Arizona, California, Florida, Georgia, Illinois, Michigan, and Nevada—could experience even higher losses. The Government Accountability Office projects that property tax receipts peaked as a share of the national economy in 2009, and will not surpass that peak until 2039.[46]

Some local governments have responded by raising property tax rates. Sarasota, Florida, for example, has lost nearly a third of its tax base, or $3.5 billion, over the past three years. In September 2011, the city closed its budget shortfall by increasing property rates for the first time since 2007.[47] In Washington, local governments set a target amount of property taxes to collect each year. If values fall, as they did in 2010, the tax rate rises automatically.[48]

But in many cases, states limit what municipalities can do to generate revenue. Following California's Proposition 13 in 1978, all but four states now in some way restrict their local governments from raising taxes.[49] Recently, in 2008 and 2011, respectively, Indiana and New York enacted caps on tax rates despite objections from localities.[50] States also can limit the amount levied on a given resident, the total revenue generated, or the share of property assessed as taxable.

46 states limit the local property tax

	Revenue Limits	Levy Limits	Rate Limits	Assessment Limits
Alabama		●	●	
Alaska		●	●	
Arizona	●	●	●	●
Arkansas		●	●	●
California	●		●	●
Colorado	●	●	●	●
Connecticut				●
Delaware		●	●	
Florida			●	●
Georgia			●	●
Hawaii				
Idaho		●	●	
Illinois		●	●	●
Indiana		●	●	
Iowa			●	●
Kansas		●		
Kentucky		●	●	
Louisiana		●	●	
Maine	●	●		
Maryland				●
Massachusetts		●	●	
Michigan	●	●	●	●
Minnesota	●	●		●
Mississippi		●		
Missouri		●	●	
Montana		●	●	●
Nebraska	●	●	●	
Nevada		●	●	
New Hampshire				
New Jersey	●	●		
New Mexico		●	●	●
New York		●		●
North Carolina			●	
North Dakota		●	●	
Ohio		●	●	
Oklahoma			●	●
Oregon			●	●
Pennsylvania		●	●	
Rhode Island		●		
South Carolina			●	●
South Dakota		●	●	
Tennessee				
Texas		●	●	●
Utah		●	●	
Vermont				
Virginia		●		
Washington	●	●	●	
West Virginia		●	●	
Wisconsin	●	●	●	
Wyoming			●	

SOURCE: Pew Center on the States analysis of data on Tax Limits from the Significant Features of the Property Tax, Lincoln Institute of Land Policy and George Washington Institute of Public Policy, 2010

The Impact

With little margin in their budgets, even small declines in revenues can present huge challenges for local governments. Many counties, cities, and school districts are rethinking the level of services they provide, the way they do business, and how they spend money. "Imagine that each of these local governments had 70 cents on the dollar," explained Frank Shafroth, director of the Center for State and Local Government Leadership at George Mason University. "They cannot simply cut every budget line by 30 percent. One could hardly opt to respond to only 70 percent of 911 calls, or fill only 70 percent of potholes."[51]

Policy makers have shrunk the workforce and trimmed back services or found new ways to deliver them, among other actions. Meanwhile, they are monitoring the long-term impacts of the squeeze on public-sector pensions, debt, and credit ratings.

Downsizing Workforces

In 2009, localities spent $572 billion, more than 35 percent of their total costs, on salaries and wages.[52] Through a combination of layoffs, attrition, hiring freezes, and furloughs, local governments shed half a million jobs, or 3.4 percent of their overall workforce, between September 2008 and December 2011, with half of this loss coming from the education sector. At the same time, states eliminated an additional 150,000 jobs, or about 2.9 percent of their workers.[53]

Cities, counties, and school districts in Nevada, for example, lost nearly 15,000 jobs, 13.5 percent of all employees, in this three-year period. Localities in California trimmed close to 100,000 from their public sector workforce. Some states, like Texas, added net employees, but at a rate slower than population growth; as a result, the number of local government workers per capita there declined nearly 5 percent.[54]

Cutting Key Services

From trash pickup and public safety to welfare programs and schools, local services affect residents' everyday lives. In many places, the recession has put greater strain on government programs by driving up demand. A number of their costs result from state mandates that require localities to provide specific services, such as special education, or to comply with certain reporting or competitive bidding requirements.

Welfare and Social Services

Many counties and some cities administer and partially fund public welfare programs such as cash or food assistance, healthcare, low-income housing, and workforce development. During the recession, the number of Americans in poverty grew to 46 million—a 14 percent increase between 2007 and 2010. In some states, the growth was at least 20 percent.[55] Meanwhile, national unemployment reached a high of 9.6 percent in 2010; by March 2012, it had fallen somewhat to 8.2 percent.[56]

As in past recessions, all of this has driven demand for local health and safety net programs.[57] In Racine County, Wisconsin, for instance, participation in programs for rent assistance, energy assistance, Medicaid, Wisconsin Food Shares, and child-care support all grew about 12 percent between 2008 and 2011. In Maryland, the number of residents coming to Harford County for food stamps has more than doubled since 2007.[58]

But many local offices serving these constituencies are shrinking budgets and staff. For example, overloaded county-based systems in California, Ohio, and Alabama now rely on workers specializing in child protective services to also cover adult cases involving elders and people with disabilities.[59] The New York City Housing Authority has struggled with backlogs in repairing and renovating public housing units. In June 2011, the agency launched a Work Order Task Force to deal with the issue, but 280,000 outstanding repairs remained in the queue at the end of the year.[60]

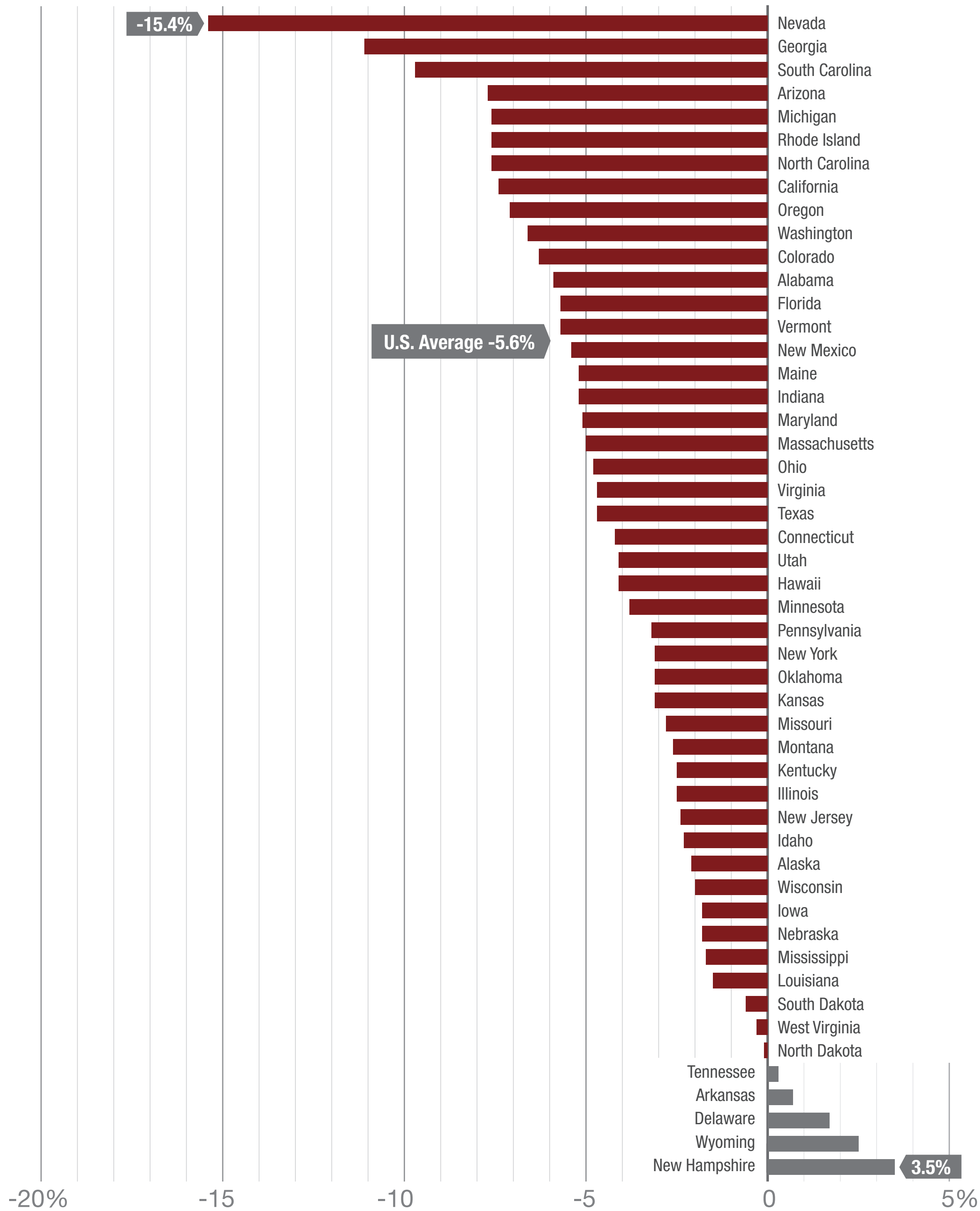
Education

Public school resources also are being stretched in the wake of the recession. Rising poverty rates have resulted in more poor students who require greater attention and resources—as evidenced by the number of students receiving federally subsidized lunches, which increased 17 percent since the 2006–2007 school year.[61] Some school officials also are seeing a growing number of students whose parents choose to send them to public instead of private schools.[62]

Meanwhile, many schools are receiving less financial support from states. Since 2008, 17 states have reduced per-student funding by more than 10 percent. The impact was buffered by the infusion of about $90 billion in federal stimulus funds for education in 2010 and 2011.[63] But the expiration of the funds this year leaves local governments on their own in the face of additional reductions in state aid.

Local governments shed half a million jobs, 2008-2011

Percent change in local government employees per resident (December 2008 to December 2011)



SOURCE: Pew Center on the States analysis of Bureau of Labor Statistics State and Metro Area Employment, Hours, and Earnings Database

Changes in state aid hit some districts harder than others. After Texas enacted $4.3 billion in cuts to school districts in 2012, for example, poorer districts wound up with $800 less per pupil than wealthier ones.[64]

With fewer resources, some school districts have eliminated courses; reduced the school week from five to four days; laid off teachers, support staff, and guidance counselors; or asked families to pay for sports and extracurricular activities.

In Portland, Oregon, class sizes grew as the school district was forced to eliminate teaching positions to balance its budgets in 2010 and 2011. To mitigate the impact, high schools replaced class time with study halls supervised by teaching assistants or other adults.[65] Similarly, the loss of 5,100 school employees across Pennsylvania, including more than 1,600 teachers, led to larger class sizes and fewer electives, such as foreign languages and music. In fiscal year 2012, the Philadelphia school district—the state's largest—cut 12 percent of the workforce, eliminated programs, and received a $53 million aid package from the city, funded by property tax and parking fee increases.[66]

Public Safety

Maintaining safe streets is another critical responsibility for most cities and counties. With budgets increasingly tight, local leaders have begun weighing the costs and, in many cases, trimming services.

Foley, Minnesota, near Minneapolis, stopped paying nearby Benton County Sheriff's deputies to patrol streets, replacing them with private security guards who, while cheaper, do not have the authority to investigate crimes or make traffic stops.[67] Los Angeles' budget for fiscal year 2012 cut overtime pay for police by $80 million, and eliminated ambulances and fire trucks at one in four fire stations throughout the city.

Nearly two-thirds of finance officers said that public safety costs have increased in recent years, putting pressure on city budgets, according to a 2011 survey by the National League of Cities.[68] Some counties have seen costs rise even though crime rates have remained constant or even declined during the recession; among other reasons, offenders spend more time in jail because they have less money to pay bail or because public employee layoffs cause backlogs in criminal trials. [69]

Other Services

A range of other day-to-day responsibilities long provided by local government also have been hit, taking a toll on residents' quality of life. Services such as trash pickup, park maintenance, and library programs are now often on the chopping block.

The small town of Belvidere, New Jersey, for instance, opted in early 2012 to cut garbage collection entirely, but still faced a projected deficit of $250,000.[70] Residents now have to haul their own trash to the landfill or pay for private service. Trash collection also has had an unexpected impact on Tampa, Florida, where foreclosures and hard economic times have translated into less volume dumped in the city's incinerator, reducing the revenue from that facility. Local officials have maintained regular trash services, but only by imposing a 15 percent fee increase.[71]

As Dallas closed a $130 million budget shortfall for fiscal year 2011, it cut its workforce by 450 employees—nearly 4 percent of the total—with more than half from the parks department. As a result, park maintenance was performed less frequently and recreation centers reduced their hours.[72]

Cities across the country are struggling to keep libraries staffed and open, even as the numbers of visitors climb. Since the start of the recession, Phoenix laid off a quarter of its full-time library staff and trimmed hours by nearly 40 percent. When budget gaps grew in Philadelphia in 2008, Mayor Michael Nutter's (D) proposal to close 11 of the city's 49 library branches sparked public outcry, protests, and litigation. Nutter backed down, calling the attempt his "biggest mistake" as mayor. But the city still reduced library funding by nearly 20 percent over the next two years.[73]

PROFILE:

RIVERSIDE COUNTY

At the same time most localities are looking to cut back programs and services, some are being forced to take on new responsibilities. In 2011, California began diverting nonviolent, non-serious, non-sexual offenders to local jails and shifting responsibility for parole violators and parolees to county probation officers. The state is also increasing county responsibility for various mental health programs, drug and alcohol programs, child welfare and foster care, and adult protective services.[74]

With a budget shortfall of $80 million in fiscal year 2012, Riverside County needed a way to pay for these new obligations. The county decided to charge inmates $142 per day for food, healthcare, and other expenses, taking it out of their wages once they are released. The county hopes to raise between $3 million and $5 million in annual revenue.[75]

Increasing Efficiency

Some policy makers have promoted privatization, regional partnerships, or technological innovations to try to reduce costs and increase efficiency. The New Jersey Privatization Task Force, commissioned by Governor Christie in 2010 and composed primarily of business leaders, concluded that "through sensible planning and implementation, privatization offers a variety of benefits to governments and taxpayers, including lower costs, improvements in the quality of public services and access to private sector capital and professional expertise." The report cited cost savings in other localities, such as when Indianapolis opened more than 80 services to competitive bidding throughout the 1990s.[76]

In recent years, Anaheim, California, and Luzerne County, Pennsylvania, contracted out park maintenance, graffiti removal, and the collection of delinquent taxes to the private sector. Facing a $190 million deficit in the 2010 budget, the Dallas City Council turned over the operations of the city zoo to a nonprofit organization.[77]

Others have restructured departments or consolidated services with other localities. The city of Olathe, Kansas recently partnered with surrounding Johnson County to build and run a single 911 dispatch facility, saving the city more than $300,000 in annual staffing and equipment costs. In Nevada, Washoe County and the cities of Sparks and Reno have started issuing streamlined, multi-jurisdictional business licenses from a single location in an attempt to improve efficiency.[78]

Even before the recession, some localities made investments in technology that reduced the number of workers needed to deliver services. For example, trucks that lift and dump garbage cans using hydraulic arms, such as those used in Beaverton, Oregon, require only one worker per route. Santa Clara County, California, implemented an online tool for visitation requests for inmates in its large jail system, lowering the demand for staff and reducing complaints.[79] Officials in Glendale, Arizona now employ remote technology to monitor outages in traffic lights instead of having volunteers drive around the city once every three to six months.[80] On the other hand, these improvements and the cost savings they yield often require large upfront investments that tight budgets may make impossible.

Using One-Time Fixes

Some localities have turned to one-off measures, including spending emergency funds or selling assets to avoid drastic cuts. For instance, in fiscal year 2011, Minneapolis moved $1.8 million from its general contingency fund to the fire and police departments to avoid cutting staff or closing stations. The transfer saved 31 firefighter positions.[81]

In a 2011 survey, 40 percent of counties reported using rainy-day funds, and almost half said they delayed purchases and repairs to keep their finances in order the previous fiscal year.[82] Cory Booker (D), mayor of Newark, New Jersey, sold the police and fire headquarters and symphony hall at the end of 2010 to fill budget gaps anticipated in the following year.[83] In 2008, Chicago leased its parking system, the third largest in the country, to a consortium led by Morgan Stanley to balance that year's budget. The city received more than $1 billion, but the company now expects to make at least $11 billion over the course of the 75-year deal.[84]

Exacerbating Pension and Debt Woes

Local governments are legally obligated to pay for some large-ticket costs, such as debt service and pension obligations, which can consume a large share of their budgets. For many municipalities, those

PROFILE:
STAMFORD, VERMONT

The small town of Stamford, Vermont uses the town meeting form of government. Every March, residents gather to approve their upcoming budget. For fiscal year 2013, they had to decide what to keep and what to cut to close a $37,500 shortfall in a $600,000 budget. Everything was up for debate: cemetery upkeep, computer software, firefighters, all-day kindergarten, the library, and an after-school program. The town considered closing the elementary school and paying the tuition for students to attend elsewhere. The closest school was in Massachusetts, though, and high transportation costs and the legal issues of crossing state lines made the proposal untenable. At a later meeting, the town board decided to close the gap with a $40,000 transfer from their highway fund balance.[85]

Some responsibilities are out of their hands. "We have contractual obligations," treasurer Dave Fierro, Jr. told the *North Adams Transcript* in March, "and the other item is health insurance, which is out of our control."[86] Federal and state regulations also required the town to build a $200,000 facility to prevent salt from filtering into waterways. The town has resisted, in spite of potential fines.

costs had been growing for years, but the Great Recession exacerbated the impact.

In 2010, for example, debt service on incinerator bonds in Harrisburg, Pennsylvania, had grown to $68 million, more than the city's entire general fund budget.[87] The capital city soon found itself unable to make payments, and the state passed legislation allowing the governor to mandate oversight of Harrisburg's finances.

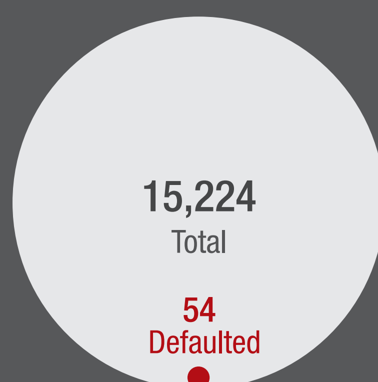
When Central Falls, Rhode Island, filed for bankruptcy in 2011, the small city owed $80 million to its public-sector retirees. Since then, the state-appointed receiver for the insolvent city signed new contracts with retired employees that reflected deep concessions, reducing the unfunded pension liability by almost 50 percent.[88]

Risking Credit Ratings

Despite the fiscal squeeze, true debt crises at the local level—defaults and bankruptcies—are rare. Only 54 of more than 15,000 municipal issuers rated by Moody's Investor Service defaulted between 1970 and 2009, and most were in the healthcare and housing sectors.[89] Bankruptcy is equally uncommon; since 1980, less than half a percent of all issuers have gone through the process, a rate that remained unchanged during the recession.[90]

Reneging on obligations to bondholders has traditionally been a last resort for struggling localities, in part because of the associated costs—penalties, fees, and potentially higher borrowing costs in the future. States, also concerned with these costs, have gone to great lengths to prevent local defaults and bankruptcies. Fearing ripple effects in the credit markets, for instance, Pennsylvania in 2011 appointed a receiver for Harrisburg and blocked the city from filing for bankruptcy.[91]Michigan also seized control over several struggling communities, including Flint and Pontiac, to restore stability and prevent default. Under Michigan law, emergency managers in these takeovers can change union

Very few local governments have defaulted



NOTE: Among issuers of debt rated by Moody's Investor Services

SOURCE: Presentation by Bob Kurtter, Moody's Investor Services, *U.S. Municipal Credit Update*, Charlotte, North Carolina, March 31, 2011, page 3

Less than

0.5%

of all localities issuing debt have gone through bankruptcy since 1980

SOURCE: The Pew Center on the States, "Harrisburg and a Brief History of Municipal Bankruptcies," October 19, 2011

contracts, lay off workers, and recommend the consolidation or privatization of functions.[92]

Still, state aid cuts, declining property tax collections, and a slow recovery have hampered some localities' ability to borrow. Early in 2011, Moody's warned that it would be the "toughest year yet" for local government budgets, and in some instances, their credit ratings have begun to reflect that—based on declining core revenues, high unemployment, and falling real estate values.[93]

In 2010 and 2011, there were 87 municipal super credit downgrades—downgrades of three or more ranks. A third of these involved cities, counties, or school districts (the remainder occurred in special purpose governments, largely in the housing sector). In November 2010, Atlantic City, New Jersey was downgraded by three notches, based on the likelihood of declines in gambling revenues following the recession. Sarasota County, Florida, largely because of its eroding property tax collections, fell by six ranks in fall 2011.[94]

Conclusion

Localities' dependence on two faltering sources of revenue—property taxes and state aid—presents profound challenges. The housing market is still struggling and additional cuts in federal and state funding are likely. At the same time, demand for government services is rising. More tough choices lie ahead as leaders look to balance the day-to-day needs of their communities with their long-term prospects. Their decisions may produce temporary fixes or permanent changes. Either way, the impact of the local squeeze will be felt for years to come.

Endnotes

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