Report: Cities' Fiscal Problems Run Long and Deep

It's been more than four years since the Great Recession ended, but for America's cities, fiscal problems continue to linger and won't go away anytime soon.

BY TOD NEWCOMBE | NOVEMBER 26, 2013

The economies of America's major metro areas grew 2.5 percent in 2012, according to a report prepared by IHS Global Insight for the U.S. Conference of Mayors. That's good news, and it's a sign that cities are finally turning the corner economically. The bad news is that it has been an usually long and painful return for America's urban areas.

Looking at data from the nation's 30 largest cities, a new report from The Pew Charitable Trusts found that most cities hit their lowest revenue in 2010 or 2011, well past the low point for state governments in 2009. The reason for that lag has to do with property taxes, which are slow to respond to economic swings. "They delayed the early effects of the Great Recession for most of these cities," the report found. "The fiscal effects of this decline were compounded by increasingly unpredictable aid from state and federal governments." By the end of 2011, more than two-thirds of the cities still had not recovered to their previous revenue peaks.

The Pew report looks at the specific factors that led to the overall reductions in city revenues during the recession, keying in on two leading causes for declines in 20 of the 30 cities. Reductions in intergovernmental aid drove revenue down in 9 cities, while declines in small revenue sources -- like investment income, charges, fees and some taxes -- were the lead causes in 13 cities.

While intergovernmental aid is important to all cities, it particularly hurt those that rely more heavily on it. More than half of Cleveland's revenue decline during the downturn came from cutbacks in intergovernmental aid. The American Recovery and Reinvestment Act pumped more than $9.3 billion into the 30 cities Pew researched. While the money served as a stopgap to declining revenue and a jumpstart for local economies, it ran out before many cities saw their own revenue sources recover. Baltimore, Boston, Houston, Las Vegas, Minneapolis, Philadelphia, Phoenix and Washington found themselves exposed when the stimulus dollars dwindled away.

Nontax revenue, such as charges, fees and investment income had a larger than expected impact on the decline of city revenue, according to the Pew report. In Dallas, the decline in nontax revenue was the primary reason for its revenue decline. Drops in contributions and investment income in Kansas City, Mo., lead to a $57 million loss in revenue between 2008 and 2010.

But cities that rely on sales and income tax saw the fastest fiscal declines, as these revenue sources took quick hits early as workers lost their jobs in large numbers at the start of the recession. For New York City, the drop in sales taxes represented almost one-quarter of the city's total revenue decline. Among the cities studied, 20 levy sales taxes and 18 saw declines in 2009. Only 10 of the cities studied collect an income tax,

but the levy makes up a large portion of their revenue -- an average of 25 percent. Collections dropped in 9 out of 10 cities.

The report also looks at how cities weathered the storm. Since the decline in property taxes took a while to hit, cities were able to stave off service cuts early on. They dipped into their reserve funds to ensure basic services kept functioning. Overall 29 of the 30 cities used their reserves during the recession and after. Sacramento relied on its reserve so heavily that the fund balance plummeted from 31 percent of general revenue in 2007 to just 6 percent in 2011.

Eventually the recession's squeeze forced cities, such as Sacramento, to begin to cut what they considered noncore services, such as closing swimming pools and community centers. But these service cutbacks proved to be too little, and eventually all 30 cities cut spending to core services between 2007 and 2011. Cities opted to cut spending on housing, economic development, parks and other cultural activities, public works, and transportation. But as revenue continued to drop and reserves dried up, more cities began making cuts essential services such as police, fire and EMS services.

These days, fiscal austerity is still a fact of life for many of America's largest cities. "Ongoing fiscal constraints suggest further contractions in federal and state aid to the nation's cities," reports Pew. In 2012, property tax revenue continued to decline and showed only small increases in collections in the first quarter of 2013. Cities have also struggled to rebuild their reserve funds: Many cities had built them back up by 2011, but 18 of the 30 cities still had slimmer reserve funds than in 2007.

Perhaps the greatest ongoing fiscal concern is the rising costs of retirement benefits. As of fiscal 2010 (the last fiscal year for which complete data are available), the 30 cities faced more than $225 billion in unpaid pension and retiree health-care costs. Despite this huge fiscal hole, "nearly half of the cities were not paying their full, recommended annual contributions."

In recent years, cities have been seen by numerous economic experts as America's engines of growth, and they have become attractive places for young people as well as empty nesters, childless couples and retirees seeking a more vibrant and interesting lifestyle. The recession put some of that economic and demographic growth on hold. And now, cities should be poised to start growing again. But without major -- and long-term -- fixes to their fiscal health, cities stand to lose much of what they gained.