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Recovering From Volatile Times

The ongoing financial struggles of America's big cities

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Overview

In the three years between 2009 and 2012, the U.S. economy began recovering from the Great Recession. Nationally, housing prices rose and the unemployment rate fell, but for many major U.S. cities, the fiscal crisis persisted, making the recovery a geographically uneven experience. In fact, in some major cities, revenue declines continued into 2012—a full three years after the national recession ended.

The Pew Charitable Trusts reviewed the latest available data from 30 major U.S. cities and found that more than half—18—saw governmental revenue decline from 2011 to 2012 after adjusting for inflation.[1] (See Figure 1 for a list of the cities studied.) Of these, eight reported their lowest revenue since the downturn began in 2007. This analysis expands on Pew's previous report, *America's Big Cities in Volatile Times*, which examined the fiscal conditions of the same 30 cities from 2007 to 2011.

An ongoing slump in property tax revenue was a significant contributing factor in the prolonged fiscal strain on some cities. City property assessments and tax collections typically lag behind the real estate market by 18 to 24 months. This time, however, the national housing crisis so dramatically undercut this important revenue source that Pew's analysis found collections in many cities remained anemic a full three years after the national economy began to improve.[2] In 2012, the majority of cities—24—reported year-over-year losses in real property tax collections—the most to declare such losses in any year since 2007. Even today, "the recovery still feels like a recession," said Federal Reserve Chair Janet Yellen.[3]

In addition to weak property tax revenue, city officials have faced the added challenge of cuts in state aid as state lawmakers strained to balance their own budgets. In 2011, federal aid began shrinking too, as cities' share of federal stimulus money tapered off. City officials covered shortfalls by cutting spending, raising fees and taxes, and drawing down reserves.

Not all cities were worse off in 2012 than the year before, however. Boston, Cincinnati, Minneapolis, New York, and Seattle exceeded their prerecession revenue peaks in 2012—mostly due to gains in sales and income taxes and increased charges and fees.[4] The boost in cash allowed Cincinnati to take a needed "breather," as City Manager Milton Dohoney Jr. put it, from the deficit-driven budgets of the preceding three years.[5]

The findings of this analysis are explored in detail later in this report, but briefly:

- Governmental revenue fell in 18 of the 30 cities between 2011 and 2012, double the number from 2010 to 2011. In 2012, eight cities recorded their lowest level of revenue since the start of the recession.[6]
- In the majority of cities, drops in property tax revenue and state and federal aid accounted for most of the revenue loss; both fell 4 percent on average across the 30 cities.
- Revenue increases from sales and income taxes—in cities that collect them—and from charges and fees helped to mitigate losses in some cities.
- In 2012, 10 cities had revenue above their prerecession peaks, after adjusting for inflation.[7]
- Four of the nine cities that had surpassed their pre-downturn revenue peak in 2011 fell back below that level again in 2012.[8]
- Seventeen cities managed to increase spending on some programs and services and replenish reserves in 2012, but overall spending in most cities remained below prerecession levels. This cautious approach suggests that many city officials have adjusted to the reality of an unusually slow recovery.

The fiscal data reviewed in this report reflect conditions as of 2012, but analysts note that, even with improving property tax collections, the effects of the Great Recession are still being felt in some cities as of 2014. For example, Amy Laskey, managing director of U.S. public finance for Fitch Ratings, said in July 2014 that "both the degree of housing market improvement and the time lag vary by state and regions within states."[9]

Strained revenue underscored the recession's toll

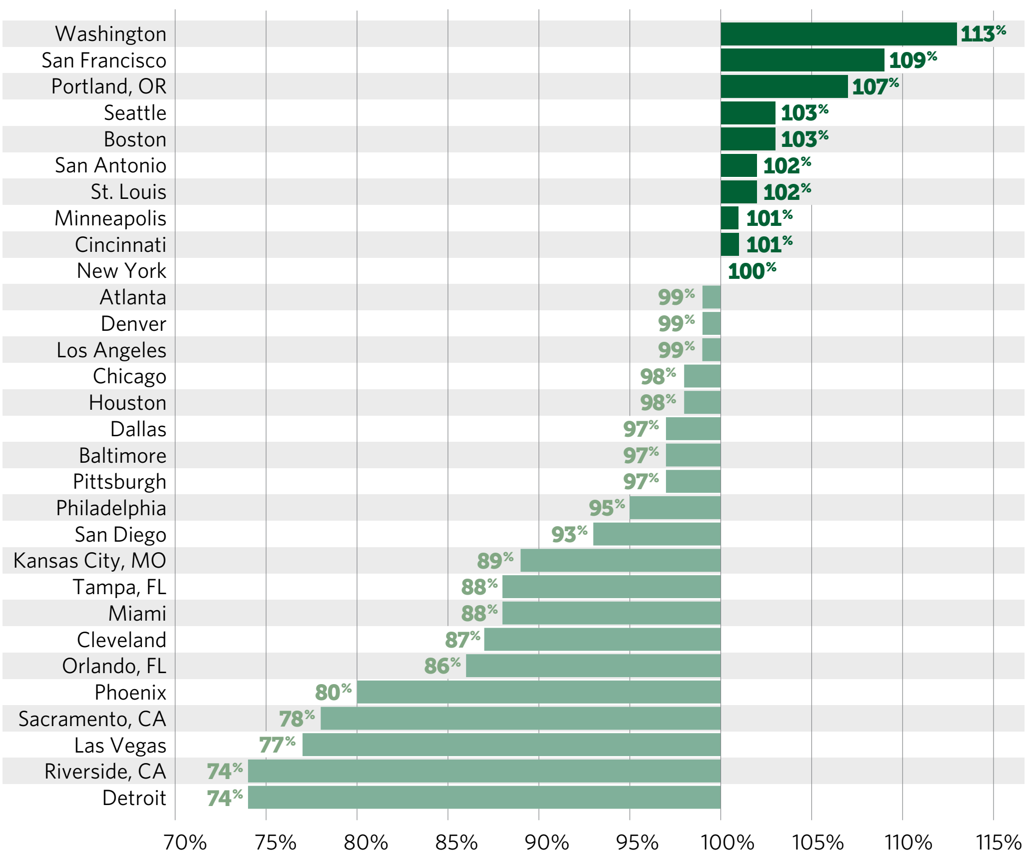
The lingering impact of the Great Recession continued to tighten city finances in 2012; 18 of the 30 cities in Pew's analysis lost revenue between 2011 and 2012, double the number from one year before. Across the 30 cities, inflation-adjusted revenue fell by an average of 1.2 percent between 2011 and 2012 after increasing slightly the previous year, when federal stimulus money helped prop up some city budgets.[10]

Though the recession officially ended in June 2009, Pew found that two-thirds of the cities still were below prerecession revenue peaks in 2012. (See Figure 1.) For seven of those, 2011 to 2012 was the worst year of revenue declines since the recession began in December 2007. Atlanta, Dallas, Detroit, Las Vegas, Phoenix, Pittsburgh, and San Antonio reported larger drops in total revenue between 2011 and 2012 than any prior year, according to Pew's research.

Figure 1

Most Cities Had Not Recovered to Prerecession Revenue Peaks by 2012

2012 revenue as a percent of the previous high, by city



Note: Atlanta fell slightly below its pre-recession revenue peak in 2012—to 99.9 percent.

Source: Pew's analysis of city comprehensive annual financial reports

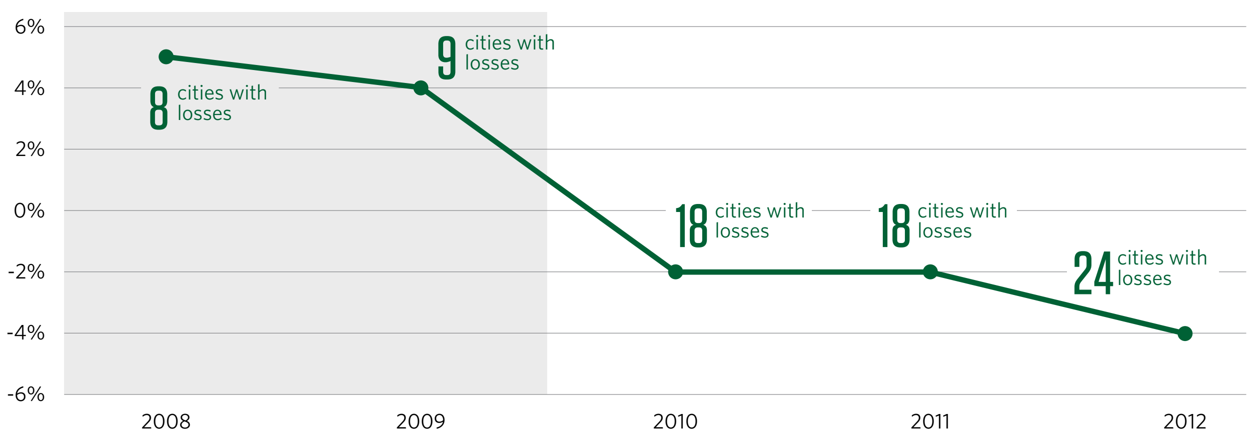
Falling property tax revenue and decreasing state and federal aid—two key sources of cash for cities—triggered most of the declines. Both categories dropped an average of 4 percent across the 30 cities between 2011 and 2012, extending the downward trend observed in Pew's previous research. Over the six-year study period (2007-2012), 2012 saw both the greatest number of cities with lower property tax collections and intergovernmental aid and the largest average magnitude of decline.

Property taxes generally are a city's largest, most stable revenue source, but the housing crash that started the recession shattered that dependability. The impact on city treasuries was not felt immediately because of the delay between real estate assessments and tax collections, which is often as long as three years. Miami's lag is typical: The city assessor values property annually on Jan. 1, but bills are not sent out until later in the year and the owner has 15 months from the valuation date to pay the bill.[11] As a result, revenue often does not show up in the city treasury until at least the following fiscal year. By 2012, big cities were feeling the full brunt of the real estate crisis even though housing prices had begun to rebound nationally. (See Figure 2.)

Figure 2

Property Tax Declines in Most Cities Began After the Great Recession and Continued in 2012

Year-over-year percent change in collections, average across 30 cities, 2008-12



Note: Shaded area represents the period of the Great Recession as defined by the National Bureau of Economic Research.

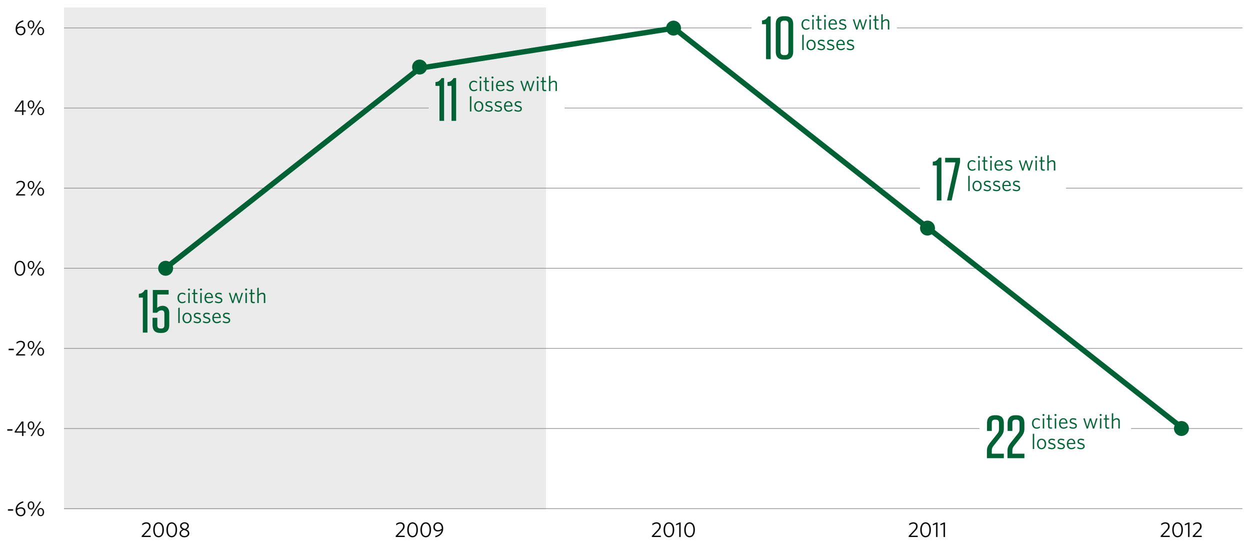
Source: Pew's analysis of city comprehensive annual financial reports

The significant weakening of federal and state aid reflected ongoing budget tightening in Congress and state legislatures. (See Figure 3.) The automatic spending cuts mandated in the deficit reduction legislation—the Budget Control Act—that Congress approved in 2011 included a decrease in aid to localities that took effect in fiscal 2012. At the same time, the federal economic stimulus, or American Recovery and Reinvestment Act, was winding down. Of the 10 big cities in Pew's analysis that separate state and federal aid in their financial statements, seven reported year-over-year reductions in federal aid in 2012, compared with only one (San Diego) in 2010 and two (Atlanta and Washington) in 2011.[12] In New York, intergovernmental aid fell by more than $2 billion between 2010 and 2012, equivalent to about 3 percent of the city's $70 billion budget. The decline in Phoenix was even more dramatic: The $201 million loss in intergovernmental aid amounted to 10 percent of the city's total revenue in 2012. Federal aid to Washington dropped $264 million during the same two-year period.

Figure 3

Intergovernmental Revenue Helped Cities in 2009 and 2010 but Fell as Austerity Measures Took Hold

Year-over-year percent change, average across 30 cities, 2008-12



Note: Shaded area represents the period of the Great Recession as defined by the National Bureau of Economic Research.

Source: Pew's analysis of city comprehensive annual financial reports

The delayed impact of property tax declines and the falloff in federal and state aid had outsize effects on many cities in 2012. Atlanta's property tax collections fell by 12 percent, accounting for more than two-thirds of the city's total revenue losses of $57 million that year.[13] In Pittsburgh, a steep 28 percent drop in intergovernmental aid completely offset gains elsewhere and caused overall revenue to drop by $35 million, or 7 percent. Atlanta and Pittsburgh joined Chicago and Dallas as cities in Pew's analysis that surpassed their pre-downturn revenue peak in 2011 only to fall below it again in 2012.

The deterioration of property tax revenue and intergovernmental aid was so severe in 2012 that eight cities—Dallas; Detroit; Kansas City, Missouri; Las Vegas; Miami; Orlando, Florida; Phoenix; and Riverside, California—reported their lowest revenue totals of the six-year study period:

- Detroit, Las Vegas, and Riverside were particularly hard-hit, with all reporting total revenue of less than 80 percent of their prerecession peak.
- Miami, which felt the drop in Florida home values most acutely of the state's big cities, was the only one among the 30 to have lost revenue each of the past five years; its annual receipts fell to 88 percent of their 2007 high point.
- The decline in Riverside's home prices was more severe than in the rest of California, as was the jobless rate, which together explain why revenue nosedived in the mostly residential city.
- In Dallas, Orlando, and Phoenix, the losses in both property tax receipts and intergovernmental aid offset the gains the cities made in other revenue.

But property taxes and intergovernmental revenue were not the only drivers of financial weakness in cities. Kansas City faced a fifth straight no-growth budget for the fiscal year that began May 1, 2012. The city's largest general revenue source is not property taxes but a 1 percent earnings tax on wages and salaries of people who live or work in Kansas City. Voters must approve the tax every five years, which creates perpetual revenue uncertainty. "We walk on [a] razor's edge to make sure we don't lose 40 percent of our revenue every five years," said City Manager Troy M. Schulte.[14]

> "The deterioration of property tax revenue and intergovernmental aid was so severe in 2012 that eight cities reported their lowest revenue totals of the six-year period."

Not all cities struggled to the same extent in 2012. Some saw positive signs as revenue improved. A third of the 30 cities topped their prerecession peak revenue. Five cities—Boston, Cincinnati, Minneapolis, New York, and Seattle—reached that benchmark in 2012, and five—Portland, Oregon; San Antonio; San Francisco; St. Louis; and Washington—attained it by 2011 and remained above it in 2012, though Portland, San Antonio, and St. Louis experienced slight declines between 2011 and 2012. Despite this improvement, however, a recovery to prerecession levels did not necessarily portend a sustained economic recovery. For example, four cities—Atlanta, Chicago, Dallas, and Pittsburgh—that had surpassed their pre-downturn revenue peak in 2011 fell below that level again in 2012, with the declines driven largely by losses in property tax revenue and state and federal aid.

Where revenue rebounded above pre-downturn peaks, it did so in part due to growth in the local economies. Boston and Minneapolis, for example, hit their six-year revenue low points in 2011 but rebounded quickly in 2012. Boston, which did not experience the serious fiscal stress that dogged other cities, had the highest year-over-year revenue growth, from 97 percent to 103 percent of the city's previous high point in 2009. Minneapolis benefited from growth connected to strong construction activity; city officials approved $1 billion in residential and commercial projects in 2012, the most since 2000.[15]

Other cities also saw revenue growth due to strong local economic recoveries:

- In New York, a bustling real estate market boosted property tax revenue, which—coupled with gains in sales taxes and other nontax revenue—propelled the city past its previous revenue peak.
- After losing 35,000 jobs during the recession, Seattle's economy outperformed the rest of the nation in 2012, and the city collected an additional 4 percent in property taxes. Combined with other gains in sales and business taxes and with utility rate increases, this lifted city revenue to new highs.[16]
- Unlike most other cities, Cincinnati's recovery was driven mostly through increases in intergovernmental aid in 2010 and 2012.

A common thread running through nearly all of these rebounding cities was the role that revenue from sales and income taxes and charges and fees played in supporting the recoveries. In nine of the 10 cities that surpassed their prerecession peaks—Cincinnati was the exception—the rise in revenue from sales taxes, income taxes, or charges and fees contributed to an increase in total revenue or mitigated losses from other sources.

In the cities that collect these taxes, sales tax revenue rose by an average of 4 percent between 2011 and 2012 and income tax revenue increased 3 percent. Revenue from charges and fees jumped 5 percent. Even in 14 of the

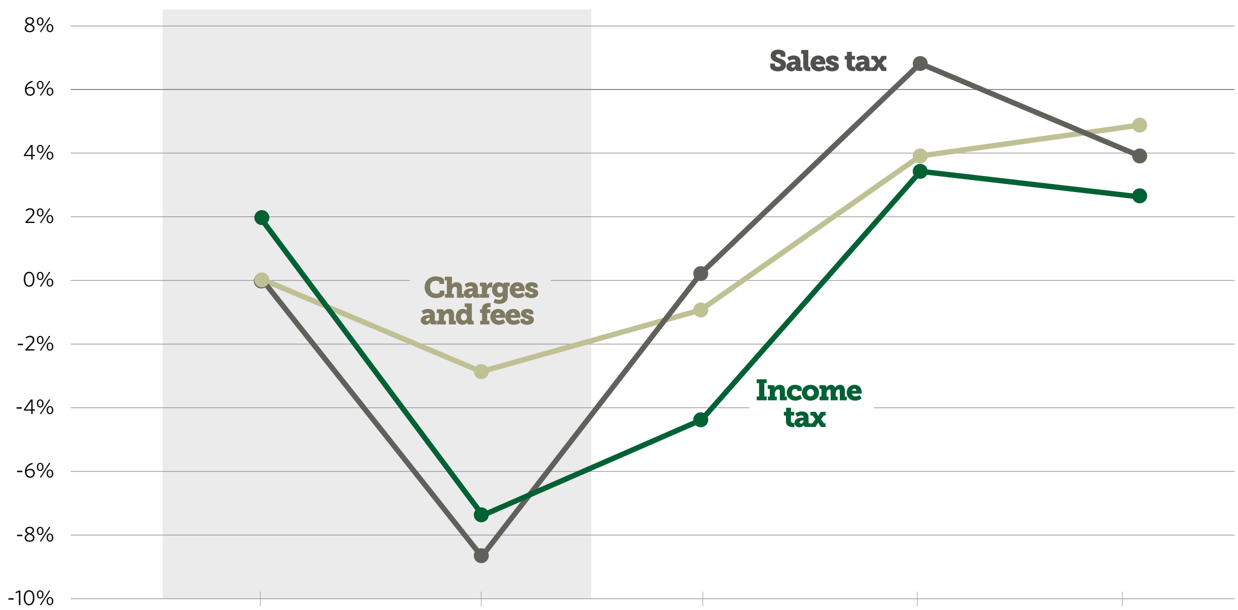
20 cities where revenue had not yet rebounded, growth in income tax, sales tax, or charges and fees offset losses in other streams. (See Figure 4.)

Despite the improvement in city economies, however, the increases in these revenue sources typically were not enough to overcome the drops in property taxes and intergovernmental aid for most cities. Additionally, not all local governments have access to these sources of revenue: Twenty of the 30 cities are authorized by their states to impose a local sales tax, and only 10 may levy a personal income tax.[17]

Figure 4

Revenue from Sales Taxes, Income Taxes, and Charges and Fees Reacts Quickly to Economic Change

Year-over-year percent change, average across 30 cities, by source, 2008-12



	2008	2009	2010	2011	2012
Sales tax	9 cities with losses	18 cities with losses	12 cities with losses	2 cities with losses	2 cities with losses
Income tax	3 cities with losses	9 cities with losses	9 cities with losses	1 city with losses	4 cities with losses
Charges/fees	16 cities with losses	22 cities with losses	17 cities with losses	11 cities with losses	10 cities with losses

Note: Shaded area represents the period of the Great Recession as defined by the National Bureau of Economic Research. Twenty of the cities studied collect a local sales tax: Atlanta, Chicago, Dallas, Denver, Houston, Kansas City, Los Angeles, Minneapolis, New York, Philadelphia, Phoenix, Pittsburgh, Riverside, Sacramento, San Antonio, San Diego, San Francisco, Seattle, St . Louis, and Washington. Ten collect a local income tax: Baltimore, Cincinnati, Cleveland, Detroit, Kansas City, New York, Philadelphia, Pittsburgh, St. Louis, and Washington. All 30 cities collect some charges and fees.

Source: Pew's analysis of city comprehensive annual financial reports

A Tale of Two Cities' Revenue

Boston's economic strengths helped it weather the recession

Boston emerged from the recession with amazing resiliency despite a heavy reliance on property taxes and intergovernmental aid, which made up 83 percent of revenue in 2012.[*] City leaders leveraged the built-in advantages that come with being a state capital; seaport; tourist destination; and center of high technology, life sciences, medicine, and higher education. In 2012, wages, home prices, property values, and construction activity in Boston rose at rates higher than the rest of the nation while unemployment fell.[†]

Unlike most of the cities in Pew's analysis, Boston recorded increases in property tax revenue each year between 2007 and 2012, reflecting a robust real estate market. This growth, combined with a substantial boost in other tax revenue due to the introduction of a local meals and hotel tax in 2009, helped carry the city through the recession relatively unscathed.[‡]

Of the five cities—the others were Cincinnati, Minneapolis, New York, and Seattle—that surpassed their previous peak revenue in 2012, Boston had the most revenue growth, from 97 percent of its 2009 peak in 2011 to 103 percent in 2012. "One of the most important things I tell people about being mayor is understanding the finances, because if your finances work, your city works," said Thomas Menino, Boston's mayor from 1993 to 2014.[§]

Las Vegas' reliance on tourism and housing amplified the downturn's effects

Las Vegas illustrated the recession's other extreme. Until the downturn, Las Vegas was one of the nation's fastest growing cities, with a sizzling housing market and plentiful construction jobs to go along with the core tourism and gaming sectors. Revenue from property, gaming, sales, motor vehicles, and tobacco climbed at an average yearly rate of 12 percent between 2002 and 2006, allowing the city to adhere to its policy of maintaining at least 12 percent of revenue in reserve.[||]

Then came the economic battering that one gaming industry consultant said hit Las Vegas with the force of a 100-year storm.[#] The housing industry collapsed, and many Americans stopped discretionary travel; those who did come to Las Vegas spent less money than in past years. Thousands of construction and leisure industry workers lost their jobs, housing values plummeted, and foreclosures spiked, forcing the city government to trim spending, cut jobs, and negotiate wage and benefit reductions with unionized workers.

The impact affected Las Vegas and the rest of Nevada well after the recession's official end in 2009. Las Vegas was one of eight cities where revenue dropped below the previous low point between 2011 and 2012.[**] By 2012, there were some signs of recovery, with slight growth in employment and tourism. But home values declined for the sixth straight year, continuing the decrease in property tax revenue.

Continued on the next page

Las Vegas has typically been one of the last cities to suffer during a downturn and one of the quickest to recover. But the effects of the Great Recession linger. Stephen Brown, director of the Center for Business and Economic Research at the University of Nevada, Las Vegas, refers to a "lost decade" of growth for the city between 2007 and 2017. "And 2017 may be optimistic," he said. "Las Vegas had been traveling on a superhighway. Now it sort of has shifted onto a secondary road, with a long way to go."

* City of Boston, Comprehensive Annual Financial Report, for the Fiscal Year Ended June 30, 2012 (2012), 68, http://www.cityofboston.gov/images_documents/CityBoston-CAFR-612_tcm3-35324.pdf. Property tax collections are such a large piece of total revenue in Boston in part because the city is one of four Pew examined that operate and finance their own school systems. As a result, Boston collects property tax levies that in many jurisdictions go to independent school boards.

† City of Boston, Comprehensive Annual Financial Report for the fiscal Year Ended June 30, 2013 (2013), iv, http://www.cityofboston.gov/images_documents/CAFR_FINAL_SECURED_tcm3-42531.pdf.

‡ "Meals & Hotel Tax Increase Approved in Boston" (Aug. 26, 2009), https://www.cityofboston.gov/news/Default.aspx?id=4330.

§ Thomas Menino (former mayor of Boston), interview by The Pew Charitable Trusts (May 2014).

|| Moody's Investor Service, "Moody's Upgrades to Aa2 from As3 the Rating on Las Vegas, Nevada's Limited Tax General Obligation Debt" (October 2007), 2.

\# Dean M. Macomber, "The Fiscal Forensics of the Las Vegas Strip: Lessons From the Financial Crisis," Center for Gaming Research, University of Nevada, Las Vegas (May 2012), http://gaming.unlv.edu/papers/cgr_op17_macomber.pdf.

** In addition to Las Vegas, the other seven cities that saw revenue drop below its previous low point in 2012 were Dallas, Detroit, Kansas City, Miami, Orlando, Phoenix, and Riverside. Las Vegas, Detroit, Riverside, and Sacramento recorded 2012 revenue of just about 75 percent of the level they had reached at their pre-downturn peak. Detroit was the lowest of the four, at 73.7 percent.

Spending cuts and cautious investments

The revenue crunch took its toll on many city services in 2012. Although some cities made strategic investments in areas such as public works and transportation, overall spending fell between 2011 and 2012 in nearly half of the 30 cities examined. Among the 17 cities where spending went up, the average increase was 2 percent—just half the average increase in those same cities between 2007 and 2008.

Half of the cities cut public safety spending, with six reporting the lowest level of spending in that category over the six-year study period, indicating that even critical services remain vulnerable. Cities confronted smaller spending pressures as well. For example, Kansas City was forced to increase its budget for mowing grass and other nuisance abatement measures stemming from the increase in foreclosures during the recession.[18]

Despite increased revenue slumps, the 30 big cities collectively did not cut spending as deeply in 2012 as they did the year before. In 2012, 13 cities cut total operating expenditures, compared with 24 cities in 2011.[19] The cuts were also not as severe overall, with average total spending across the 30 cities falling just 0.4 percent between 2011 and 2012, compared with 1.6 percent the previous year.

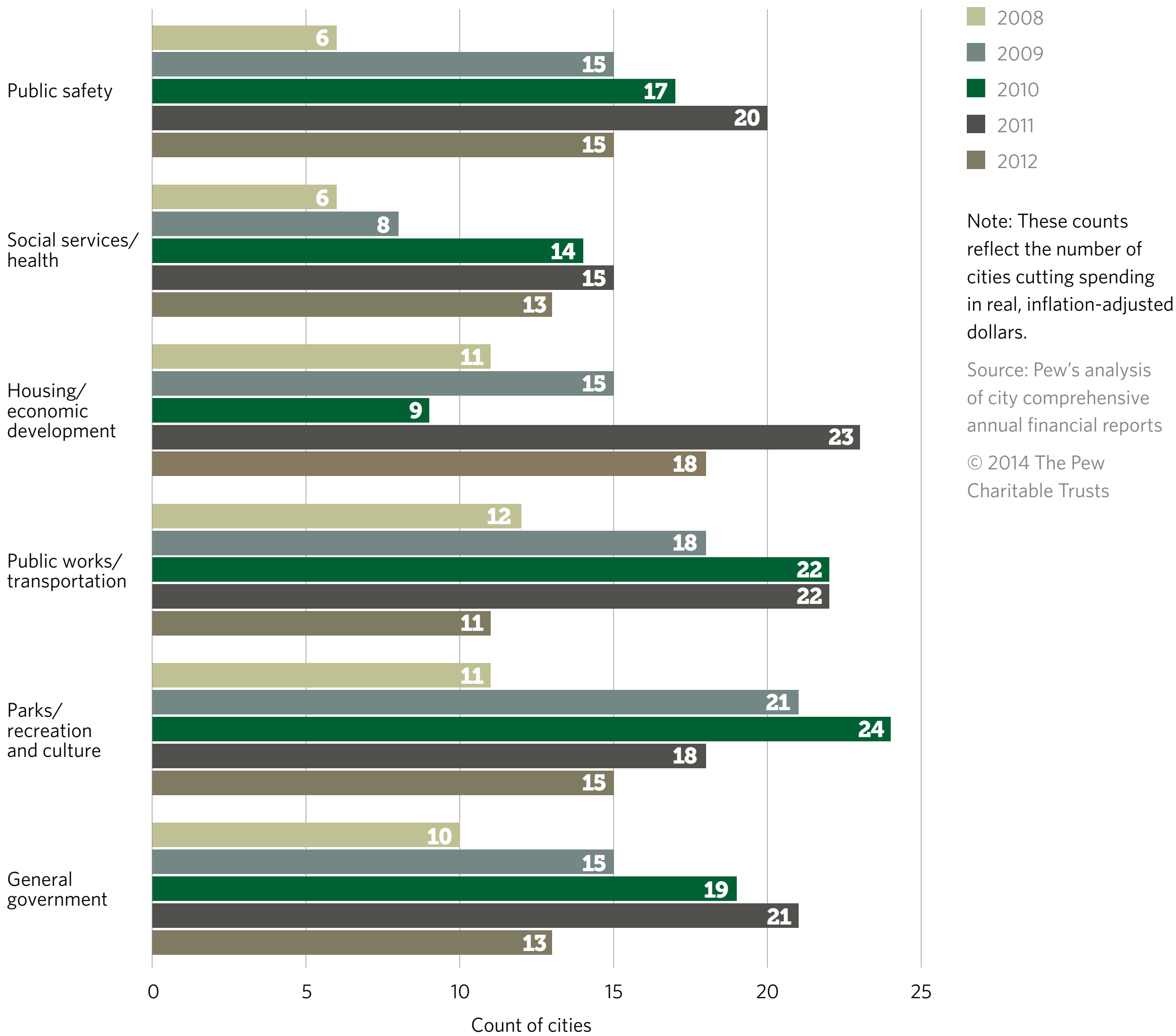
Among the 13 cities that did cut total spending, however, the reductions were generally deep. Eight reduced spending to six-year lows: Cleveland; Dallas; Detroit; Miami; Orlando; Phoenix; Pittsburgh; and Sacramento, California. Perhaps not surprisingly, this group included four of the eight cities that recorded six-year revenue lows as well.[20] Local priorities and financial conditions influenced cities' spending choices, and as a result, some continued cutting core services while others made strategic investments and began to grow city budgets.

Public safety, often the largest category of spending and one of the cities' most critical functions, was a prime example of this variation.[21] Fifteen cities cut public safety costs in 2012, with six of those experiencing the largest year-over-year drops in that category since before the recession began.[22] (See Figure 5.) Some cities also spent less on public safety in 2012 than in any previous year since the recession began—in Cincinnati, Cleveland, Las Vegas, Miami, Sacramento, and San Diego, public safety spending was the lowest over the six-year period.

Figure 5

Some Cities Rolled Back Spending Cuts in Major Categories in 2012

Number of cities cutting specific spending categories, 2008-12



Note: These counts reflect the number of cities cutting spending in real, inflation-adjusted dollars.

Source: Pew's analysis of city comprehensive annual financial reports

Miami's public safety spending fell after the city negotiated a series of wage and benefit reductions with its police and fire unions.[23] Las Vegas saved money through police and fire job cuts, pay reductions, higher health contributions, and making public safety personnel cover the cleaning costs of their uniforms.[24] Sacramento cut 167 positions in its police department and 49 firefighter jobs to close a budget gap.[25]

By contrast, Chicago; Kansas City; San Antonio; San Francisco; and Tampa, Florida; all spent more money on public safety in 2012 than at any time during the six years studied. These increases occurred even as revenue in three of these cities—Chicago, Kansas City, and Tampa—remained below prerecession levels.

> "Half of the cities cut public safety spending, with seven reporting the lowest level of spending in that category over the six-year study period, indicating that even critical services remain vulnerable."

Helped by voter approval of a sales tax increase to fund public safety, Kansas City spent a rising share of its budget—nearly 60 percent—on police and fire protection, including filling about 40 vacant police officer jobs.[26] Personnel costs also rose in Chicago, where police and firefighter unions are the largest of 40 with collective bargaining agreements.[27]

The same pattern surfaced for spending on other core city functions, including housing and economic development, social services and health, parks, recreation, and cultural activities, as well as administrative services.

For example, 18 of the 30 cities reduced spending on housing and economic development in 2012, down from 23 cities in 2011. Denver, Detroit, Houston, and Pittsburgh shaved the most off these programs. In Pittsburgh, spending fell by 60 percent, from $15 million to $6 million. But Portland, San Antonio, San Diego, Seattle, and St. Louis, among others, increased year-over-year housing and economic development expenditures. San Antonio and San Diego made particularly large investments in these areas, increasing spending threefold—from $38 million to $131 million—and more than doubling it—from $91 million to $221 million—respectively.

Compared with 2011, fewer cities cut 2012 spending on social services and health; parks, recreation, and cultural activities; and general government administrative services. Seattle restored money for human services programs, including assistance to homeless families and low-income mothers and medical and dental care for uninsured residents.[28]

Among the cities that decreased spending in some or all of these core areas, most cuts in 2012 brought spending to its lowest level for the six years of the study. In social services and health, 10 of the 13 cities that cut spending reached six-year lows. In parks and recreation, the data show 12 of the 15 cities that reduced funding reported lows for the 2007-12 period. In general government, eight of the 13 cities that decreased spending reached lows.

One notable difference was in public works and transportation spending. Between 2011 and 2012, spending in this category rose 3.6 percent across the 30 cities after dropping more than 7 percent on average the previous year. Atlanta, Cleveland, Denver, Kansas City, Riverside, and San Diego led the way, increasing public works and transportation spending by more than 10 percent. Overall, only 11 cities cut spending in this category in 2012, half the number from the year before.

- Atlanta geared up for a federal-city project to build a downtown streetcar line.[29]
- Denver boosted public works spending to support construction of a regional rail-bus system.[30]
- San Diego began addressing a nearly $900 million backlog of street and storm drain maintenance projects.[31]
- Kansas City raised its spending on maintenance projects, largely because a portion of its sales tax was dedicated for capital improvements.[32]

Still, officials in many cities lamented that sluggish revenue prevented them from fully addressing accumulating infrastructure needs.

Signs of a turnaround were evident in some cities that managed to restore spending cuts from previous years, especially in personnel. After eliminating 400 jobs between 2008 and 2011, Orlando avoided another round of cuts in 2012, though employees gave up pay increases.[33] Atlanta provided funding to add 100 police officers.[34] Phoenix extended hours and services at libraries, parks, pools, and senior centers for the first time in five years.[35] New York preserved 20 firehouses that were scheduled to close.[36] Las Vegas reinstated weekend cleanup crews at city parks.[37]

City officials also sought to save money by improving efficiency in 2012. Cincinnati closed nineteen pools after concluding it had too many for a city its size and reduced maintenance on some parks, saving the city $2 million.[38] Seattle scrapped plans to build its own jail and instead contracted with King County to house its inmates—saving $6 million a year.[39] Chicago's fire department moved from rented offices into police headquarters, saving on rent.[40]

Most cities also examined new approaches to curb rising public pension costs. Minneapolis' police and fire pension funds merged with the state fund, cutting $20 million from the city's pension obligations.[41] Atlanta officials approved a major overhaul that eliminated fixed pension payments for new hires, providing them with a 401(k)-style plan instead.[42]

The focus on public pension costs in 2012 underscored a broader worry among city officials about meeting long-term obligations, a concern that worsened due to unprecedented investment losses during the recession. Historically, many cities have underfunded these obligations, relying on employee contributions and investment returns to support their pension systems. As aging workers retire later and live longer, those contributions have been going up, but typically not as fast as liabilities. Coming out of the downturn, the 30 cities collectively faced $225 billion in unfunded liabilities for public pension and other retirement benefits, mostly health care.[43]

Seattle's experience was typical of many big cities. When 2008 began, the city had a manageable $30 million in unfunded public pension liabilities. Two years later that had grown to $1.4 billion because of a 30 percent market loss in assets during the recession. In response, officials increased the city- and employee-contribution rates from a combined 16 percent in 2010 to 21 percent in 2012.[44] In 2014, the combined rate jumped to 24 percent, or about $22 million more each year in contributions compared with the additional $10 million the city and employees had to come up with in 2010 as a result of the previous contribution rate hike.[45]

Double-digit investment gains in 2013 helped ease the burden on many city pension funds, but the challenge of paying for retirement benefits continues. Chicago's current $32 billion unfunded pension liability is five times its governmental revenue—tops among the cities examined—but the city is taking steps to reduce that obligation.[46] The biggest cost increase in Houston's proposed 2015 budget is a 21 percent rise in the city's public pension contributions—more than what the city spends on libraries, parks, trash, and courts, combined.[47]

Detroit's Finances in 2012: A Sign of Future Trouble

In a year when most big cities suffered budget turmoil, Detroit's experience stood out for its historic severity. The city was not taking in enough money to cover expenses. Between 2007 and 2012, three of the city's largest revenue sources declined precipitously. The largest source—state aid—fell 39 percent.[*] Property tax and income tax revenue dropped by 22 percent and 23 percent, respectively. Detroit's public pension system was only 9.2 percent funded as of 2012, compared with the 80 percent level analysts often use as the benchmark of a sustainable system.[†] Years of borrowing to plug deficits and pay pension contributions were taking their toll; as of June 30, 2012, the city's long-term liabilities exceeded $14 billion.[‡]

City officials tried to cut costs. The two areas where spending fell the most between 2007 and 2012 were public works and transportation (56 percent) and general government (47 percent). The reductions were visible throughout Detroit, as the city did not pick up trash as frequently as in the past and stopped replacing many broken streetlights. In 2007, the city had 217 employees in the public lighting division; in 2012, just 103. At the same time, the city made smaller cuts to public safety—Detroit's top priority and largest budget expense—reflecting a need to protect residents as blight plagued many neighborhoods. Officials reduced public safety spending by only 5 percent over the six years studied.

Despite the cost-cutting, the budget gap lingered into 2012 without an obvious remedy. Detroit's jobless rate (18 percent) was higher than the national average, and its population had fallen 28 percent since 2000, the largest percentage decline for the city since the 1910 census.[§] Significantly, the taxable assessed value of real property in Detroit declined from $10.8 billion in 2007 to $8.5 billion in 2012. This 21 percent decrease made it difficult for the city to strengthen its tax revenue and recover from its financial crisis. There were no emergency reserves to tap.

By the end of 2012, as the city was sliding toward insolvency, Michigan officials dispatched a financial review team to Detroit. Concluding that the city had no plan to correct its finances, the team set in motion a series of events that eventually led to Governor Rick Snyder appointing an emergency manager to run the city, which later filed the largest municipal bankruptcy in U.S. history in July 2013. State and city officials had set a goal to exit bankruptcy by mid-October 2014, but getting approval for a proposed $1.5 billion recovery plan to stabilize services has been difficult. On November 7, 2014, federal Judge Steven Rhodes approved Detroit's plan to exit Chapter 9 bankruptcy.[||]

"All major systems are broken," said John Hill, Detroit's chief financial officer. Hill, who ran the control board that rescued Washington, from a similar crisis in the late 1990s, stressed that the hardest task going forward will be determining what businesses will drive Detroit's economy in the future and what governing structure will oversee the city's recovery. "The post-bankruptcy

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structure is critical, but it is uncertain now," he said in April 2014. "No one wants to get out of bankruptcy and get right back in there."#

* Much of the drop in state aid occurred because the state withheld revenue-sharing payments when Detroit did not reduce income tax rates as required.

† U.S. Bankruptcy Court, Eastern District of Michigan, Southeast Division, "Disclosure Statement With Respect to Plan for the Adjustment of Debts of the City of Detroit" (February 2014), 19, http://www.detroitmi.gov/Portals/0/docs/EM/Bankruptcy%20Information/Disclosure%20Statement%20_Plan%20for%20the%20Adjustment%20of%20Debts%20of%20the%20City%20of%20Detroit.pdf.

‡ John Hill, "Recovery Process for Two Financially Distressed Cities," chief financial officer, city of Detroit (slide presentation at the Federal Reserve Bank of Chicago, April 2014), http://www.civicfed.org/sites/default/files/J.%20Hill%20PowerPoint.pdf.

§ Kevyn D. Orr, "Financial and Operating Plan" (June 10, 2013), 2–3. http://www.detroitmi.gov/Portals/0/docs/EM/Reports/6_10_13%20Community%20Mtg%20_Financial%20and%20Operating%20Plan%20Slides.pdf; Moody's Investors Service, "Detroit's Precipitous Population Decline Intensifies City's Credit Problems," comment (March 2011), 1.

|| Nathan Bomey, Matt Helms, and Joe Guillen, "Judge Deems Detroit Bankruptcy Fair and Feasible," Detroit Free Press, Nov. 7, 2014, http://www.freep.com/story/news/local/detroit-bankruptcy/2014/11/07/rhodes-bankruptcy-decision/18648093.

\# John Hill (chief financial officer, city of Detroit), interview by The Pew Charitable Trusts (April 2014); and keynote speech to Civic Federation of Chicago-Federal Reserve Bank of Chicago conference on distressed cities (April 2014).

Replenished reserves still fall short of prerecession peaks

Cities began modest efforts to rebuild depleted reserves in 2012.[48] Eighteen of the 30 big cities increased their unreserved general fund balances between 2011 and 2012, compared with 10 between 2010 and 2011.[49] Still, when comparing 2012 reserve fund levels with those from 2007, 20 cities' reserves were still below previous levels, 10 by more than 5 percent. Further, the average reserve fund level across the 30 cities in 2012 was 13 percent of general fund revenue, well below the 18 percent average before the recession. The Government Finance Officers Association, a nonprofit representing public finance professionals, recommends a baseline of at least two months of general fund revenue, or about 16 percent.[50]

Cities' ending balances differ from states' so-called rainy day funds. "Rainy day funds almost always require a 'trigger' to release those funds, while reserve funds can be moved more easily unless they were dedicated for a specific project," said Michael A. Pagano, dean of the College of Urban Planning and Public Affairs at the University of Illinois, Chicago. But cities transfer their ending balances forward to the next fiscal year, which often increases reserves, according to Pagano. He also explained that in addition to building up balances for unexpected events, cities have developed a sophisticated system of creating reserves for planned events such as capital improvement projects and that federal and state budget cuts are forcing cities to become more self-reliant; healthy reserves help with that.[51] One consideration state and local policymakers share, however, is the impact of reserves on bond ratings.[52]

Foreshadowing the crisis that led to its bankruptcy filing, Detroit's reserves plummeted from minus-16 percent in 2011 to minus-30 percent in 2012 as the city repeatedly transferred money from other funds to the general fund to plug budget gaps. In contrast, Tampa's drop was larger, with reserve funds falling 15 percentage points between 2011 and 2012, but unlike Detroit, Tampa did not have to backstop its finances by pulling in money from other funds, so the overall fiscal impact was less severe. In fact, Tampa began 2011 with 44 percent of its general fund in savings, so its fall in 2012 to 29 percent was still significantly above the 30-city average of 13 percent. Phoenix managed to set aside only 3.7 percent of its general fund in reserves in 2012, short of the 5 percent goal officials had set in 2010.[53]

The 18 cities that improved their reserves increased savings to an average of 14 percent. Orlando reported the largest funding level—40 percent of the general fund in 2012, up 1 percentage point from the previous year—despite using a portion to plug a budget shortfall. Baltimore had the largest year-over-year increase in reserves, up from 7 percent in 2011 to 16 percent in 2012.

Conclusion

The effects of the weak national recovery lingered into 2012 as most big cities coped with revenue and spending challenges. Pew's analysis found that the majority of the 30 big cities studied continued to struggle three years after the official end of the Great Recession. Although these major cities may continue to face challenges, an improving housing market, rising consumer confidence, declining unemployment, and wage growth could translate into a rise in tax revenue. On the downside, however, escalating costs of public employee retirement benefits, further federal budget cuts, and state-level austerity pose fiscal risks to cities, which local leaders may be coping with for some time.

Endnotes

1 Pew examined fiscal data collected from the audited financial statements of the central city in each of the nation's 30 largest metro areas according to the 2010 decennial census. For more information, see the full methodology at http://www.pewtrusts.org/cities-methodology-2014.

2 Michael A. Pagano and Christiana McFarland, "City Fiscal Conditions in 2013," National League of Cities (October 2013), http://www.nlc.org/Documents/Find%20City%20Solutions/Research%20Innovation/Finance/Final_CFC2013.pdf. While the lag between city finances and market conditions can range from 18 months to several years, an 18- to 24-month lag is probably typical for most localities.

3 Janet Yellen, "What the Federal Reserve Is Doing to Promote a Stronger Job Market" (speech to the National Interagency Community Reinvestment Conference in Chicago, March 31, 2014), http://www.federalreserve.gov/newsevents/speech/yellen20140331a.htm.

4 These include licenses and permits; charges for services; and fines, penalties, and forfeitures.

5 City of Cincinnati, *2012 Recommended Budget Update: City Manager's Message* (2012), 1, http://www.cincinnati-oh.gov/finance/linkservid/E804A735-A694-C8B6-C5EF4C4FA13F7607/showMeta/0.

6 The eight cities are Dallas, Detroit, Kansas City, Las Vegas, Miami, Orlando, Phoenix, and Riverside. Dallas is unique among these cities. Its revenue surpassed its prerecession peak in 2011 only to fall a year later to its lowest point since 2007. Unlike many of the other cities hitting six-year revenue low points, Dallas' decline was also moderate, just 3.6 percent below its 2011 high.

7 The five cities that surpassed their prerecession revenue peak for the first time in 2012 are Boston, Cincinnati, Minneapolis, New York, and Seattle. Of the nine cities that were above peak in 2011, Portland, San Antonio, San Francisco, St. Louis, and Washington remained there in 2012.

8 The four cities that previously surpassed their prerecession revenue peak in 2011 only to fall back below it in 2012 are Atlanta, Chicago, Dallas, and Pittsburgh.

9 Amy Laskey (Fitch Ratings), interview by The Pew Charitable Trusts, July 2014.

10 During the study period, the 2009 American Recovery and Reinvestment Act, also known as the stimulus, provided aid to state and local governments. Based on the cities' own financial reports, it is difficult to isolate how the amount and timing of stimulus funds provided directly to local governments influenced revenue performance as compared with aid from states.

11 City of Miami, *Comprehensive Annual Financial Report for the Fiscal Year Ended September 30, 2011* (2012), 51, http://www.miamigov.com/finance/CAFR/2011%20CAFR_w_EY%20Opinion_v1_5-18-12.pdf.

12 The 10 cities that separate state and federal aid are Atlanta, Baltimore, Cincinnati, Cleveland, Detroit, Phoenix, San Diego, San Francisco, Tampa, and Washington. Of these, Atlanta, Baltimore, Detroit, Phoenix, San Diego, San Francisco, and Washington reported reductions in revenue in 2012.

13 Atlanta's declines in valuation were exacerbated by a 2009 law establishing a three-year moratorium on growth of real property that allowed assessed values to decline, and another law requiring foreclosures to be counted as fair market sales for property reappraisals.

14 Troy M. Schulte (city manager of Kansas City), interview by The Pew Charitable Trusts, June 2014.

15 Janet Moore, "With $1B in Projects, Building Is Booming in Minneapolis," *Minneapolis Star-Tribune*, Dec. 4, 2012, http://www.startribune.com/local/minneapolis/181939101.html.

16 Mike McGinn, "State of the City Address 2012" (Feb. 21, 2012), http://mayormcginn.seattle.gov/2012-state-of-the-city-address.

17 The cities that may impose a local sales tax are Atlanta, Chicago, Dallas, Denver, Houston, Kansas City, Los Angeles, Minneapolis, New York, Philadelphia, Phoenix, Pittsburgh, Riverside, Sacramento, San Antonio, San Diego, San Francisco, Seattle, St. Louis, and Washington. Las Vegas, Miami, Orlando, and Tampa have a local sales tax, but the receipts are collected by the state and sent back to local governments. The cities that states allow to levy a local personal income tax are Baltimore, Cincinnati, Cleveland, Detroit, Kansas City, New York, Philadelphia, Pittsburgh, St. Louis, and Washington.

18 City of Kansas City, *Adopted Activity Budget FY 2011–12*, transmittal letter from Troy M. Schulte, interim city manager, p. 3 (Feb. 2011), https://data.kcmo.org/Budget/Adopted-Activity-Budget-FY2011-12/pgyj-vy9g.

19 Operating expenditures refers to a city's total governmental expenditures minus the portion spent on capital outlays. See the full methodology at http://www.pewtrusts.org/cities-methodology-2014.

20 Detroit, Miami, Orlando, and Phoenix.

21 Public safety generally includes police and fire and occasionally courts and jails (for combined city-counties).

22 The 15 cities that cut public safety spending were Cincinnati, Cleveland, Dallas, Detroit, Houston, Las Vegas, Miami, Minneapolis, New York, Orlando, Phoenix, Pittsburgh, Sacramento, San Diego, and Washington. Among those, Detroit, Houston, Minneapolis, New York, Orlando, and Washington saw their largest year-over-year drops of the six-year study period.

23 City of Miami, *Comprehensive Annual Financial Report for the Fiscal Year Ended September 30, 2011*, (2012), 9, http://www.miamigov.com/Finance/CAFR/2011%20CAFR_w_EY%20Opinion_v1_5-18-12.pdf.

24 Moody's Investors Service, "Moody's Assigns Aa2 Rating on City of Las Vegas" (April 2012), 3.

25 City of Sacramento, *Approved Budget Fiscal Year 2011/2012* (2011), 210, 227, http://portal.cityofsacramento.org/Finance/Budget/Documents/2011-12Budget.

26 City of Kansas City, *Adopted Activity Budget FY 2011–12*, 4.

27 City of Chicago, *2013 Annual Financial Analysis* (2013), 42, http://www.cityofchicago.org/content/dam/city/depts/obm/supp_info/2013%20Budget/62689_3_AFA%202013_Revised_Book.pdf.

28 City of Seattle, *2012 Adopted Budget* (2011), 15, http://www.seattle.gov/financedepartment/12adoptedbudget/documents/2012AdoptedBudget_002.pdf.

29 City of Atlanta, "Mayor Reed, Transportation Secretary LaHood Launch Atlanta Streetcar Construction," news release (Feb. 1, 2012), http://www.atlantaga.gov/index.aspx?page=672&recordid=681.

30 City and County of Denver, *Mayor's 2013 Budget: Vol. 1* (2012), 205, http://www.denvergov.org/LinkClick.aspx?fileticket=iHxB6bX_qbE%3d&tabid=442869&mid=517003.

31 City of San Diego, *Comprehensive Annual Financial Report: Fiscal Year Ended June 30, 2012* (2012), 16, http://www.sandiego.gov/comptroller/pdf/reports/121214cafr2012.pdf.

32 City of Kansas City, *Adopted Activity Budget FY 2011–12*, transmittal letter, p. 3.

33 City of Orlando, *Annual Budget 2011/2012: Chief Financial Officer Letter* (October 2011), 4, http://www.cityoforlando.net/obfs/wp-content/uploads/sites/23/2014/03/b2011-12.pdf.

34 City of Atlanta, *Fiscal Year 2012 Adopted Budget* (2011), 1-1, http://www.atlantaga.gov/modules/showdocument.aspx?documentid=2613.

35 City of Phoenix, "Mayor Greg Stanton's State of the City Address" (April 11, 2012), http://archive.azcentral.com/ic/community/pdf/stantonspeech.pdf.

36 Henry Goldman, "New York City Council Approves $66 Billion 2012 Budget Restoring Teachers," *Bloomberg* (June 29, 2011), http://www.bloomberg.com/news/2011-06-29/new-york-city-council-approves-66-billion-2012-budget-restoring-some-cuts.html.

37 City of Las Vegas, *FY 2013 Final Budget: Final Budget Message* (May 2012), 2, http://www.lasvegasnevada.gov/files/CLV_2013.pdf.

38 City of Cincinnati, *Approved 2011/2012 Biennial Budget* (2010), 17, http://www.cincinnati-oh.gov/finance/linkservid/E7F30C36-F410-39AA-B2CE4F3C28558415/showMeta/0/.

39 City of Seattle, *2012 Adopted Budget,* 22.

40 City of Chicago, *Comprehensive Annual Financial Report for the Year Ended December 31, 2012* (2013), 10, http://www.cityofchicago.org/content/dam/city/depts/fin/supp_info/CAFR/2012/CAFR_2012.pdf.

41 City of Minneapolis, *2012 Council Adopted Budget: Section 01—Introduction* (2011), 1, http://www.ci.minneapolis.mn.us/finance/budget/WCMS1Q-068777#P6_512.

42 Moody's Investors Service, "Moody's affirms Aa2 rating on the City of Atlanta's outstanding general obligation debt" (June 2012).

43 All 30 cities keep pension funds separate from day-to-day operating expenses but still are required to pay annual contributions to the pension system out of the general fund. The $225 billion represents the combined unpaid commitments for retiree pensions ($121 billion) and retiree health care ($104 billion) for the 30 cities as of 2010. For a more lengthy discussion of the funding status of the 30 city pension plans, please see two previous Pew reports, "America's Big Cities in Volatile Times" http://www.pewtrusts.org/en/research-and-analysis/reports/2013/11/11/americas-big-cities-in-volatile-times and "Cities Squeezed by Pension and Retiree Health Care Shortfalls" http://www.pewtrusts.org/en/research-and-analysis/reports/0001/01/01/cities-squeezed-by-pension-and-retiree-health-care-shortfalls.

44 Of covered salaries.

45 Seattle City Council, *Options for a Sustainable Retirement Benefit* (April 2012): 7, 20, http://www.seattle.gov/council/burgess/attachments/201204retire_idt_report.pdf; City of Seattle, *2013–2014 Proposed Budget* (2013), 503, http://www.seattle.gov/financedepartment/13proposedbudget/documents/20132014ProposedBudget_Se28_230pmwithBookmarks.pdf.

46 The Civic Federation, *Status of Local Pension Funding Fiscal Year 2011* (May 2013), http://www.civicfed.org/civic-federation/publications/status-local-pension-funding-fy2011.

47 Mike Morris, "Houston's Budget Picture Growing Bleak," *Houston Chronicle,* May 27, 2014, http://www.houstonchronicle.com/news/houston-texas/houston/article/Houston-s-budget-picture-growing-bleak-5508205.php.

48 For most cities, reserves consist of the general fund balances that can be used to buffer economic shocks and manage risk.

49 This report measures each city's unreserved general fund balance as the sum of the assigned and unassigned portions, as defined by the Governmental Accounting Standards Board (GASB), Statement No. 54, and as the unreserved portion as defined by GASB before Statement No. 54 went into effect. See the full methodology at http://www.pewtrusts.org/cities-methodology-2014. City reserves typically are a percentage of general fund ending balances. Like state rainy day funds, city reserves help manage budget volatility. Unlike states, many cities do not have formal policies or triggers specifying when officials can tap those reserves.

50 Government Finance Officers Association, "Determining the Appropriate Level of Unrestricted Fund Balance in the General Fund" (2009), http://www.gfoa.org/determining-appropriate-level-unrestricted-fund-balance-general-fund.

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52 Jane Hudson Ridley, Rich Raphael, and Robert Kurtter, "Rating Agencies: How New Evaluation Criteria Could Impact Your Rating" (presentation at annual conference of Government Finance Officers Association, May 2014), http://www.gfoa.org/sites/default/files/Rating%20Agencies.pdf.

53 City of Phoenix, "General Budget and Financial Policies," 76, https://www.phoenix.gov/budgetsite/Documents/17summary201314.pdf.

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