This year most Utah cities will struggle to balance their budgets due to the global economic recession. Budget gaps caused by declining revenues are forcing municipalities to make difficult budget decisions, including cutting services or employees and increasing revenue streams. Revenue generation options for local government are very limited, not to mention politically unpopular. As a result, most Utah municipalities are looking at a combination of creative options such as cutting services, deferring costs, and attempts to streamline costs to balance their budgets.

To better understand the fiscal stress that cities are experiencing, the Utah League of Cities and Towns (ULCT) recently conducted a survey among all municipalities in the state. Around 80 cities responded, ranging in population from 26 to over 170,000. The majority of the respondents were either the city finance director or city manager.

During fiscal year 2009 (July 1, 2008 to June 30, 2009), local governments experienced some of the largest budget shortfalls in decades. Utah’s cities and towns are vulnerable to economic booms or busts because of their reliance on sales tax. However, declining sales tax revenue isn't the only factor creating fiscal strain; increasing employee health benefits, infrastructure needs, increasing pension costs, and declining revenue sources (e.g., fees, motor fuel tax, state and federal revenue sharing) all contributed to budget shortfalls.

**Overall Fiscal Health**

According to the recent ULCT survey, 70 percent of Utah cities have experienced declining health in their local economy during the past year. In fact, the local economy has improved for only 10 percent of cities – all cities that are characterized as fast growing communities. The improved economic health of this limited group of cities is likely due to the development of new businesses from the previous year.

This variance in fiscal conditions among cities and towns is due to varying tax dependencies and differing tax bases. While sources of available revenue to Utah’s local governments are essentially the same, cities’ dependency on specific taxes differs. The major revenue sources for Utah’s cities are a combination of property tax, sales tax, utility taxes, and fees or charges for services. Each of these revenue options is important, but the critical tax source for most Utah municipalities is sales tax. Over 90 percent of Utah’s municipalities rely on sales tax revenue as their most significant tax source.

**Sales Tax**

In reviewing the fiscal conditions of Utah’s municipal government it is appropriate to address sales tax as its own issue. According to the ULCT survey over half of Utah cities have experienced more than a 10 percent decline in this important revenue source in 2009 compared to 2008. Sales tax is closely tied with consumer behavior. When Utahns have less discretionary (and especially less nondiscretionary) money or concerns about the economy, they spend less. Utah’s cities impose a one percent sales tax that is levied on each retail transaction in the state including many taxable services as well. In fiscal year 2008, this one percent tax generated $469 million. In fiscal year 2009, this tax generated $44 million less or a 9.4 percent reduction in tax revenue. So far, in fiscal year 2010, the local option sales tax is down more than 10 percent from the previous year (see Figure 1). This significant decline in sales tax revenue is a result of a number of retail sectors experiencing significant declines in sales. For example, the most recent industry quarterly sales data provided by the Utah Tax Commission indicates well over a 10 percent decline from 2008 for certain sectors:

- Wholesale durable sales – down 23.7% (2nd quarter 2009 compared to 2nd quarter 2008)
- Retail furniture store sales – down 23.2% from 2008
- Motor vehicle sales – down 22.3% from 2008
- Hotel and lodging sales – down 10%
- Retail food sales – down 8.7%
- Retail general merchandise sales – down 4.3%

During the last three months, revenues from the one percent local sales tax declined 12.7 percent relative to the same period a year earlier. These receipts represented taxable sales from May through July. September distribution receipts were also down 12.7 percent. Notably, July’s and August’s 10 percent and 15 percent declines were on top of two percent and nine percent declines for the same months in 2008.

**Property Tax**
Property tax is the second most important revenue source for most Utah municipalities. Property tax is far more stable than sales tax during times of economic recession. In addition, Truth-in-Taxation, the automatic process of increasing or decreasing property tax rates to match changes in property values, actually works as an economic stabilizer – keeping this source of revenue stable during a volatile economy. For example, over half of municipalities have *not* experienced a decline in property tax revenue for fiscal year 2010. There are still concerns with property tax revenue, though, especially the rate of delinquency on tax payments.

**Actions to Balance Budgets**

Municipalities have very limited ways to balance their annual budgets. Essentially there are only two options: reduce services or raise taxes. The only major tax enhancement options cities may utilize is an increased property tax and most cities are avoiding increases to this unpopular tax. Fewer than 10 percent of Utah’s cities raised property taxes this year, a process requiring the city to go through Truth-in-Taxation.

So what else can cities do to balance budgets? The budgetary actions so far for fiscal year 2010 range from deferral of maintenance projects to employee furloughs. Personnel costs make up the largest share of most city budgets, which means cuts often lead to either employee layoffs or workload decreases. Most cities and towns are using a mix of solutions to bridge budget gaps in an effort to avoid both tax increases and employee layoffs. According to the ULCT fiscal conditions survey, the most commonly used budget actions are:

- *Decreasing infrastructure spending*: 41 percent of cities responding to the survey are cutting back on infrastructure spending for fiscal year 2010. This is twice as high as the previous year.
- *Imposing employee travel restrictions*: 41 percent of responding cities are decreasing funds for employee travel.
- *Use of reserve or rainy day funds*: 36 percent of responding cities are increasing their use of reserves or rainy day funds to balance budgets, this is up 5 to 10 percent from the previous year.
- *Decrease staff size*: One third of cities have laid off some employees to save personnel costs. By comparison, in the previous year less than 10 percent of cities laid off employees to balance budgets.
- *Deferring or postponing maintenance projects*: Similarly, around one third of all cities surveyed are deferring or postponing maintenance projects. This is a frequently used solution because it does not require changes to the current workforce, but it does present the danger of compounding costs or problems in the future.

Other budgetary actions that have been utilized by fewer than 30 percent of cities:

- Fee increases
- Property tax increase
- Overall service cuts
- Employee furloughs
- Privatizing or contracting out of services

**What to expect for the future?**

There are a few signs creating at least a cautious optimism that we may be progressing out of this recession. The Conference Board’s Leading Economic Indicators have been positive during the last four months. Indeed, manufacturing output and new orders have turned upwards, especially in the East. In Utah, employers are still shedding jobs and the construction sector is still reeling. Hence, the majority of Utah’s cities, however, believe that the next budget cycle is going to be even more difficult. Sixty-two percent of the survey respondents believe their city will be less able to meet its financial needs in the next fiscal year, compared to this year.

In addition, many of the budgetary actions taken so far by cities are aimed at resolving the short term consequences of budget gaps (e.g., use of rainy day funds, deferral of projects). However, if revenue for fiscal year 2010 is also down around 10 percent, cities will be faced with more grim decisions of either additional service cuts or tax increases. The next couple of fiscal quarters (fourth quarter of 2009 and first quarter of 2010) are very important as local governments hope revenue shortfalls are not worse than expected.
Figure 1: Utah Tax Commission, Utah League of Cities and Towns analysis