Fiscal Challenges for Oregon's Cities

Summary

Oregon's cities are home to 70 percent of the state's population and 80 percent of its jobs. Municipal governments provide core services—including public safety and infrastructure—that citizens and businesses value and that support economic growth.

The past two decades presented unprecedented challenges to cities' abilities to pay for these services. Property tax limitations, which were adopted during the 1990s, abruptly reduced cities' main source of revenue for core services such as public safety. In fact, some Oregon cities now spend more on public safety than they receive in property tax. Then, as cities were still adjusting to those limitations, Oregon entered a prolonged economic downturn in the late 1990s—punctuated by two recessions. Subpar growth in personal income indirectly slowed property tax receipts.

Today, as Oregon's economy slowly recovers, cities find themselves on the doorstep of yet another decade of challenges. Pension and health care costs for municipal workers are expected to continue to outpace the growth of property taxes and the economy as a whole. Personnel costs have a substantial impact on municipal finance because city services are highly labor intensive. These trends are not unique to Oregon cities and will be a common challenge for mayors and city councils across the country. But with Oregon's property taxes locked into fixed annual rates of growth, accelerated growth in compensation will be especially difficult to manage here.

Limits on property taxes and rising compensation costs pose formidable challenges for cities' general funds, but those are not the only problems. Street fund revenues have lagged behind growth in incomes and the overall economy, making it difficult to maintain Oregon's transportation system. Cities have struggled to keep up with the demand for capital expenditures, and construction costs are increasing at an above-average rate. Oregon cities do not have sufficient funds to replace aging facilities and invest in new infrastructure to accommodate growth.

These fiscal challenges are significant but not insurmountable. In this report we investigate the roots of the current situation as a first step toward identifying collaborative statewide solutions.

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City-Provided Services Play an Essential Role in Oregon's Economy

About three quarters of Oregon's population lives and works in cities. City governments provide essential services to these people, and the key services provided by cities—public safety, transportation services, water and sewer—are tied to economic growth and development.[1]

As cities spend money in these areas, businesses and individuals choose to locate in those cities. However, today's municipalities find themselves facing tough choices, as available revenues fall short of what is needed to provide the desired level of services. This problem is clearly evident with public safety and transportation funding.

Cities dealing with low permanent tax rates imposed by property tax limitations introduced in the 1990s often spend much higher percentages of property tax revenues on public safety. Spending on public safety in Bandon equaled 592 percent of property tax revenues in FY 2009-10; Myrtle Point spent 192 percent; Gresham 169 percent; and Bend 156 percent (see Table 1).

Table 1: City public safety spending as a percentage of property tax revenues

Bandon	592%
Stanfield	285%
Myrtle Point	192%
Gresham	169%
Bend	156%
Salem	114%
Corvallis	111%
Albany	106%
Portland	95%

Source: League of Oregon Cities

Transportation infrastructure is equally challenging to fund with the limited financial resources available to cities. A key pillar of the state's economy, Oregon's road system, is deteriorating. All Oregonians rely on the intergovernmental road system—to get children to school, to commute to work, and to move products and goods. In fact, almost 60 percent of Oregon's jobs are transportation dependent.[2] Properly maintaining and preserving Oregon's municipal road system is a challenge: cities need an estimated $187 million in additional annual revenues to keep up with maintenance and construction costs.[3]

Municipal Finance 101

While each city has its unique blend of revenues and expenditures, most cities in Oregon rely on similar revenue sources, spend money on the same types of services, and face persistent challenges related to their revenues and expenditures.

Historical trends show that citizens and their local governments have implicitly found a balance point for what citizens contribute to local government.[4] In Oregon, that amount has been about 16 percent of personal income.[5] However, growth of personal income in Oregon has slowed over time, falling behind national income levels. Average per capita income in Oregon was about equal to the national average in the 1990s, but is currently about 90 percent of the national average.[6]

This trend is a major obstacle for Oregon cities trying to generate sufficient revenues for services because residents are unlikely to increase spending on local government without first experiencing an increase in their own personal incomes. Even if Oregon personal incomes return to their previous levels, city revenues would not correspondingly increase, because of constraints on property tax that decoupled city revenue from increases in housing market appreciation.

City funds

Cities' funds are key to understanding municipal finance. Many revenue sources are tied to specific expenditures and can only be

used for their prescribed purpose (i.e., they are not fungible). To keep track of which revenues can be used for which purposes, cities establish multiple funds. Each fund operates like a separate bank account, with specified revenues accruing to each fund.

Though some cities may have dozens of unique funds, they can generally be organized into four main categories:

- General Funds
- Enterprise Funds
- Capital Projects Funds
- Special Revenue and Other Funds

Cities' general funds are unique and perhaps the most important of all city funds. Most general fund revenues are not tied to specific expenditures and are critical for funding general government operations. In theory, general funds have a great deal of flexibility, but in practice, most cities use nearly all general fund revenues for public safety services (police and fire). Other common services supported in part by city general funds are libraries, planning, central services, and administration.

With no sales or income tax revenues, city general funds in Oregon are funded primarily by property taxes, franchise fees, transient lodging taxes (also known as hotel-motel or room taxes), some state-shared revenues (e.g., cigarette tax and liquor tax revenues), and some charges/fees for services. Property taxes are the largest single source of general fund revenues for Oregon cities. This heavy dependence on property taxes puts property taxes at the center of city fiscal challenges in Oregon.

In contrast to the general fund, cities' other funds all have various restrictions and limitations on what their revenues can be used for. Enterprise funds are used for operations that are financed and operated in a manner similar to a private business. The intent is for ongoing costs to be financed through charges for services. Examples include water, wastewater, waste disposal, golf courses, and pools.

Capital projects funds are for new construction of public buildings and infrastructure. Capital fund revenues come from intergovernmental sources (i.e., state and federal grants), systems development charges, and bond proceeds backed by general obligation bonds (i.e., property taxes).

In addition to the funds described above, cities may have several other funds that deal with specific sources of revenues or categories of expenditures. City street funds, for example, are used exclusively to maintain transportation infrastructure. While a significant source of revenue comes from the allocation of State Highway Fund revenues, there is a substantial gap between the cost of streets and what cities receive.

Expenditures by Purpose vs. Expenditures by Object

Public-sector expenditures can be viewed in two ways: by the broad *purpose* of the expenditure or the *object* of the expenditure. Police, fire, transportation, and parks are examples of expenditures by purpose.

Objects describe what the money is spent on, regardless of purpose. Examples include personnel, capital outlay, and materials and services.

In this report, we focus on expenditures by object because all cities have basic objects in common. In contrast, expenditures by purpose vary greatly across cities (e.g., some have fire departments and others do not).

City General Funds: Three Decades of Challenges

Beginning in the 1990s, Oregon cities have experienced budget challenges relating to constrained revenue sources and accelerating costs of service provision. The following sections trace the story of fiscal challenges in Oregon cities over the past two decades and into the next.

The 1990s: Property tax revenues shrink as a share of the economy

Property tax collections in Oregon were tightly constrained in the 1990s by voter-approved ballot measures 5 and 50, which established permanent maximum tax rates and decoupled assessed property values from real market values. Passed in 1990, Measure 5 sets limits on the amount of tax levied per $1,000 of a property's real market value (RMV). If taxes exceed their designated limits, the taxes are reduced until the limits are met. This reduction, known as *compression*, results in millions of dollars in lost revenue for local governments each year.

In 1997, voters passed Measure 50, legislation that gave all existing tax districts a permanent operation property tax rate limit. A district's permanent rate was primarily determined by combining whatever tax levies existed locally when Measure 50 passed. These tax rates cannot be changed by any action of the district or its voters and remain as they were set in 1997.

In addition to being frozen, rates were reduced. Measure 50 formulas set the permanent tax rates at 1995-96 assessed market value minus 10 percent. However, voters can approve a local option levy, which allows a taxing authority to temporarily exceed the permanent rate limit. These local option levies are restricted to five years for operations and ten years for capital projects. Measure 50 also limits the annual growth rate of taxable property value to 3 percent of the assessed value.

In the five years before Oregon's property tax reform took effect, city property tax revenues grew by 9.3 percent per year. The combined effects of Measures 5/50 and a recession pushed city property tax growth down to 3.2 percent per year from 1997 to 2002. From 2002 to 2007, with an improving real estate market and new development activity, growth increased to 6.0 percent per year.[7]

Figure 1 illustrates the stabilizing but constraining effect of the property tax reform measures. As a share of overall personal income, property tax revenues for local governments in Oregon dropped from almost 5 percent in the late 1980s to about 3 percent by 1997, where it has remained.[8] This reflects the post-reform alignment of property tax revenues with overall economic conditions: as personal income growth in Oregon has slowed, so have property tax revenues.

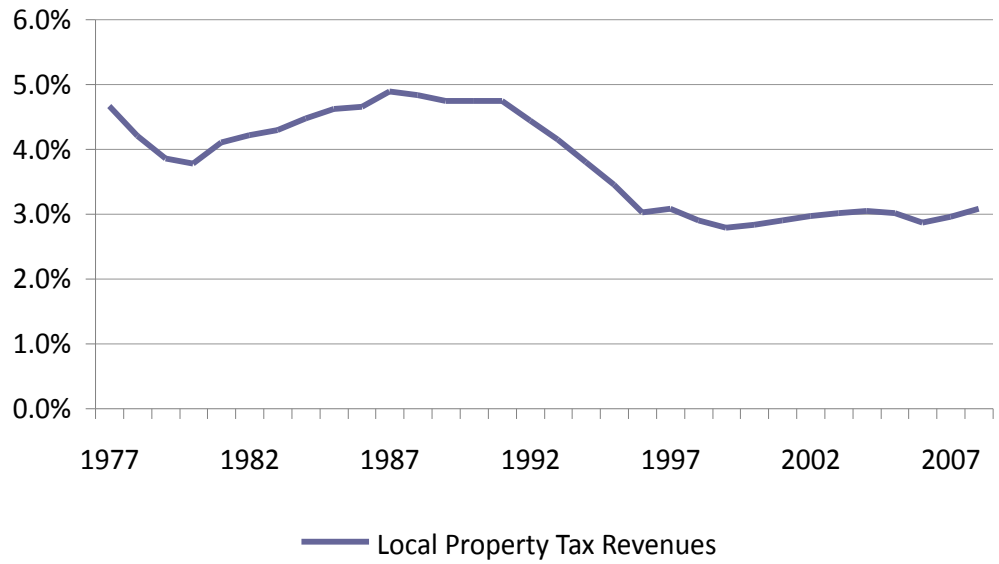
Even though property taxes are not directly tied to personal income, it makes sense that the two go hand in hand. As a city experiences growth in population, and as its residents see their incomes grow, they drive demand for new housing and new businesses. This new construction fuels growth in assessed value, and in property taxes.

In response to this relative decline in property tax revenues, cities had to choose whether to cut services, raise charges and fees, or make other budget accommodations. As Figure 2 shows, local government expenditures on core services (police and fire) as a share of total personal income have not fallen over time. This indicates that cities have found other ways to account for constrained revenues—possibly raising charges and fees or reducing other services. In other words, lower revenues do not mean lower costs—or less of a need—for public services.

Property tax reforms have put Oregon cities in a corner: they cannot raise property tax rates and are forced to find other ways to respond to constrained revenue growth, demographic shifts, and increased costs of service provision. Moreover, property tax

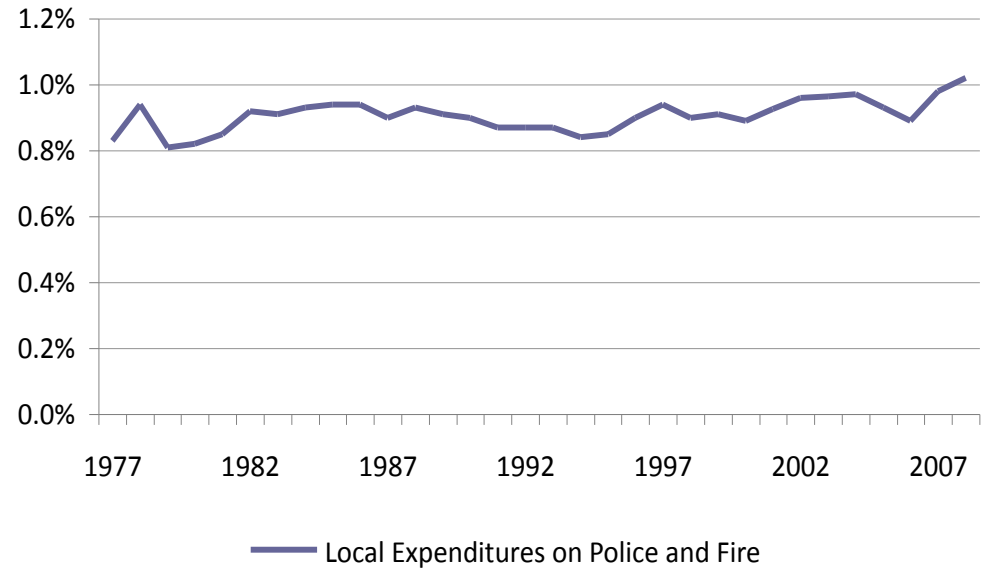
revenues are not directly linked to the general rate of inflation, putting Oregon cities at a particular disadvantage during periods of high inflation.[9]

Figure 1: Local government property taxes as a percent of personal income, Oregon, 1977-2008



Source: The Urban Institute- Brookings Institution Tax Policy Center. Data from U.S. Census Bureau

Figure 2: Local government expenditures on police and fire as a percent of personal income, Oregon, 1977-2008



Source: The Urban Institute- Brookings Institution Tax Policy Center. Data from U.S. Census Bureau

The 2000s: Cost escalation in a weak economy

In the 2000s, Oregon cities continued to deal with constrained property tax growth and also encountered a sustained stretch of weak economic performance, two recessions, and increasing personnel costs. While slow job growth and subpar personal income growth has been experienced across the country, Oregon was hit harder than other states and is recovering more slowly.

Economic conditions have affected the funds cities receive from state and federal sources. Average annual growth in intergovernmental revenues was 4.8 percent from 1992 to 2007, slower than the growth rate of other revenue sources and insufficient to keep pace with population growth and inflation. Considering that the state and federal governments are both struggling with their own budget crises, and that federal stimulus money has dried up, it is unlikely that Oregon cities will see increases in intergovernmental revenues in the near future.

Compounding the issue, existing preemptions placed on cities by state laws limit cities' ability to control certain types of revenue. For example, cities were preempted from collecting liquor tax, so the state collects a liquor tax and distributes a percentage to cities, with funds varying from year to year. From FY 2008-09 to FY 2009-10, liquor revenues decreased. To address agency budget shortfalls, additional liquor revenue was collected through an Oregon Liquor Control Commission (OLCC) surcharge, but this revenue was not included in the revenue sharing formula that determines funds distributed to cities. The surcharge is projected to generate $23.9 million for the agency's general fund in the 2009-11 biennium.[10] Cities, however, cannot make up the loss by adding a tax or surcharge, and the exclusion of these funds from revenue sharing will result in cities losing an estimated $8.1 million.

Slow revenue growth brought more attention to how cities spend their money. In Oregon, about 30 percent of all city expenditures (including capital outlay, public safety, etc) are for personnel costs (i.e., employee wages and benefits). For city general funds, personnel costs comprise an even larger portion of total expenditures, as general fund activities (predominantly police and fire) are labor intensive. As described earlier in this report, costs of public safety alone can greatly exceed property tax revenues. For the cities of Ashland and Reedsport, personnel costs comprise 55 percent of total general fund resources. Personnel costs account for 61 percent of the general fund budget in Gresham, and 65 percent in John Day. For all Oregon cities, such costs grew by about 6 percent per year from 1992 to 2007.

One contributing factor to this growth is the number of people employed by municipalities in Oregon: an increase in employees naturally increases compensation costs. Total Oregon employment increased by 2.1 percent per year from 1992 to 2007, but local government employment outpaced private, state, and federal government, growing at 2.2 percent per year (see Figure 3).

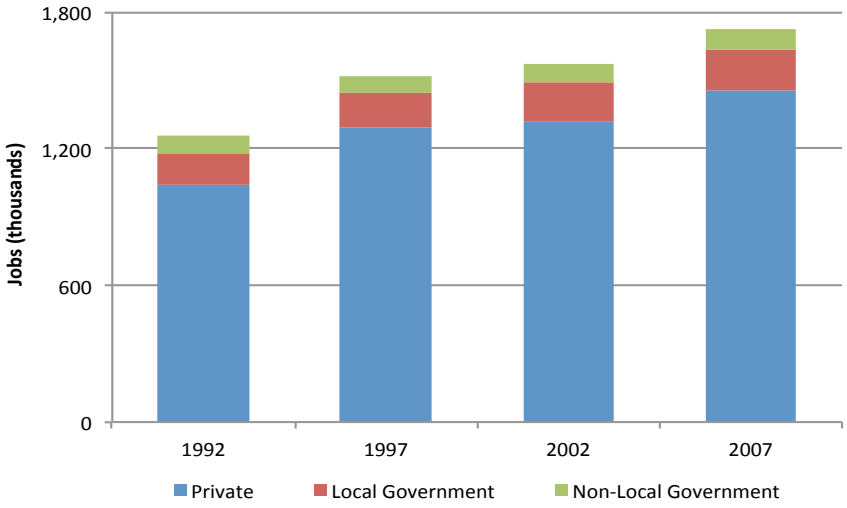
During this period, however, local government employment did not keep pace with population growth in incorporated cities. If more recent data were included, showing the impact of the recession, it would show that population growth has continued while local government employment has fallen. Oregon cities have become more efficient, serving more people per employee than in the past.

But the cost of compensation—not the number of employees—is the major contributing factor in this cost escalation. Figure 4 compares state and local government compensation costs to the consumer price index (CPI) over the past decade: *Wages* for state and local employees have remained closely tied to inflation, barely outpacing the 23 percent increase in the CPI since 2001.[11] *Benefits*, on the other hand, have

grown rapidly, with costs increasing 56 percent since 2001—twice as fast as inflation.[12] And cities typically have little direct control over the level of benefits for strike-prohibited employees (e.g., police and fire) because they are set by an arbitrator. The expanding costs of health insurance and pensions are responsible for most of the growth in state and local employment costs.

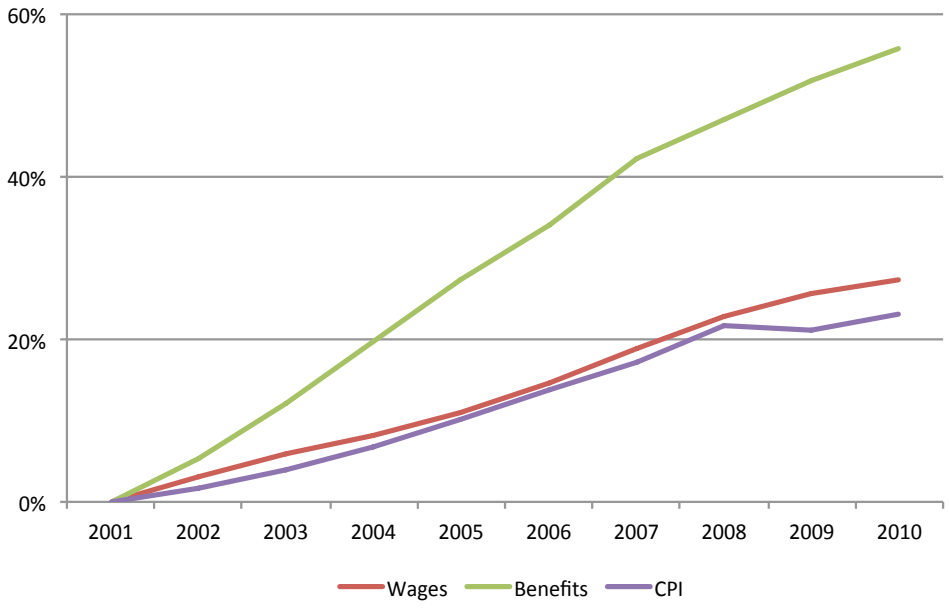
The increases in the costs of benefits are driven by the combination of rising health care costs across America and the growing costs of retirement benefits for former public employees with defined-benefit retirement plans. From 1999 to 2009, national health care costs per capita grew at an average annual rate of 5.8 percent, roughly double the rate of inflation. This rapid growth is actually slower

Figure 3: Oregon employment by sector, 1992-2007



Source: Oregon Labor Market Information System, Covered Employment and Wages Summary Report, 2010

Figure 4: Cumulative percent change in state and local government wages and benefits compared to the Consumer Price Index, United States, 2001-2010



Source: Calculated by ECONorthwest with data from BLS, 2011.

than long-term historical trends: since 1960, the average annual growth in per capita health care costs has been 8.6 percent per year. Health care spending in the United States has grown to more than 17 percent of our gross domestic product, higher than nearly all other industrialized countries.[13]

Pension costs for city employees in Oregon have also escalated rapidly. Since the inception of the Oregon Public Employee Retirement System (PERS) more than 60 years ago, Oregon PERS has undergone significant changes in how it provides benefits to Oregon's public employees, including significant reform over the last 20 years, as voters attempted to rein in what they viewed as unsustainable government spending on PERS benefits. As a result of these reform efforts, Oregon PERS currently operates as a hybrid system of defined-contribution and defined-benefit plans. In general, longer tenured employees and current retirees have defined-benefit plans, which cost substantially more than defined-contribution plans. Under defined-benefit plans, governments are committed to make guaranteed benefit payments for retirees, regardless of governments' fiscal conditions. And even with past reforms, cities must still honor the benefits of Tier 1 employees—those who qualified for the earlier retirement programs. Today, 31 percent of active local government employees are Tier 1 employees.

Local Examples of the Growing Cost of Employee Benefits

Over the past decade, total personnel costs in the City of John Day have remained virtually unchanged, but a closer analysis shows that salaries and wages in the city have actually declined by 7 percent while employee benefits have increased by 17 percent.

The City of Reedsport has also seen the cost of benefits outpace salaries and wages. In 2000, health care constituted just 12 percent of total personnel costs in Reedsport; by 2010, that rate had climbed to 18 percent.

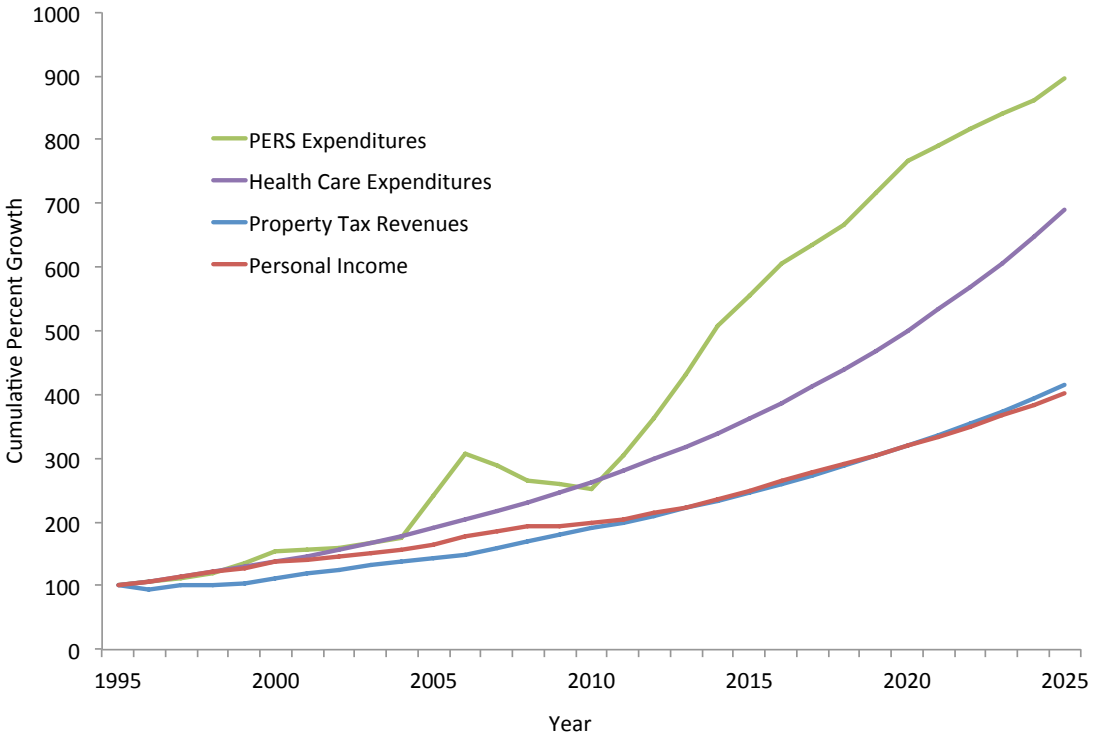
The 2010s and beyond: The trends continue

Heading into the next decade, the worst of the recession may be behind us but the challenges facing Oregon's cities may be deepening. Even though the economy is recovering, the full impact on cities has yet to be seen. Many city revenues trail economic conditions, and there are further delays in reporting and compiling city data. So, even as we enter a period of modest economic growth, the data in this report may fail to capture the true magnitude of the fiscal crises for Oregon cities.

Figure 5 illustrates the historical trends and forecasts growth for the key factors affecting city budgets in Oregon. Health care and pension costs are expected to accelerate and far outpace economic growth, personal income, and government revenues. In particular, PERS contributions are projected to grow at greater rates during the next decade.

Property taxes, the single most critical source of revenue for cities' general funds, had been expected to grow at a nominal rate of 5.4 percent per year prior to the recent recession–a figure that assumes a 1.3 percent annual increase in population but does not take into account the rate of inflation nor the additional costs of providing government services to new residents. The rate is also well below the anticipated cost escalation for public employee benefits.[14] Another model, developed by the state's Revenue Restructuring Task Force, forecast property tax revenue growth of 4.5 percent per year.

Figure 5: Comparison of trends affecting cities in Oregon, 1995-2025



Source: Calculated by ECONorthwest with source data from BEA, OEA, DOR, and Mercer.

Cities will also experience unequal property tax growth. Cities able to capture new residents and employment growth will experience more property tax growth, whereas cities unable to attract residents and jobs will experience personnel costs that far exceed any growth in property tax revenue. Over the past decade many cities have not experienced annual 5.4 percent growth in property tax revenue. For example, average annual growth in assessed value since 2000 was 3.5 percent for the Portland, 3.2 percent for Gresham, and 3.8 percent for Gladstone.

Public agencies have two options to affect the cost of health care benefits for their employees: (1) enact policies to lower the cost of health care or (2) reduce employee benefits. Any successful policies to lower health care costs need to be implemented at a broader level (some policies are possible at the state level but federal policies would be of greatest impact), and there is little cities can do in this arena. That leaves cities with the undesirable options of making cuts to employee benefits or accepting the higher benefit costs by making service cuts in other areas.

Oregon cities are not alone in struggling with this situation; states and cities across the country are facing the issue as well. In response to an 11.7 percent growth forecast in health care costs this year, the State Public Employee's Benefits Board is considering cutting health care benefits for state employees. Governor Kitzhaber summed up the situation, saying, "The cost of health care is just eating everything else alive, and it's not going to change."[15]

Oregon cities also have limited control over PERS policy changes; reforms need to occur at the state level. But cities remain on the hook to make the benefit payments to retirees with guaranteed benefits. PERS has been reformed numerous times over the past decades, but these reforms generally apply only to new hires, as courts have protected the promised benefits of current employees and retirees. This means that PERS reform efforts take many years to realize their full

effect, and any future reform efforts will require a similar length of time before cost savings are realized.

Ultimately, cities have limited options to control personnel costs. The combined impact of PERS and health care costs puts pressure on cities to request more cost sharing in health care, seek wage concessions, or hire fewer overall staff.

Other City Funds: The Cost to Maintain and Expand our Aging Infrastructure

Cities' general fund expenditures are largely for personnel, whereas other city fund expenditures are predominantly for capital projects, which pose their own set of challenges for Oregon's cities. Costs in this area are also increasing faster than revenues, and cities are responding by postponing new capital projects and maintenance.

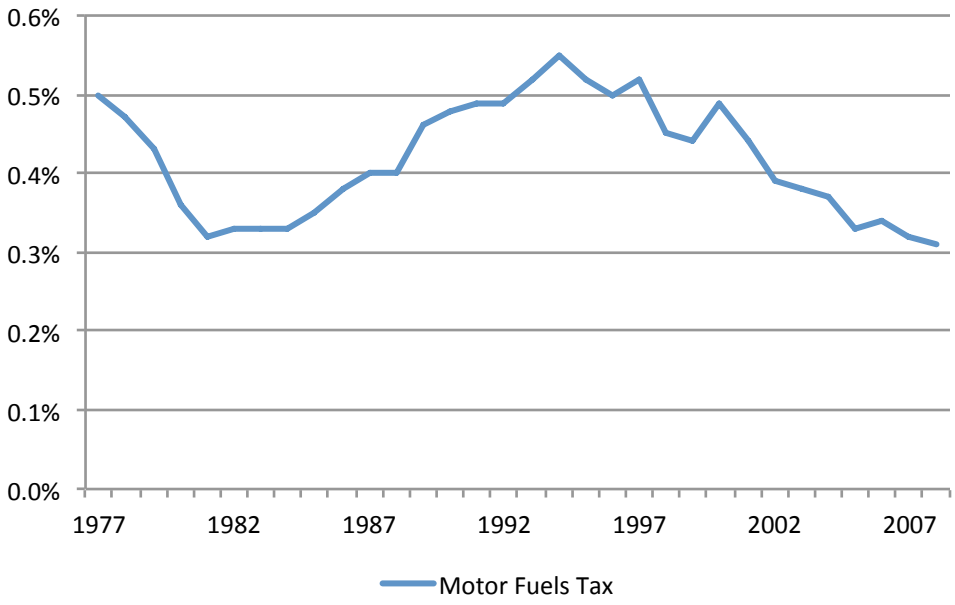
Street fund revenues are lagging

A large proportion of city street funds come from the State Highway Fund, which is composed of three major sources: DMV vehicle and driver fees, motor carrier revenues (weight-mile taxes and other heavy vehicle fees), and motor fuel revenues (commonly referred to as the gas tax).

Cities receive about 15 percent of Highway Fund revenues, allocated to each individual city based on population. Total revenue amounts have increased over time, but not enough to keep up with population growth and inflation. As a share of the general economy, motor fuel tax collections in Oregon have fallen since the mid-1990s (see Figure 6). In 2009, however, after remaining unchanged for 18 years, the Oregon State Legislature increased the gas tax rate by six cents (from 24 to 30 cents per gallon). This will lead to a significant increase in State Highway Fund revenues available for distribution to cities. Such revenues are a major source of city street funds, but the increase will not be sufficient to cover all necessary street needs of cities. And after the initial jump, gas tax revenues will likely continue their decades' long decline as a percent of personal income.

As gas prices increase, demand for fuel decreases and has a negative impact on State Highway Fund revenues. Vehicle miles

Figure 6: Motor fuels tax as a percent of personal income, Oregon, 1977-2008



Source: The Urban Institute-Brookings Institution Tax Policy Center. Data from U.S. Census Bureau.

traveled are tied to economic growth, and average miles per gallon depend on consumer demand for fuel-efficient vehicles, federal mandates for fleet fuel efficiency standards, fuel prices, and technological innovations that allow the auto industry to build more fuel-efficient vehicles. Rising fuel prices and the public's increasing interest in sustainability are likely to continue putting downward pressure on gas tax revenues in Oregon.

Capital expenditures are limited by construction costs

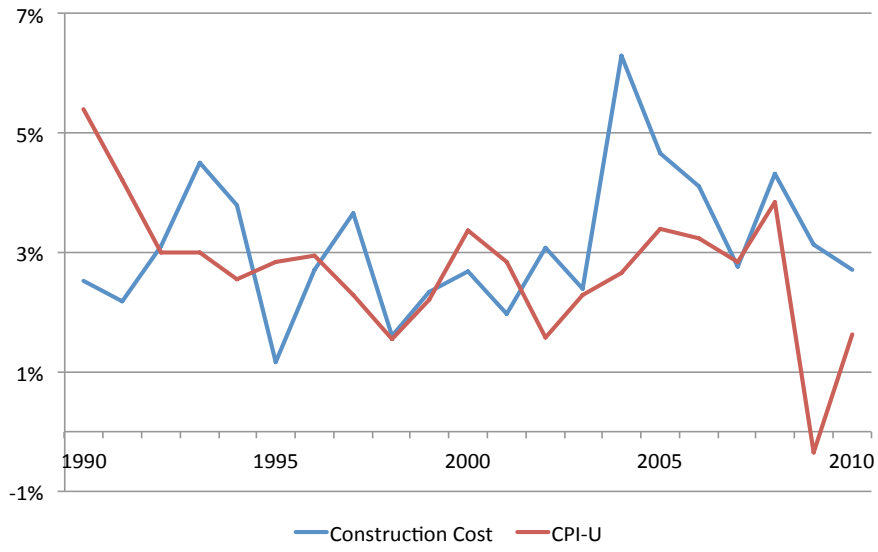
Capital expenditures are for fixed assets and durable goods with a life expectancy greater than one year, or ones intended to extend an existing asset's useful life and/or improve its efficiency, capacity, or usability. Oregon cities spend more than $1 billion annually on capital projects, roughly 30 percent of total city expenditures. Capital spending is the fastest growing category of expenditures for Oregon cities, yet cities are still falling behind because construction costs are outpacing inflation, and cities strapped for cash have deferred major maintenance and put off costly capital projects.

As with most government spending, capital expenditures are influenced by population and employment. As cities grow, adding more homes and businesses, they need more infrastructure: roads to support the flow of commerce, pipes to provide water and sewerage to homes, and fire and police stations to keep neighborhoods safe. City departments with increased workloads need additional office space, computers, and vehicle fleets to support increased staffing levels.

Capital investments tend to be dominated by large-scale construction projects, with costs closely tied to the construction cost index. Figure 7 shows the annual growth for 20 years for construction costs (3.2 percent average) versus the CPI (2.6 percent average). For most of the 1990s, construction costs grew at a similar pace to general inflation, but since 2004, construction costs have grown faster than the CPI.

Oregon's cities are not unique in this regard; all governments across the nation have less buying power for capital projects. With limited revenues, governments have prioritized operating expenditures and deferred capital expenditures to later years.

Figure 7: Construction costs versus inflation (CPI-U), United States, 1990-2000



Source: Engineering News Record Construction Cost Index 2011, and US Department of Economic Analysis Consumer Price Index for all Urban Workers, 2011

The result has been a steadily increasing age of government assets (see Figure 8). As buildings and infrastructure continues to age, the need for capital fund revenues will only increase.

Capital expenditures are difficult to forecast. Expenditures are viewed as one-time costs as opposed to annual operating costs, which can be misleading because the useful lifespans of assets eventually come to an end, and renewal and replacement is inevitable. Capital expenditures also tend to vary more from year to year compared to operating expenditures. A small city may spend millions of dollars in one year for a new library or fire station and then make few capital expenditures for several years.

In short, capital spending has been increasing in recent years, but not fast enough to keep pace with demand. This has led to a situation where government buildings and infrastructure are, on average, older than ever before, and higher construction costs make replacing that infrastructure a tall order. Cities need to be able to generate sufficient revenue to replace aging infrastructure and build new infrastructure to accommodate growth and compete in a global economy.

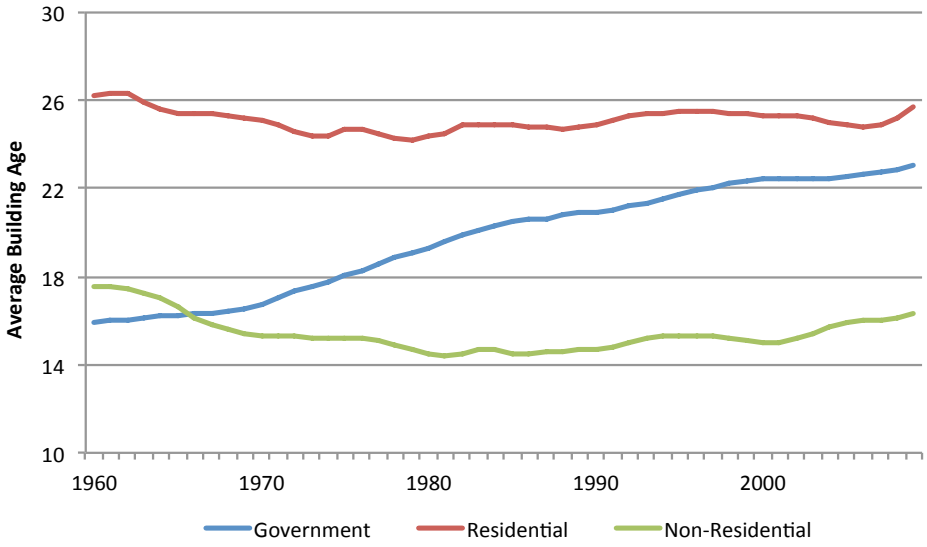
A Growing Backlog of Capital Projects

While it is easy to see the rapid growth in expenditures on capital projects, the true magnitude of the problem is hidden because cities are able to delay scheduled maintenance or new construction.

Interviews with city managers suggest there is a growing backlog of capital projects that will continue to drive capital spending in the future.

For the City of Ashland, the current Capital Improvement Plan includes at least $61 million in costs for needed, but unfunded, capital projects by FY 2016-17. Rates, fees, and SDCs are expected to cover only 75 percent of these costs, leaving a gap of at least $16 million that would need to be financed through general obligation bonds.

Figure 8: Average age of fixed assets, state and local governments, private (residential and non-residential), United States, 1960-2009



Source: United States Department of Commerce, 2010

Conclusions

Oregon's cities face critical challenges due to revenue constraints and factors pushing certain government expenditures rapidly higher. While the recent recession added additional stress to city budgets, the underlying problems are systemic and long-term. The ability of cities to react to these problems (making cuts to services, improving efficiencies, deferring capital projects, raising charges and fees) has hidden the magnitude of the situation.

Property tax revenues, a critical source of cities' general funds, were reduced by statewide reforms in the 1990s. Without sales or local income taxes to rely on, Oregon cities are left with an unbalanced tax structure with a single broad-based tax and state-mandated limits. Future property tax growth in Oregon is anticipated to average 5.4 percent per year, with significant variation among cities depending on growth in population and employment. This rate is on pace with personal income growth but falls far short of meeting rapidly increasing employee benefit costs.

City revenues are also constrained by state law preemptions that limit the ability of cities to raise revenues. Intergovernmental funds are insufficient to keep pace with population growth and inflation and are unlikely to increase in the near future.

Health insurance premiums and pension costs are requiring more and more of city budgets. Health care costs have shown expansive growth for half a century, with no end in sight. Federal (and to a lesser extent, state) policies regarding health care are necessary to change this trend. Likewise, policy actions to control public employee benefit costs need to occur at the state or federal level. Unless action is taken, expenditures on public employee benefits will continue to squeeze other categories of government spending.

Finally, capital expenditures are increasing in Oregon cities, but not quickly enough to keep up with demand. The gas tax, a major component of local street funds, is providing decreased revenues relative to overall economic growth. And construction costs are outpacing inflation, forcing cities to delay costly capital projects and defer maintenance of buildings and infrastructure. Cities will need to increase their capital expenditures if they want to remain competitive in the global economy, but funding sources have not been able to keep up with increasing costs.

The fiscal challenges faced by Oregon's cities are significant but not insurmountable. Cities keep finding ways to make ends meet, doing better with the resources they have to provide services to their citizens. But these ad hoc solutions can only go so far, and statewide, systemic policy changes are necessary to ensure long-term fiscal health of Oregon's cities. Since all levels of government across the country are dealing with similar issues, cities may find willing and eager partners at the county, state, and federal level to help tackle these problems. As policymakers search for the best solutions, cities will continue to do their best to provide valuable services to the community and sustain the high quality of life that Oregonians deserve.

Methods and Data Sources

The United States Census of Governments was a key data source. Conducted every five years since 1992, it includes detailed budget information for each level of government (e.g., municipalities, counties, special districts, etc.) for each state. Many other comprehensive datasets aggregate all of these governments under the heading of "local" government. Because cities have a different mix of revenues and expenditures, and a different set of challenges than counties, school districts, and ports, it is critical to work with data that show city budgets disaggregated from other local governments.

Data from the Census of Governments, however, are not without challenges. Because the Census is conducted only once every five years, we do not have annual data, nor do we have data since 2007, thus the impact of the recent recession is not reflected in our historical data. Additionally, the organization of revenues and expenditures in the Census is standardized to be applicable for all levels of government across all states and does not perfectly align with Oregon's categories of revenues and expenditures. Finally, the Census of Governments does not distinguish between the general fund and other funds.

In addition to Census data, we relied on our experience working with local jurisdictions across the state, and a review of reports, studies, and academic literature. We contacted four case study cities to illustrate how financial challenges are affecting actual cities. These cities, selected to provide a range of sizes, tax rates, and geographies, provided detailed budget data for the past 20 years. Four case studies cannot represent all cities in the state, but they can provide some real-world verification of our conclusions drawn from theory and more general data. The case study cities are Ashland, John Day, Gresham, and Reedsport.

[1] Fisher, R. C. (1997, March/April). "The Effects of State and Local Public Services on Economic Development." *New England Economic Review*, 53-66.

[2] Godin, K. (2003, May). "Don't Let the Economy Pass You By: Transportation Needs in the 21st Century." *Transportation Research Circular*, 12. Accessed at http://onlinepubs.trb.org/onlinepubs/circulars/ec050.pdf

[3] League of Oregon Cities, Transportation Funding Gap 2010, fact sheet, 2011.

[4] Note that throughout this report, *local government* refers to cities, counties, school districts, and other special districts.

[5] The Urban Institute-Brookings Institution Tax Policy Center. Data from U.S. Census Bureau.

[6] United States Bureau of Economic Analysis, September 2010.

[7] The average annual growth in property tax revenue of 6.0 percent from 2002 to 2007 may be initially surprising (increases in assessed value are limited to 3 percent per year). The excess growth is due to taxes levied on new development and voter-approved increases in tax rates for local option levies and general obligation bonds.

[8] These data are for all local governments, not just cities. Roughly 24 percent of property tax revenues go to cities.

[9] These challenges were identified by the 2009 Oregon Task Force on Comprehensive Revenue Restructuring, commissioned to develop a blueprint for a state and local tax system that would provide stable revenue and support the state economy.

[10] 2009 Regular Session of the 75th Oregon Legislative Assembly (2009). "Budget Report and Measure Summary for HB 5027 – A," p.2. Retrieved from http://www.leg.state.or.us/comm/lfo/budget/agency_reports/OLCC.pdf

[11] The United States Bureau of Labor Statistics compiles quarterly data on compensation for various industries, including state and local government.

[12] The rapid growth in employment costs is based on national data for all levels of state and local government. It is likely that actual growth in employment costs differ for Oregon cities. However, Oregon cities are affected by the same general trends as government agencies across the country, and if state-specific data were available, it would likely tell the same story: Personnel costs are increasing more rapidly than inflation.

[13] United States Department of Health & Human Services: Centers for Medicare & Medicaid Services, National Health Expenditure Data, 2010.

[14] We used population and employment data to construct a simple model for forecasting property tax revenue in Oregon. We used a panel dataset of historical data on population, employment, assessed value (AV), and real market value for all Oregon counties, population forecasts from the Oregon Office of Demographic Analysis, and employment forecasts from the Oregon Workforce Department.

Property taxes are not immune from economic cycles. During periods of economic growth, AV growth can exceed 6 percent per year, whereas during recessions, AV growth will be closer to 4 percent. Also, due to the process of appraising property and collecting taxes, there is a lag between when a recession occurs and when that recession negatively affects property tax revenues. Thus, our model may not fully capture the impact of the recent recession in the short term. However, the model paints a reasonable picture of what should be expected for long-term trends. Cities that do a better job of capturing population and employment growth—and the new development that comes with it—will experience more robust growth in AV than cities with less development.

[15] "Health Care Benefit Cuts Look Likely For State Workers: National Health Care Reform Is Blamed For Some Increased Costs," *The Register Guard,* Feb. 17, 2011. Accessed at http://www.registerguard.com/web/newslocalnews/25899999-41/health-board-care-benefit-changes.html.csp