Fiscal Condition of Utah’s cities and towns
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The Great Recession of 2008 and 2009 created the largest drop in state and local revenues in Utah, and across the nation, since the Great Depression. America has experienced around 10 recessions since WWII, but none as severe as the past two years. Although the recession appears to be over, Utah’s cities and towns are still looking for ways to scrape by and balance their budgets.

Looking ahead, July 1 marks the beginning of a new fiscal year and most local governments are optimistic that FY2011 will be better than FY2010. How much better is debatable. Overall the recovery will likely not “feel terrific” for any government entities.  

To assess the financial state of Utah’s municipalities, it is important to understand how cities and towns in Utah are financed. The state legislature has authorized three basic revenue sources for cities and towns: sales tax, property tax, and utility (energy, cable, and telecommunications) tax. These taxes are used to fund the general fund, which pays for the basic services most citizens associate with city government -- public safety, fire protection, parks and recreation. In addition to these taxes, cities have limited discretion on imposing fees for services (for example, utility rates, business licenses, usage fees) and also collect a portion of (motor and special) fuel taxes to fund transportation. This brief article will address the current trends in sales, property, and fuel taxes (three of the most critical sources of revenue for local government). To begin though, a brief overview of employment in Utah will provide the necessary context to understand the current revenue trends for these taxes, especially sales tax.

Utah’s Employment Indicators
Economists track two very important labor indicators to assess economic condition: non-agricultural employment and total non-agricultural wages. Through 2006 and 2007 Utah’s economy expanded at one of the highest rates in the nation. During the summer of 2006 Utah employment grew by more than 5%. However, by the fall of 2007 Utah’s employment growth slowed and began a steep contraction for the next two years. In the fall of 2009, Utah’s employment fell around 6.0%. The significant economic growth, followed by an incredible drop has created a roller coaster experience of peaks and valleys for Utahns, and likewise Utah’s government entities. The number of people employed is a critical factor in determining demand for personal consumption and hence, sales tax revenue. When multiplied by the average wage, Utah wages and salaries become the key variable in determining consumer demand and sales tax growth (as opposed to the much broadcasted unemployment rate).

On a sector-by-sector basis, employment declines were reported in the construction (-12%), manufacturing (-5.3%), leisure and hospitality (-2.7%), information (-0.2%), finance (-0.6%), and the natural resources and mining (-2%) sectors during May 2010.

Even though the construction sector represents a relatively small portion of Utah’s total employment (about 8%), it plays a key role in determining the direction the economy might turn in the future. Construction purchases are taxable. In addition, the economic multiplier for construction purchases is relatively high compared to other sectors.

After a sustained four-year boom, construction employment in Utah began to decline in February 2008. It fell 10% in 2008 and another 21% in 2009. Construction employment has been falling now for 28 consecutive months, since February 2008. In May 2010, it was down 12% below May 2009. At 65,800, jobs it is now 38% below the peak of 105,700 in December 2007.
Wage growth in Utah has also slowed during this recession. In 2008, total nonagricultural wages in Utah were just under $47 billion. Wages dropped 3.6% in 2009 to $45.2 billion. And the forecast for 2010, according to Utah’s Revenue Assumption Committee, is for very modest wage growth (a forecast increase of 1.2 percent). So what does all of this mean? Utah’s citizens have been considerably hurt by this recession. As jobs and wages have dipped, consumer confidence has slipped dropping personal consumption. This has resulted in major drops in tax revenue for the State of Utah and all local governments.

Sales Tax Reviewed
Cities and towns are authorized to impose a 1 percent local-option sales tax. This tax is largely imposed on retail purchases (apparel, motor vehicles, food, etc.), some services (hotel services), and business investments. Overall this local option sales tax generates over $400 million for Utah’s cities. For many communities sales tax generates twice as much revenue as the second most relied upon tax -- property tax.

While sales tax is a vital local (and state) government revenue source, it is also subject to high volatility. Sales tax revenue is directly impacted by the current state of the economy. As individuals lose jobs or as consumers fear the uncertainty of their own employment, personal consumption fell. Discretionary purchases are often postponed during recessions. Vacations, motor vehicles, and durable household goods are important items tracked by economists to assess discretionary purchases. All of these items fell sharply in 2009. Motor vehicle sales in Utah dropped 27.1% from 2008 (and 2008 car sales were down 21% from 2007). Furniture sales in Utah also dropped over 20% in 2009.

Tourism, which is a key element of Utah’s economy, and especially important to a number of individual cities, also suffered in 2009. For example, travel related spending in Utah dropped 10% in 2009 (from 2008), down $700 million. Additionally, occupancy rates were down 6% in 2009 from 2008. So far in 2010 the tourism forecast remains cautiously optimistic. Most preliminary tourism indicators remain even compared to last year or slightly improved (national park visits in Utah in 2010 are expected to remain even with 2009 levels, while hotel occupancy should be up 1.3%). The Utah League of Cities and Towns (ULCT) has tracked municipal revenue data since FY 1992 in partnership with the Utah State Auditor. When seasonally adjusting the sales tax revenue and measuring on a per capita basis, FY 2010 will represent the lowest collection in sales tax in over 18 years (since the beginning of the budget data collection with the UT-2 form).

While the recent decline has been historic the forecast for the next two years is cautiously optimistic. Sales tax revenue appears to have hit a bottom in the spring of 2009 and has made modest improvements in the last year. In the last three months sales taxes have improved a bit from low levels in 2009. Distributions have increased 3.2% in April through June 2010 compared to the same three months last year. The ULCT is forecasting local sales tax revenue to be up around 2.4% from FY2010.

Property Taxes Reviewed
Property taxes are the second most relied upon local government tax. While only 15% of the average property tax bill goes to the local city it is a critical tax revenue source, especially during periods of economic downturn. Property taxes are considered one of the most stable revenue sources available to government. And Utah’s Truth-in-Taxation system, which requires property tax rates to adjust to account to increases or decreases in property values, makes the property tax even more stable.

Just under half of the total property taxes paid in Utah are paid by homeowners. Homeowners in Utah also receive a 45% exemption on their primary residential property, which comparatively keeps Utah’s property tax burden well below the national average.
Cities have the flexibility to adjust their tax rates, to generate more revenue than the previous year through the Truth-in-Taxation process, which requires public noticing and public meetings disclosing the tax increase. However, this tax increase process is used rarely by Utah cities. In 2009, around 7% of Utah’s cities and towns raised their property tax rate. The data for 2010 is not available yet, but it is expected that around 10% of cities will pursue a property tax increase for FY2011. And, despite the fact that the Truth in Taxation process raises rates when values fall, many property tax entities are experiencing significant declines in their collection rates. Usually, coming in at 95% or better, 2009 collection rates are rumored to be falling 91% in Salt Lake County and in the 80% to 85% range for some Utah County property tax entities. Many rural counties are also collecting property taxes at a rate closer to 80%.

Motor Fuel Tax Revenue
The state of Utah and Utah’s municipalities also rely on motor fuel tax revenue to fund transportation projects. The current state gas tax is 24.5 cents on a gallon of gasoline and diesel fuel. The gas tax is split 70/30 between the state of Utah and local government (the local portion split based on a formula of population and weighted lane miles). In 2009, motor fuel tax declined by 4%. The tax is charged on gallon consumed, so in 2009 tax revenue dropped due to high gas prices and efforts made by Utahns to drive less or drive more fuel efficient vehicles. In 2009 vehicle miles traveled in Utah dropped for only the second time 20 years.

The drop in motor fuel tax revenue creates pressure for local government to dip more into general fund revenue sources (property, sales, and energy sales and use taxes) to fund transportation maintenance and improvements. Currently the motor fuel tax funds about 40% of an average city’s transportation expense, but this ratio obviously dips during times of motor fuel revenue decline. During the first eleven months of fiscal year 2010, motor fuel and special fuel taxes in addition to motor vehicle registrations were down 6% compared to a year earlier.

What about FY2011?
Cities are left with few budgetary options when tax revenues decline. The options to balance local budgets boil down to either increase property taxes (or some fees) or cut services. According to a recent survey by the ULCT, cities have balanced their budgets with a number of service cuts. According to the 55 cities that we surveyed the most utilized strategies responding to this fiscal stress are:

- Postpone capital projects (93% of cities surveyed)
- Cut staff support (89%)
  o Cuts to employee travel
  o Cuts to employee training
- Adjust staffing levels (87%)
  o Leaving position vacancies unfilled
  o Staff layoffs
- Draw down on reserves or rainy day funds
- Eliminate programs (39%)
- Plan to increase property taxes (10%)

The weakened economy has opened up budget gaps for essentially each of the 245 cities and towns in Utah. Revenue, especially sales tax, has declined sharply during FY2009 and FY2010. Despite this fiscal stress, Utah’s municipalities have been able to balance budgets without significant tax increases. And for the most part the cuts that have been made have not significantly altered the level of service or quality of life Utah citizens expect in their communities. As the sales tax levels off in 2010 and increases slightly, we expect fewer cuts in staffing and program cuts for Utah cities in FY2011.