Rural Minnesota Cities at Risk: State Leaders Can Take Steps to Curb the Trend

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When the new Governor and Legislature take office a few short months from now, their collective energy and attention will be directed to how to solve yet another state budget deficit, most likely several times larger than the $1 billion deficit that proved so difficult to resolve in the last session. The task will be even more difficult because most, if not all, of the relatively easier options have already been implemented; stark choices between deep service cuts and higher taxes will be the reality.

For cities across the state as well, budgets are at the top of the list of concerns today and when looking ahead. The economic downturn afflicting the state and the nation has hit greater Minnesota cities directly in the form of foreclosures, unpaid utility bills, rising unemployment, business closures, and indirectly as the state, buffeted by the economy, cuts local government aid and credit reimbursement payments. City officials are burdened with balancing their budgets in light of these financial stressors. They struggle to do so in the face of rising expectations from residents and business owners that they will deliver quality local services with little or no property tax increases.

Over the past few months, the League of Minnesota Cities has administered two research projects and also conducted anecdotal tracking of city budget actions in an effort to better understand the depth of fiscal challenges facing our state's communities.

City officials pessimistic about future finances

Recent survey data from the League's 2010 *State of the Cities* report shows that most city officials are very pessimistic about their cities' financial circumstances. Greater Minnesota city officials were slightly more likely to express optimism about their fiscal conditions in 2009 and 2010 than were officials in cities within the seven-county metro area. While 92 percent of metro cities indicated they were less able to meet their financial needs in 2009, 76 percent of greater Minnesota cities offered that response. While the same holds true for looking ahead to 2010, the gap does narrow a bit (87 percent metro vs. 76 percent greater Minnesota).

Many greater Minnesota cities that responded to the survey were spared the cuts to Local Government Aid in 2008, 2009 and 2010, but did experience significant reductions to credit reimbursements for 2010 as a result of the supplemental budget passed by the State Legislature and signed into law by the Governor. Given the magnitude of the state's projected deficit for the upcoming biennium, there is serious concern within the city community that future cuts will certainly occur and will likely impact all cities.

Other *State of the Cities* report data shows that city officials in greater Minnesota are more likely to expect recovery from the recent economic recession to take a significant amount of time. While four out of five metro officials predict that their cities will recover in the next two to five years, only half of the officials in greater Minnesota share that view. The portion of greater Minnesota city officials who consider recovery to be more than five years away is more than twice as large as the portion of metro officials that do so. Cities in the metro area and in greater Minnesota report many symptoms of the economic downturn at similar rates, including unpaid utility bills, unpaid property taxes and requests for tax and utility bill payment deferrals. In the seven-county metro area, almost two-thirds of cities have witnessed business closures while slightly more than 40 percent of greater Minnesota cities have done so.

Some budget decisions made at the state level will, of course, affect Minnesotans regardless of where they reside.

An increase in the state income tax rate would impact people with similar incomes the same whether they live in Afton or Warroad. Yet, most certainly, some decisions will affect residents differently because of where they live. Those cities that are heavily dependent on local government aid, for example, may see significant erosion in their budgets if that program is cut again, as it most assuredly will be considered. For residents in those cities, which disproportionately are in greater Minnesota, the impact will be higher property taxes, fewer services, or both.

City budget-balancing strategies include service cuts, capital reductions

Since December 2008, the League has been informally tracking — through compiling news clips and collecting member city anecdotes — budget-balancing strategies undertaken by cities throughout the state. Administrative cuts, capital cuts, and park cuts are most common among greater Minnesota cities. Administrative cuts can mean a reduction in staff hours, which may limit the time that staff is available to serve the public or may lead to longer processing times for licenses or permits. Other administrative cuts taken by greater Minnesota communities include decreasing training and travel budgets, hiring fewer part-time seasonal staff, and reducing or eliminating overtime.

Capital cuts have come in the form of delayed or cancelled building or infrastructure projects and equipment purchases. Several cities have put off purchasing new squad cars for the foreseeable future. City residents may see fewer lifeguards, have fewer options for summer recreation programs, and encounter longer grass in city parks due to cutbacks in parks and recreation services. Other difficult budget-balancing choices include closing community centers, reducing hours at senior centers, or scaling back funding for playground equipment.

An individual city's options, of course, are limited by the menu of services it provides, its local ordinances and policies, citizen demands, and opportunities for raising revenue. Regional centers have taken a greater number of actions, likely because more options are available to larger cities. Regional centers tend to serve residents of surrounding communities and offer more services than smaller rural localities. Of the cities included in the LMC tracking list, regional centers have taken an average of 15 actions while the average non-regional center city in greater Minnesota has employed just five strategies.

Cities can only make cuts in areas they control. In interviews conducted as part of another study completed for the League by the Hubert H. Humphrey Institute at the University of Minnesota, several officials from small rural communities expressed the difficulty in making cuts when there are few services from which to make cuts. City officials were also asked about service cutbacks or elimination on the League's survey. Greater Minnesota cities were more likely than metro cities to maintain the level of service cuts and less likely to increase the level of cuts. No metro cities reported not having authorization to make service cuts while 6 percent of greater Minnesota cities did. In the area of law enforcement specifically, greater Minnesota cities were slightly more likely to make changes to the way in which this service is delivered than to make cuts to the level of service (10 percent vs. 8 percent). It is also true that cities with small staffs do not have the option to reorganize departments or gain significant savings through furloughs or wage freezes. Survey data shows that metro city officials were more likely than greater Minnesota officials to report decreasing the workforce over the last year (53 percent vs. 21 percent). Almost three-quarters of greater Minnesota cities reported maintaining the size of the workforce over the last year.

For decades, Minnesotans have taken for granted that regardless of where we lived or traveled in this state, we could expect to receive essentially the same level of basic local government services. Needing police attention in Winona or Wayzata was expected to, and for the most part did, result in the same type of response. That has been changing in recent years as the state's budget dilemma has grown and funding for programs such as local government aid were consequently reduced. The result is a growing disparity in the ability of

Minnesota's 854 cities to provide similar services. While not exclusively a function of geography, many communities in greater Minnesota are among the most adversely affected.

This has not been the result of an overt policy shift; rather it has occurred because of the cumulative effects of individual decisions about where to find money to balance the state budget, with programs important to cities often being the choice. This outcome might even be described as an unintended consequence since most of the attention has been on solving the budget problem and not so much on understanding the consequences of those decisions. The salient question facing the new Governor and the 2011 Legislature is whether this kind of piecemeal public policy making can continue without even more negative results. Hopefully, our new state leaders will make difficult budget decisions having first answered such important public policy questions as: Do we want to sustain a vibrant rural Minnesota, and what are the consequences if we don't?

Nearly all cities face deficits by 2025

At the core of the Humphrey Institute analysis mentioned earlier was a projection, based on historical revenue and expenditure trends, of what city budgets would look like in the year 2025. Overall, cities across the state will face a deficit of 30 percent of revenues by that year. When considering cities outside the Twin Cities metropolitan area, regional centers will have a 2025 deficit of 30 percent of revenues. Other large cities as a group will face a 2025 deficit of 25 percent. Small cities in greater Minnesota will see a deficit overall of 29 percent in that year, and exurban fringe cities as a group will face the smallest deficit — 9 percent in 2025.

As important as the question of how we can retain an effective state/local fiscal partnership to curb these disturbing projections is, we know there are also many other stresses facing communities outside the metro area — declining and aging population; inadequate housing stock to meet job growth when that does occur; in other instances, a workforce lacking in numbers or training to attract growth; distances between cities that makes collaboration to provide services difficult if not impractical, and more. Solutions, on the other hand, are much more difficult to identify. One-on-one interviews with city officials across the state conducted as part of the Humphrey analysis shed some light on how these trends impact city conditions. One official from a small rural community discussed the challenges changing demographics have created for the city. That official's city has been unable to retain younger residents due to a lack of job opportunities, and the city is feeling this loss through a decrease in local tax and fee revenue. The city now has more elderly residents than school-age children. Other communities expressed concern over the fact that many seniors live on fixed incomes and, thus, are sensitive to property tax increases.

Information garnered from the interviews showed that another rural community is meeting the challenge of population change by taking a leadership role in helping residents understand what the demographic shift means. The city has held community meetings to explain potential impacts on families and city services. That city is also working with banks and utility companies to print bills with larger, easy to read text. Yet another city official commented that his city will hope to retain its elderly population thanks to inexpensive housing and easy living.

Through all this demographic change and the fiscal stress it brings, it seems increasingly clear that cities can no longer expect the state government to be the great equalizer. Communities are going to need to find local solutions to local problems. To do that, the state will need to loosen its hold on local governments. When the "Minnesota Miracle" was embraced in the early 1970s, it meant not only relatively uniform revenues for cities, but with that, the expectation that cities would be more tightly regulated. In addition, with state funding came an increasing number of mandates which have proliferated over the years adding cost for local governments as well as inflexibility. The new Governor and Legislature should rethink this part of the state/local relationship: if the revenue side of the partnership is no longer relevant, then neither should be constraints on local control.

State can take specific actions to ensure a better future for cities

Aside from this overarching and important public policy issue that must first be addressed, there are specific actions our state leaders can take to help secure the vibrancy of rural Minnesota, starting with mandate reduction. Virtually every year, legislators ask local officials to submit their list of those state imposed mandates that, if relieved, would have the greatest benefit. Those requests, while undoubtedly well intentioned, yield little or no results. Why, for example, should local governments be forced to publish official notices in a newspaper when other media may reach more residents? Of course, every mandate has its own constituency, and preserving any particular mandate may not seem especially onerous to legislators, so the newspaper lobby preserves this anachronistic requirement year after year. Cumulatively, however, mandates increase the cost of providing local services and limit flexibility and creativity.

Additionally, revenue options for all cities are limited by state statute. Cities do not have general authority to impose a local sales tax, but can only raise revenue through the property tax, and fees and charges. According to the interviews done as part of the Humphrey Institute research, many cities strive to maintain a flat property tax rate. Others try to keep the rate low while also providing the services their residents have come to know and expect. Several of the smallest greater Minnesota cities interviewed acknowledged that, due to state aid cuts and rising costs, property taxes will likely go up in the community. The survey results show little difference between the share of greater Minnesota cities and metro cities reporting property tax increases for 2010. The survey does indicate a difference in the share of cities raising fees, charges and licenses. Almost half of metro cities reported increasing these revenue streams while just one third of greater Minnesota cities did so.

To offset cuts in state aids to cities and to minimize constant property tax increases, cities need more flexibility in raising revenues. Cities must currently petition the Legislature for local sales tax authority and, even on rare occasions when granted, the authority has been for limited purposes. In recent years, the Legislature has become increasingly reticent to grant even that limited authority. Certainly not all cities in greater Minnesota could benefit by having the ability to impose a local sales tax, but many undoubtedly would. City council members are in a much better position to decide if a local sales tax makes sense than are legislators.

Rural communities also need a stronger state commitment to infrastructure, especially roads and broadband. The geographic disadvantage of distance facing many communities cannot literally be shortened, but it can be addressed. The economy of many outstate communities depends on a good road system to get products to market, and our investment in that part of the transportation system has been woefully inadequate. Likewise, more than ever, rural communities need high-speed Internet access to attract and retain business and allow children in those communities to compete with their urban counterparts.

Land use controls (or lack thereof) are yet another area in need of gubernatorial leadership and legislative reform. Many communities in greater Minnesota find that their economic vitality is strangled by development just outside their borders. While township government is an important part of Minnesota's heritage, current land use laws do not encourage compatible co-existence between cities and adjacent townships, but rather are often the source of non-productive competition. Township residents benefit from strong cities and they, in turn, are part of the city's economy.

Developing incentives to promote collaboration among cities is also another way that state and local governments can work together, though geography is a strong consideration. Cities that are located in close proximity to other communities may have more opportunities for collaboration or consolidation of duplicative services than extremely rural cities. Almost one-third of metro area city officials responding to the *State of the Cities* survey reported increasing inter-local collaboration while just 10 percent of greater Minnesota cities did so. Rural cities were more likely to report not having the authority to increase collaborative agreements (21 percent vs. 2

percent of metro cities). One area where many rural cities have collaborated is in law enforcement. Many cities contract with the county or other local entity for coverage in the community.

It is clear that Minnesota will have fewer resources to invest in its future. Rather than making those decisions based on immediacy or politics, the state would be well served to have an overall vision of where and how state investment will have the largest return and benefit. Answering questions such as how can the resources of greater Minnesota help the state compete in the global economy and what needs to be done to take full advantage of that potential will be increasingly important. That kind of vision would undoubtedly reveal the wisdom of strategic investment in rural Minnesota.

All that said, however, it is clear that the success of greater Minnesota will increasingly fall on the shoulders of those who live there. That success will demand greater creativity and a willingness to break down long standing barriers and ways of thinking. It will no longer be helpful to think in terms of "city," "school" or "county" problems or responsibilities. Rather, they must be seen as *community* challenges and opportunities. Simply because the city or school district has traditionally provided a service does not mean it continues to make sense, and local officials will need to be willing to look at how best to meet community need regardless of how that might change how things have been done.