MUNICIPAL FISCAL RESPONSES IN THE POST-RECESSION ERA

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This article examines the fiscal challenges Illinois municipalities faced following the 2009 recession and the ways in which they responded. In order to shed light on the strategies and actions employed during this post-recession period, Census of Governments' data were used to identify the impacts on municipal revenues and expenditures from 2007 to 2017, and over 90 mayors and managers of Illinois municipalities were also surveyed. The results suggest that state aid to municipalities did not keep pace with inflation between 2007 and 2015, and the most common strategies used to maintain balanced budgets were increasing water and sewage charges and delaying infrastructure projects.

This article examines how municipal officials responded to the slow statewide recovery following the Great Recession ending in 2009. As the Illinois economy recovered slower than in other states, unemployment remained high, major employers closed or temporarily cut back employment and the state adjusted its revenues shared with local governments. This article analyzes results from an electronic survey sent to mayors with 91 unique responses across the state describing changes in both expenditures and revenues during the post-recession recovery. The effects of the recovery differ by municipality, as do the responses, since they were tailored to local conditions.

Some adjustments brought about long-term changes in services provided and financing approaches. Reductions in capital spending to preserve current operations were cited by mayors, as was greater use of technology in delivering services. Increases in user fees and charges were relatively common methods to offset reductions in sales tax revenues, and, in some cases, property tax collections. This article provides insight into local decisions during the past five to six years and suggests approaches that could be useful in other municipalities.

The 2009 recession and subsequent slow recovery in Illinois affected municipalities of all sizes. High unemployment and losses in critical jobs, including relatively high-paying manufacturing jobs, reduced tax revenues in many municipalities. Downstate municipalities were hit especially hard by the recession. This article explores the responses of municipalities to budget shortfalls in recent years and describes the results with implications for future trends.

The lagging state economy and associated finances reduced state-shared revenues on which many municipalities rely to finance local services. In some cases, that resulted in significant program cutbacks and difficult budget decisions. Conditions worsened with no state budget for several years and serious fiscal uncertainty that discouraged business investment.

In addition, mandates by the federal or state government, often without funding, caught local leaders between shrinking revenue sources and a need for staff to provide high-quality services. Persistently low state support for services such as education created pressures on property taxes, making Illinois second highest in effective property tax rates, following New Jersey.[1] Even though property taxes for municipal services represent a relatively small portion of the total property taxes collected, municipal officials were limited by public pressure in their ability to rely on this source when revenues such as sales taxes and shared revenues declined. A growing number of employee retirements with pension obligations further increased the fiscal pressures. While some pension contributions paid for past underfunding, pension costs were an increasing share of the overall municipal budget.

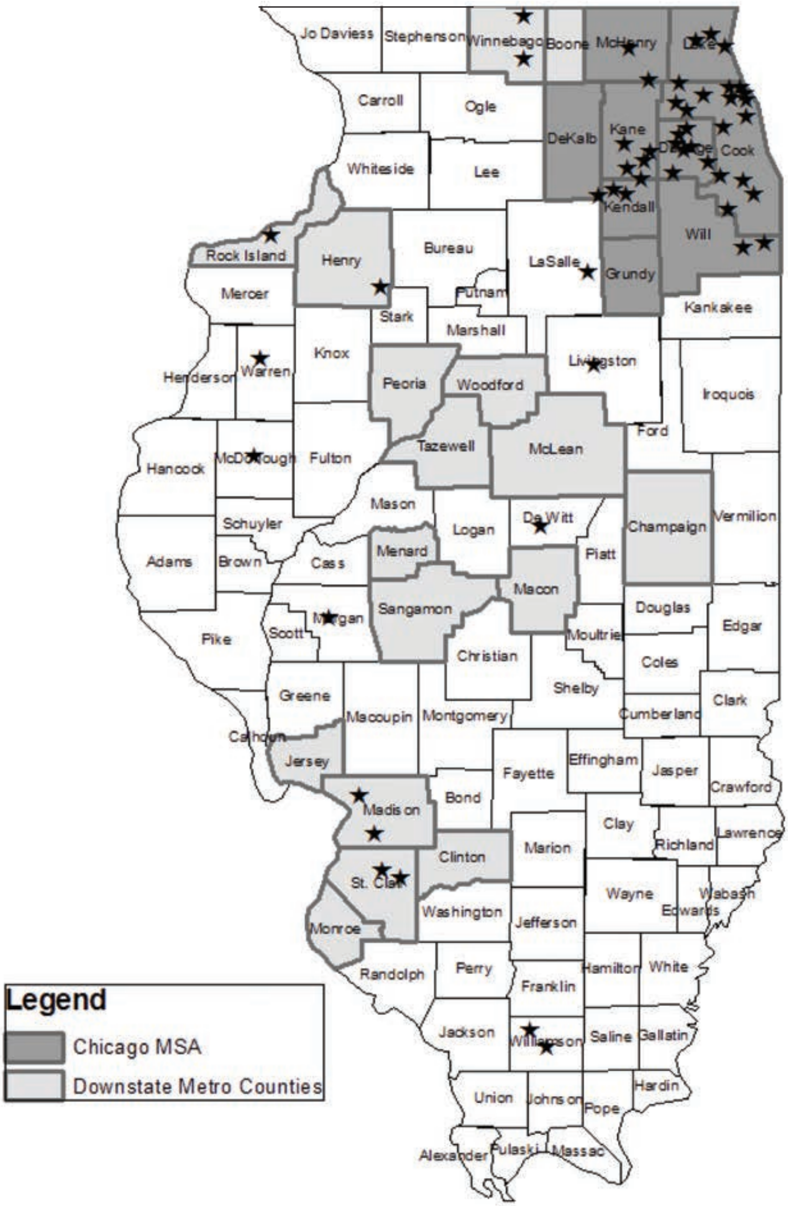
The fiscal situation is more difficult in non-home rule municipalities or those facing property tax extension limitations, tax rate limits and less flexibility in other revenue-raising powers. Likewise, the economy in many small and rural municipalities did not respond well in the post-recession period, further enhancing the need for innovative ways to finance essential services.

DESCRIPTION OF ANALYSES

Comparisons of municipal responses to budget shortfalls in Illinois municipalities following the 2009 recession used Census of Governments' (CoG) data to identify the effects on municipal revenues and expenditures from 2007 to 2017. This work expands on a previous study of fiscal performance in Chicago-area communities (Brewer, Vitone, & Schweiterman, 2016). An electronic survey of mayors and managers in municipalities larger than 5,000 in 2018 (91 responses) by the Northern Illinois University (NIU) Center for Governmental Studies (CGS) and the Illinois Municipal League (IML) sheds further light on actions during the post-recession recovery using approaches from past studies.

FIGURE 1

FISCAL STRATEGIES SURVEY RESPONSES



The map does not include all responding municipalities because some respondents did not identify their location in the CGS-IML FY 2018 fiscal strategies survey.

Municipal responses are grouped by region to better understand conditions leading to specific strategies used. Sample respondents mainly represent those with populations between 5,000 and 75,000 distributed across the state (Figure 1). Responses are grouped by location in the Chicago-Naperville-Elgin metropolitan statistical area (Chicago MSA), downstate metropolitan areas (i.e., all Illinois metropolitan areas outside of the Chicago MSA) and non-metro counties. The average population size of responding municipalities is 26,000, the average household income is $53,000 and 48.4% have home rule authority. If anything, smaller municipalities may be slightly overrepresented in the sample, making the findings more appropriate to conditions and strategies in this group.

CHANGING ECONOMIC AND FISCAL CONDITIONS

The adverse effects of the Great Recession on municipal finances are well documented, but more important for current purposes is what happened in subsequent years and possible long-term effects. Mayors reported the overall effects on the local economy to provide a background for discussing responses. Slightly more than half (54.7%) reported a general slowdown in activity (less than 5%) but with no large employer layoffs or terminations. Important to note is that the survey was conducted prior to recent closures in large retail chains such as Macy's and Bergner's that relate more to longer term changes in purchasing patterns or business financing strategies than the recession.

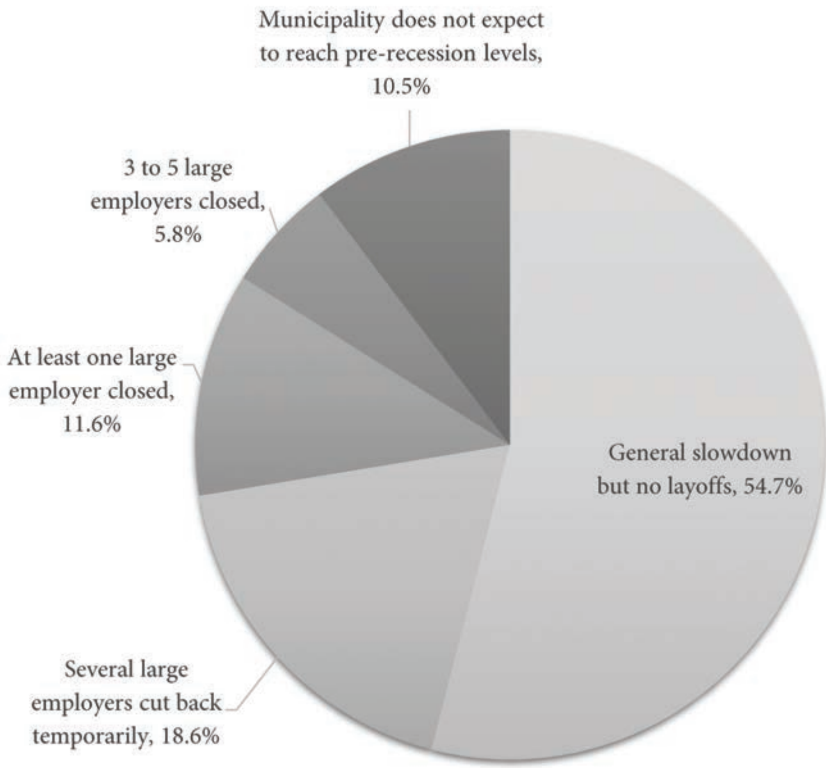
The remaining mayors reported either that several large employers had cut back operations temporarily but had regained employment (18.6%) or that at least one large employer closed permanently (11.6%). Some (10.5%) reported long-term effects, indicating the municipality does not expect to reach pre-recession levels in the future. Only 5.8% reported closure of three to five large employers with job losses for several years or indefinitely.

When asked about economic conditions since 2015, mayors were evenly divided between expecting a continued slow recovery during the next several years (27.0%), stable conditions with no significant anticipated employment changes in the next year (30.3%) and clear signs of steady growth—2% in the next several years (30.3%).

Municipalities in the Chicago metropolitan area or downstate metro areas such as Champaign and the Quad Cities gave more positive responses. However, no significant correlation has existed between population size and economic conditions since 2010 or 2015, which was unexpected due to the broader economic opportunities available in larger municipalities.

FIGURE 2

ECONOMIC TRENDS SINCE 2010



Source: CGS-IML, FY 2018 Fiscal Strategies Survey

The effects of the post-recession recovery are more evident in mayors' responses regarding the effects on FY18 municipal revenues. One-third reported sufficient FY18 revenues to provide current levels of service and some with a budget surplus, so the effects of the recession may have passed in these cases. Another 25.6% reported revenues adequate to meet the current needs but not sufficient to cover inflation. One-quarter (25.6%) said revenues were inadequate to provide current services but with no immediate employment cutbacks expected.

However, 15.6% of mayors reported employee cutbacks. Most municipalities reporting cutbacks are in the Chicago metropolitan area with lower median household incomes and populations between 10,000 and 50,000. Three are in rural parts of Illinois, and two are in downstate metropolitan areas. An average of five employees were reported in the cutbacks. Furthermore, in 38.4% of respondents, revenues matched expenditures (+ or −1%) with 16.4% reporting a surplus of 1% to 4% on April 30, 2018. An additional 13.7% had a surplus of 5% or more with nearly the same number (19.2%) reporting budget deficits of 1% or more. Deficits were more common in municipalities with populations below 50,000 and in those with lower incomes in the Chicago MSA.

Budget shortfalls arose from several primary factors according to mayors who rated factors on a scale of 1 to 5 in terms of importance. Higher pension contributions ranked an average of 4.3, with 77.3% listing pensions as essential or very important. The second most significant was underperforming local economies including lower sales taxes reported by 57.1% as a significant factor leading to stress. Cutbacks in state aid were listed as important or very important by 45.2% of respondents.

The financial literature considers reserves sufficient to pay at least two months of bills to be prudent (Sohl, Blanke, & Walzer, 2016), so mayors were asked about the number of days of unrestricted net cash reserves on hand at April 30, 2018. Among the 84 mayors responding to this question, 16.7% reported 60 or fewer days available with another 17.9% reporting 61 to 90 days. The remaining 65.5% of municipalities reported reserves of more than 90 days. Thus, by these responses, most of the Illinois municipalities responding had weathered the financial storm and are on solid financial footing.

When asked about expected economic conditions in the next two years, responses were generally optimistic but with some reservations. The largest number (51.3%) had a favorable view, with more local businesses expanding than stagnant or declining. Almost as many (42.5%) expect a stable economy with no significant pending business expansions or contractions. Fewer (12.5%) were optimistic about local businesses growing and prospering. Respondents optimistic about the next two years are located in the Chicago MSA, downstate metro areas and rural Illinois. Those expecting the local economy to remain stable were typically mid-sized with populations between 10,000 and 50,000.

While a large number of mayors expecting a positive future are an important finding, the processes used to overcome financial setbacks exhibit a variety of strategies. The approaches used are important to understand because some may have long-term implications for financing and delivering services. They typically included revenue increases plus expenditure adjustments affecting both capital outlays and current operations.

ADJUSTMENT STRATEGIES

Past research reveals a pattern of common strategies followed during periods of fiscal retrenchment (Clark & Ferguson, 1983; Kim & Warner, 2016; Maher & Deller, 2007; Pagano, 1993; Walzer & Jones, 1992) and usually reflects efforts to avoid or minimize the immediate effects on local public services. Often high on the list is delaying planned projects to expand future services, especially capital items, until the budget situation improves (Pagano, 1993).

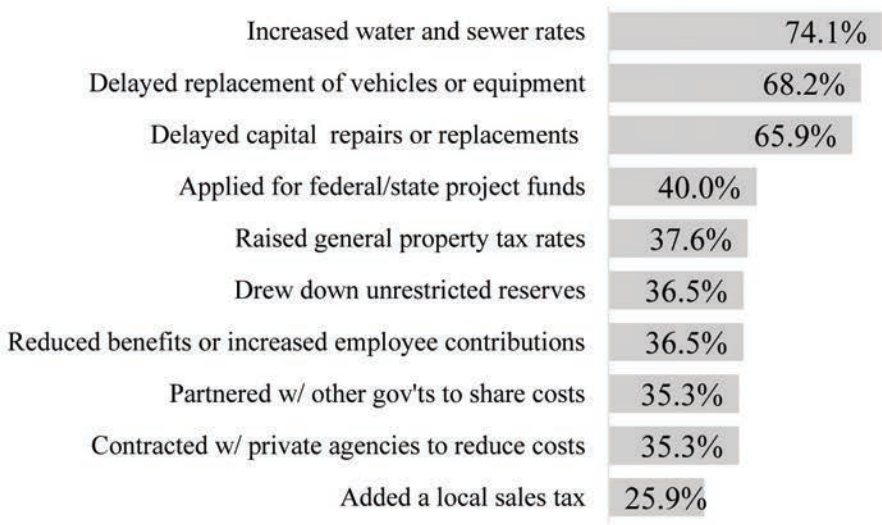
Another common approach involves postponing vehicle or equipment replacements knowing this short-term option may mean higher costs in the future. Political pressures influence the fiscal adjustment strategies used. Several mayors in the survey expressed an intent to preserve essential services and hold the line on property taxes. With short election cycles, mayors face more pressure to preserve services in the short term while limiting the local tax burden instead of taking a longer range view. This approach may have been required by losses in other revenues.

Least preferred strategies include personnel layoffs and terminations because of the immediate effects on service delivery and, in some instances, negotiation restrictions (Maher & Deller, 2007). Smaller pay increases may also be an option but depend on contract arrangements and related issues. When revenue adjustments are considered, it may be more politically acceptable to increase service charges since they primarily affect those benefitting directly from the services (Weinzierl, 2018).

Mayors identified potential strategies in adjusting to budget shortfalls, including both revenues and expenditures (Figure 3). The strategy most often reported (74.1%) by the 85 responding mayors was to increase water and sewer rates. Since these may operate as enterprise funds with revenues dedicated to specific uses, it is not clear that the rate increases are solely in response to fiscal cutbacks unless general revenues supplemented user fees in the past. However, a recent national study shows that adding or increasing service charges can prevent reductions in those services (Kim & Warner, 2016).

FIGURE 3

FINANCIAL ACTIONS TAKEN SINCE 2015



Note: For simplicity, actions taken by fewer than 2% of respondents are not shown.

The next two common strategies include postponing the replacement of vehicles and equipment (68.2%), followed closely by delayed capital infrastructure spending (65.9%). These strategies are relatively easy to impose without immediately affecting services. However, they only work for so long, and replacement costs may be higher in the future when the equipment or facilities deteriorate even more.

Revenue adjustment strategies were also relatively common but can be more challenging to use, especially when they involve tax increases, than delaying infrastructure or maintenance. Within this category, 40.0% of respondents applied for state or federal project funds to support current operations, and 36.5% had drawn down unrestricted reserves. Those using reserves were mainly populations less than 50,000, with lower median incomes. Municipalities with fewer than 25,000 people more often pursued grant funding for operations including downstate municipalities such as Jacksonville and Macomb or those in the Chicago MSA including Sugar Grove and Willowbrook.

Increasing property taxes (37.6%) or reducing employee benefit costs, such as requiring employees to pay a higher share (36.5%) of benefits, were next in importance. These strategies are not available to all municipalities because of negotiations and tax rate limitations. Smaller municipalities and those in the Chicago MSA more often raised property taxes. Few downstate municipalities reported reducing benefits or increased employee contributions, and usually, those that did had populations between 25,000 and 50,000.

Finding lower cost ways to finance services through partnerships with other public agencies, or contracting with private agencies, was reported by one-third of responding municipalities. These strategies involved contracts with other public agencies (35.9%) or with private businesses to reduce costs (35.9%). Contracting was rarely reported by respondents outside the Chicago MSA and was mainly used in those with populations between 25,000 and 75,000.

Mayors also described types of contracting or cost sharing with other agencies. Most common are communications arrangements for police, fire and emergency services with high fixed costs that can be reduced by expanding the population served. Several respondents including Rockford, Lake Forest and Grayslake participate in shared safety communications. Likewise, Batavia, Geneva and St. Charles collaborate on a central dispatch center that answers 911 calls for police, fire and ambulance services in the three cities as well as fire and ambulance services in Elburn.

Other municipalities in DuPage County reported participating in shared dispatch services via the countywide *DuComm* arrangement that serves 44 agencies in DuPage County, which is one of the largest consolidated 911 centers in Illinois. Additional examples of shared services include joint purchasing arrangements for items such as salt, fuel or other materials, as well as sharing personnel with specialized expertise that can manage operations for larger agencies. Municipalities involved in such shared purchasing or procurement arrangements include Yorkville, Glencoe and Lincolnwood. Numerous other examples of municipalities sharing staff and equipment exist across Illinois.

One-quarter of respondents (25.9%) added a sales tax to generate additional revenues with the most common reported uses of the revenues being capital improvements, especially roads and streets, which supports previous discussions about delaying capital projects. These sales tax increases may also support capital projects in the future. Other municipalities such as Marion, Oak Lawn and Carol Stream reported sales tax rate increases with the revenues allocated to the general fund. Use of this strategy varied with population size and local authority.

One-fifth of respondents (21.2%, not shown in table) reported postponed or smaller wage adjustments for non-bargaining employees, and 11.8% increased an existing utility tax. An additional 10.6% reported imposing a utility tax or added a tax to a previously untaxed utility.

Nearly one-tenth (9.4%) borrowed from enterprise accounts (mainly water/sewer) for current operations, shifted services to other governmental agencies to reduce costs (8.2%) or borrowed short-term to finance current operations (8.2%). These strategies suggest serious fiscal pressures resulting from the lagging recovery, the severity of the recession and the options available for making adjustments. However, relatively few (14) municipalities reported cutting employees in the past three years, and the average reduction was not large (five employees or fewer). These positions may not include those lost from not replacing retirees, which is a more probable short-term strategy.

Several municipalities shared innovative practices not classifiable elsewhere in the Fiscal Strategies Survey. Kewanee conducts citizen satisfaction surveys to identify core services and continuously improve them. Schaumburg saved personnel costs by carefully reviewing vacant positions and only filling positions that clearly maintain or improve current service quality. North Chicago is exploring the possibility of contracting with a private security company to provide several services. Monmouth eliminated its community/economic development director position and now collaborates with the chamber of commerce on local development issues. In any event, there is clear evidence that some municipal officials and managers made significant local adjustments in the post-recession years.

LONG-TERM EFFECTS

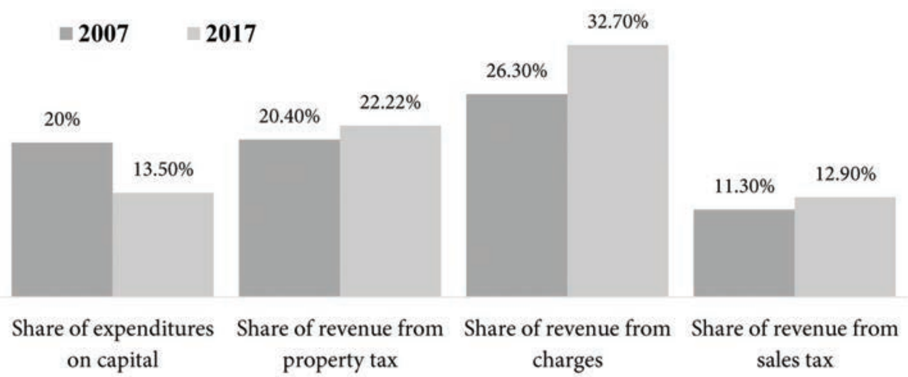
The short-term impacts of the recession were described, and the responses also caused longer term adjustments in municipal revenues and expenditures as local officials managed the fiscal setbacks. Some of these changes will affect the financing and delivery of services in the future. Reorganization of service delivery brought about by fiscal responses may have positive outcomes as public agencies collaborate to increase the use of technology or find less expensive ways to provide high-quality services.

In other instances, delayed investments in capital or cutbacks in operating expenditures may adversely affect future residents. The comparison of shifts in the revenues collected and resulting expenditures is provided next based on comparisons of data from the 2007 and 2015 CoG surveys (latest available).[2] This data source has the most consistent information for comparing fiscal changes in the sample municipalities. Responding municipalities differ widely in economic experiences with many showing significant recovery while, in others, revenues exceeded expenditures. This section describes several critical financial trends.

First, property taxes did not keep pace partly due to an underperforming local economy that increased reliance on user charges including utility taxes. Figure 4 shows the impact of these trends with an increase in the relative importance of fees and charges as a percentage of revenues collected between 2007 and 2015. This change in revenue structure may continue in the future depending on how the local economy and the property tax base respond.

FIGURE 4

SELECTED REVENUE/EXPENDITURE RATIOS

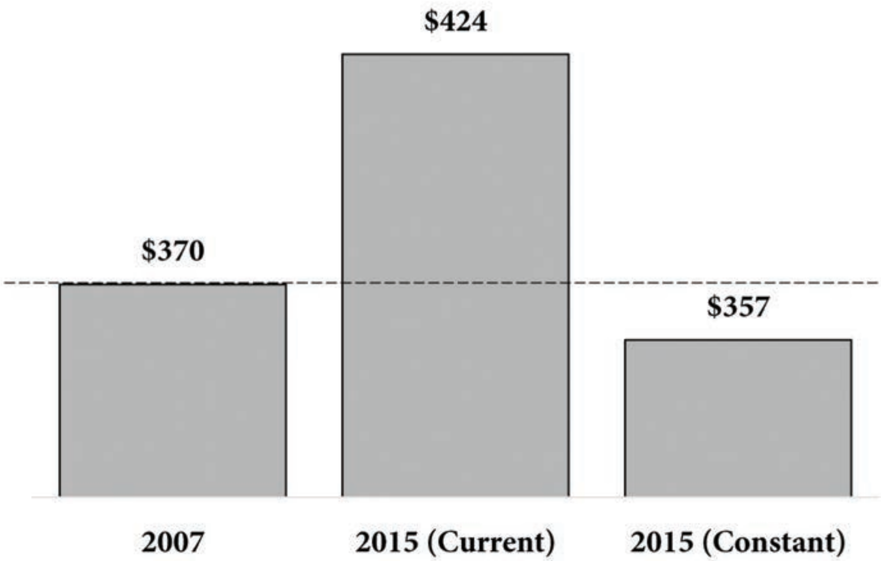


Source: U.S. Census Bureau, 2007 CoG and 2015 Annual Survey of Government Finances

In nominal terms, state aid per resident increased from $370 to $424 since 2007. However, after adjusting for inflation using the Illinois Municipal Price Index (MPI), state aid *decreased* to $356 per resident (a 3.7% loss). The CGS-IML Fiscal Strategies Survey identified declining state aid as a leading factor underlying budget shortfalls. By comparison, revenue from federal agencies remained relatively constant at less than $25 per resident or 1.5% of total revenues. The loss in the purchasing power of state aid made municipalities rely more on other sources.

FIGURE 5

STATE AID TO MUNICIPALITIES PER CAPITA, 2007 AND 2015



Source: U.S. Census Bureau, 2007 CoG and 2015 Annual Survey of Government Finances

Thus, municipalities became slightly more reliant on property taxes. In 2007, 20.4% of municipal revenues were from property taxes but had increased to 22.22% by 2015. While local property values may have declined in some cases during this time period, property taxes remain one of the most stable revenue sources for municipalities. Likewise, sales taxes increased slightly from 11.3% of total revenues to 12.9%.

Municipalities also became significantly more dependent on service charges and fees, which increased from 26.3% of total revenues to 32.7%. The average municipality collected $434 per resident for services in 2007 but collected $613 in 2015. A recent study reported that cities with more resilience in fiscal crises tend to pursue new service charges as a way to maintain service levels (Barbera, Jones, Korac, Saliterer, & Steccolini, 2017).

Second, expenditures and services had similar types of adjustments. For instance, some mayors reported postponing capital projects and delaying equipment replacement to maintain current operations. Those decisions should appear in capital expenditures in 2017, representing a smaller percentage than in 2007, especially in those communities still feeling the effects of the recession. In 2007, 20.0% of total expenditures went for capital expenditures, but in 2015, capital expenditures represented only 13.5% of expenditures.

Related to the declining share of expenditures for capital, several mayors reported spending less on repairs for roads/bridges and water/sewer facilities than needed to keep them in acceptable condition. The median respondent in the survey reported it should spend $1.3 million on water/sewer systems and $1.9 million on streets each year, but the median respondent expects to spend $1 million on water/sewer and $1.5 million on streets. Deferring capital projects may mitigate the need for other fiscal adjustments in coming years, but infrastructure will continue to age as some cities fall behind on maintenance. The median municipality in the survey estimated that it would cost $12 million to repair existing sewage treatment systems, and such projects will likely require bond issues or further service charge increases in the future.

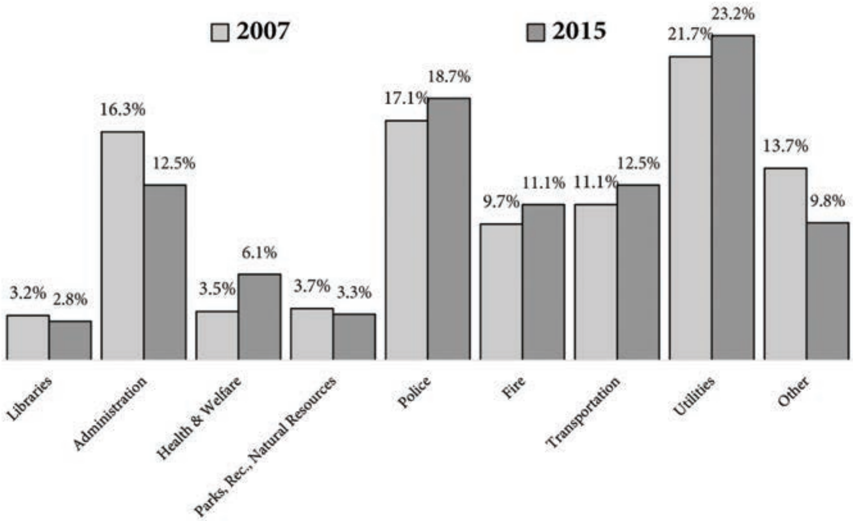
After adjusting for inflation using the MPI,[3] capital expenditures decreased from $328 to $209 per capita, including both construction and vehicle/equipment purchases. These figures confirm that local governments experiencing budget shortfalls resorted to incremental measures to minimize the short-term impact on service delivery by delaying the replacement of equipment and so on (Levine, 1978; Scorsone & Plerhoples, 2010; Johnson, Oliff, & Williams, 2011). Clearly, there are implications for future financing needs.

The composition of expenditures by service type also shifted since 2007. Expenditures for administration decreased from 16.3% to 12.5% of aggregate spending. These cutbacks may reflect better use of technology but also indicate more focus on other services, including police and fire, both of which increased in the share of expenditures. For example, in the Fiscal Strategies Survey, the Village of Schaumburg implemented online payments for all services to make it more convenient for residents and to reduce the costs of processing transactions. Health and welfare costs also increased during this period as one might expect. The same is true for utility expenditures funded with higher charges for services to meet increasing utility costs.

Total expenditures increased from $1,638 to $1,845 per capita between 2007 and 2015, with the increase distributed across several service areas. Expenditures on police protection increased by $65 per resident (Figure 6). Utility spending increased $74 per resident, and fire protection costs increased $46. Administrative expenditures decreased $36 per resident. Total expenditures for parks, recreation and libraries remained relatively constant, but the share of expenditures decreased as spending in other areas increased. Not all municipalities have park/recreation districts or libraries, with those services provided by special districts.

FIGURE 6

SHARE OF TOTAL EXPENDITURES



Source: U.S. Census Bureau, 2007 CoG and 2015 Annual Survey of Government Finances

PRIMARY FINDINGS

Six findings from the study stand out:

- State aid to municipalities in Illinois did not keep pace with inflation between 2007 and 2015, forcing greater reliance on charges and sales taxes. Several cities such as Marion, Oak Lawn and Carol Stream increased sales taxes to support general fund operations, while other cities increased sales taxes to fund future capital projects.

- Equalized Assessed Valuation declined 24.1% between 2008 and 2015, requiring some municipalities to raise property tax rates to maintain revenues. Declining property values have also caused some smaller municipalities including Jacksonville, Macomb, Sugar Grove and Willowbrook to pursue grant funding for operations.

- The most common strategies used to maintain balanced budgets involved increasing water/sewer charges plus delaying infrastructure projects and equipment replacement. The median city expects to spend less on infrastructure repairs than is sufficient to keep water/sewer systems, roads and bridges in acceptable condition, so cities might need to issue bonds or increase service charges again to support future construction projects.

- Administrative expenditures decreased, while spending on police, fire protection, utilities and health/welfare increased. Some administrative cost savings reflect collaboration and shared services. For example, municipalities such as Yorkville, Glencoe and Lincolnwood participate in shared purchasing or procurement agreements.

- Areas most often reported in service sharing arrangements include communications for police, fire and emergency services. In addition, joint purchasing and sharing personnel with specialized expertise were cited in several cases. An example of shared communication services is the *DuComm* arrangement, which is one of the largest 911 centers in Illinois, serving 44 agencies in DuPage County.

- A majority of responding mayors reported more than 90 days of unrestricted reserves, which exceeds the recommended minimum of 60 days cited in the professional literature, suggesting that some are well on the way to recovery and are prepared for potential shortfalls in the future.

Municipalities in Illinois responding to the 2018 survey were adversely affected by the recession, and some made significant adjustments in their finances. In part due to political pressures to maintain current services and hold the line on property taxes, they followed traditional approaches such as delaying capital and construction. In some instances, however, rising pension costs and related expenditures caused cutbacks in personnel. The more positive news is that a majority of municipalities survived the financial changes and see a more positive future for the next few years.

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FOOTNOTES

[1] More information on Tax Foundation research is available at https://taxfoundation.org/how-high-are-property-taxes-your-state

[2] The Census Bureau collects data on all municipalities' finances every five years and conducts a more limited annual survey. There were 163 Illinois cities with data in both the 2015 survey of government finances and the 2007 Census of Governments finances.

[3] More information on the Municipal Price index is available at https://cgs.niu.edu/publications/MunicipalPriceIndex.shtml

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