Municipal Fiscal Health
Observations from the U.S.
Bogota, November 2014
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TITLE PAGE
My goals today

• Describe the Lincoln Institute’s plans for engagement with the topic of MFH
  – Research using FiSC database
  – Engaging others with similar interests in US, LAC, China
  – Global conference (2016?)

• Recognize/name the challenges of municipal fiscal health

• Discuss current fiscal health of US municipalities
Figure 0.1: A framework of rules: Planning, connecting, and financing

**Plan**
- Value land use through transparent assessment
- Coordinate land use with infrastructure, natural resources, and hazard risk
- Leverage competitive markets alongside regulation to expand basic services

**Connect**
- Value the city’s external and internal connections
- Coordinate among transport options and with land use
- Leverage investments that will generate the largest returns—individually and collectively

**Finance**
- Value and develop the city’s creditworthiness
- Coordinate public-private finance using clear, consistent rules
- Leverage existing assets to develop new ones, and link both to land use planning

Source: Urbanization Review team.
Note: This framework draws on World Bank (2012a) and the findings from various country pilots under the Urbanization Reviews.
In theory, theory and practice are the same. In practice, they aren’t (Berra)

- In theory, municipal fiscal health is simple:
  - Raise sufficient revenue to meet expenses
- In practice, fiscal health of municipalities is more challenging because of many dynamic factors outside of municipal control
  - Macro-economic changes
  - Economic transition
  - Demographics
  - Poor planning
  - Multiyear/cyclical challenges (capital budgeting, infrastructure)
FIGURE 12

Annual Chapter 9 filings by municipalities

Filings

* through May 7, 2010
Source: James E. Spotts, Chapman & Cutler LLP
**FIGURE 6:** Factors with *Most* Positive and Negative Impacts.

(Percent of city finance officers listing item as one of three most impactful factors on budget)

<table>
<thead>
<tr>
<th>MOST NEGATIVE IMPACT</th>
<th>MOST POSITIVE IMPACT</th>
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<tbody>
<tr>
<td>Infrastructure needs</td>
<td>Health of local economy</td>
</tr>
<tr>
<td>Cost of employee/retiree health benefits</td>
<td>Value of city tax base</td>
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<tr>
<td>Cost of employee/retiree pensions</td>
<td>Population</td>
</tr>
<tr>
<td>Employee wages and salaries</td>
<td>Amount of state aid to city</td>
</tr>
<tr>
<td>Public safety needs</td>
<td>Amount of federal aid to city</td>
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What are the macro factors?

• National economy
  – Employment
  – Housing markets
  – Interest rates
  – Trade/Exchange rates
  – Shifting politics

• Regional economy
  – Industrial transition
  – Demand for key commodities
  – Climate
THE LAG

- The gap between when macroeconomic conditions change and when those conditions have an impact on reported city revenue collections
- The lag ranges 18 months to several years, related to:
  - Timing of property tax collections
  - Frequency of reassessment
  - Sales and income tax collections & administration issues
  - Debt structure
FIGURE 2: Year-to-Year Change in General Fund Revenues and Expenditures (Constant Dollars).
Demographics

• Population growth/loss
• Population movements
  – Immigration
  – Local Outmigration
  – Distant Outmigration
  – Adverse selection
• Age structure of population
Economic Transition

- Industrialization/Deindustrialization
- Loss of major employer
- Changes in extractive industries
- Energy
- Competition with other municipalities over large businesses
Economic Restructuring

- US Job creation: among the 30 occupations expected to have the largest employment growth during this decade, 23 require a high school diploma or less.
- Occupations with the largest projected growth in next decade (US BLS): retail sales, home health aides, food prep and food service, landscaping/groundskeeping, security guards, and child care.
- Jobs are low-wage, have irregular and erratic hours, few employment benefits, and limited advancement possibilities.
Fiscal/Economic Factors

- Changes in public revenue schemes
  - Revenue sharing from nat’l government
  - Revenue sharing from state/provincial gov’ts
- Partially funded nat’l programs
- Unfunded mandates
  - Water/wastewater
  - Social/affordable housing
- Interest rates
- (Dis)economies of scale and collective action problem
FIGURE 3: Year-to-Year Change in General Fund Tax Receipts (Constant Dollars).
NLC: key concerns of US city leaders

- the fast growth of low wage jobs
- real estate market strength--new housing starts; increased numbers of renters
- internet commerce and the emergence of disruptive, Internet-based businesses
- vulnerability to external policy shifts, federal and state cuts to aid, global instability
- main issues: providing services, investing in infrastructure; meeting the health, safety and welfare requirements of their residents, taxpayers, workers and visitors.
Application to other jurisdictions

What are the right indicators of that one can rely on to measure the fiscal health of a municipality?

Given an indicator level, what strategy would one implement to address fiscal stress? When should you act? How does one build political will to address local fiscal issues?
FIGURE 7: City Revenue Actions in 2014.
FIGURE 8: City Expenditure Actions in 2014.
Recommendations (Milken)

- adopt standardized actuarial assumptions, similar to corporate standards
- implement multi-year budgeting plans/rainy-day funds
- assess possible economies of scale from shared services/consolidation
- convene key stakeholders to find ways to make fiscal adjustments to ensure long-run solvency
- establish control boards as a last resort for municipalities in extreme distress
- provide short-term federal aid to municipalities that implement steps to restructure finances
FIGURE 10: Ending Balances as a Percentage of Expenditures (General Fund).
Insolvency & Pensions

• In a study of city fiscal problems, Boston College researchers found that fiscal mismanagement (32 percent) and economic issues (28 percent) were the top two factors leading to financial problems.
• Pensions were a factor for 9 percent of the cities.
• On average, the portion of combined state and local government spending dedicated to retirement system contributions is less than five percent.