GOVERNING
THE STATES AND LOCALITIES

With Less State Aid, Localities Look for Ways to Cope

In much of the country, states are offering localities less financial help than they were before the recession. That won't change anytime soon.

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The fire department in Springfield, Ohio, has grown accustomed to frugal times. Calls for service keep climbing, but staff levels are frozen. Firefighters themselves fix vehicles and breathing equipment in order to save money on repair contracts. Recently, when a fire engine's generator failed and they couldn't afford to replace it, they had to mount a portable generator and rig it to work.

Springfield's revenue is below the levels of a decade ago, not even counting inflation. The city has responded by eliminating administrative staff, deferring maintenance and taking other measures intended to be least burdensome for residents. "The last five or six years has been nothing but one cut after another," says

Local officials have held out hope that the cuts would be temporary. But sluggish state revenue growth doesn't bode well for a return to pre-recession aid levels. The latest fiscal survey by the National Association of State Budget Officers found that more states were expecting revenue numbers to come in below projections than in any year since 2010. Most local officials now say they've come to view the current environment as the new normal, and are developing new strategies to cope.

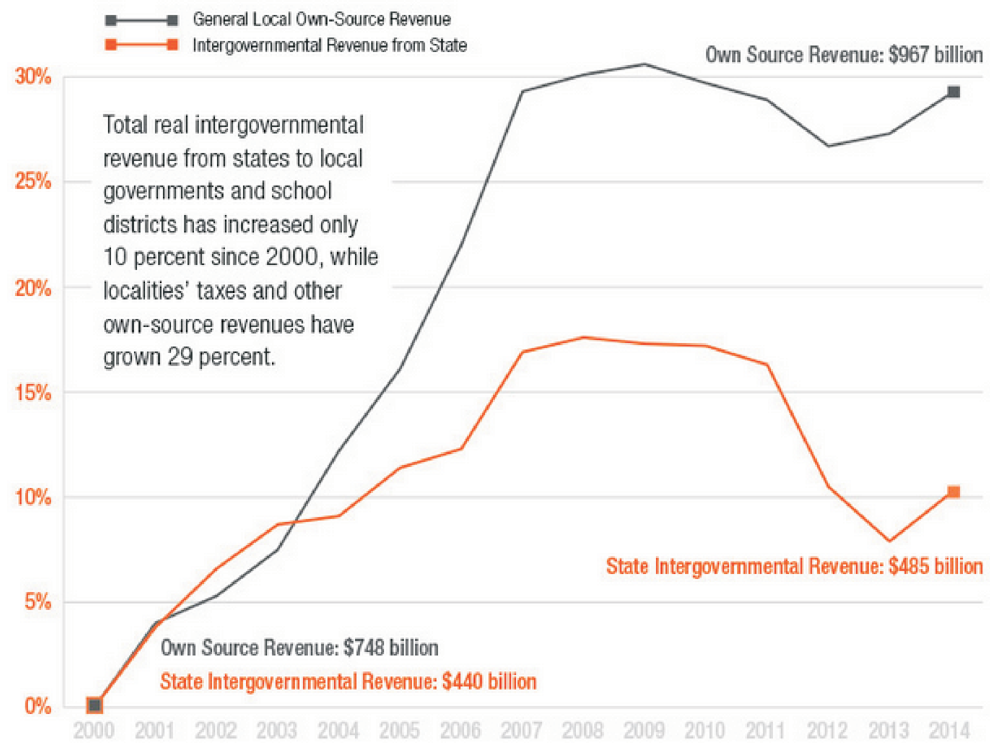
Maine is a good example. Four years ago, the state municipal association produced a TV ad that aired in many communities. In a voiceover, an official from the town of Waldo explained in plain English what revenue sharing was and why proposed cuts mattered to the average Mainer. "From Kittery to Caribou," the announcer said, "your town gets help from a 40-year-old revenue sharing law between the state and towns to provide basic services." The spot showed a montage of those basic services, including a snow plow, ambulances and trash removal. It finished with a kicker: "Politicians in Augusta are ignoring this law by shortchanging our towns and cities the money promised for these services. And worse, without that state money, property taxes will go up."

The ad was an attempt by municipal leaders to protect an obscure but important source of local government funding. "To the lay person, the term 'revenue sharing' is abstract," says Geoff Herman, executive director of the Maine Municipal Association. "It doesn't mean anything."

Herman's staff created a website on revenue sharing with banner ads warning of higher local property taxes and shrinking services. They armed local leaders with talking points for media interviews, town halls and meetings with state lawmakers. Ultimately, the legislature set revenue sharing disbursements below their historic levels, but protected them from deeper cuts proposed by the governor. The media campaign paid off, Herman says, "and showed that we were pretty serious about this issue."

Such tactics by municipal groups are becoming more common in battles over revenue sharing. In Michigan, mayors and county exec-

HOW LOCALITIES' REVENUES HAVE CHANGED SINCE 2000



NOTE: *Amounts adjusted for inflation*

(SOURCE: Governing *calculations of U.S. Census annual surveys of state and local government finances*)

utives have launched an initiative called "saveMIcity," which includes a statewide tour, a new blog, interviews with local press and a research page detailing the reasons the state's municipal finance system is broken. Much of the campaign is focused on restoring cuts to state aid, although it's also about finding ways to contain public employee retirement costs and lift limits on local tax collections.

Mayors of Ohio's 30 largest cities recently formed the Ohio Mayors Alliance to give them a greater voice at the state Capitol. As in many states, urban areas aren't well represented among the legislature's Republican leadership. When lawmakers negotiated with local officials, it had in the past usually been just with those from the three biggest cities: Cincinnati, Cleveland and Columbus. The alliance aims to change that. "These matters affect all of us," says Nan Whaley, the mayor of Dayton. "We've got to figure out a way to work with the state."

The hotly contested politics of revenue sharing is a relatively modern feature of state and local relations. Decades ago, states set up the funds in lieu of granting localities broad taxing authority. The arrangement functioned as a partnership: States were the tax collectors and local jurisdictions used some of the money to pay for essential services, such as road repair and emergency response. Since the recession, many governors and legislatures have come to view the funds as discretionary items in the budget and obvious places to trim state spending.

It's more than a philosophical shift — it's a function of long-term state budgetary pressures. Baby boomers leaving the workforce aren't helping income tax collections. Antiquated revenue systems that fail to tax services and online transactions have created a further fiscal hole. Meanwhile, Medicaid is eating up an increasing share of state budgets.

Nationally, inflation-adjusted state support to localities and schools dipped 6 percent when compared with averages from 2007 to 2009. Localities in Arizona (-24 percent) and Ohio (-19 percent) suffered the largest reductions, with Massachusetts and West Virginia not far behind. And that was mostly on earmarked funds — the cuts in unrestricted dollars flowing from those states were even greater.

The cuts in state funding couldn't have come at a worse time for localities. In Michigan, when the housing bubble burst, most homeowners' property values dropped, as did local property tax collections. And because of a quirk in Michigan state law, when the values rebounded, property tax revenues did not. In the 1990s, voters had capped annual property tax increases at 5 percent a year. As a result, many Michigan municipalities today receive less in state aid and property tax revenue than they did in 2006. "No one would argue that we shouldn't do our fair share in a tough economy, but we have no upward mobility in a strong economy," says Anthony Minghine, executive director of the Michigan Municipal League. "If you talk to the average person on the street, there's probably a belief that, 'Well, my 401(k) is doing better, I'm assuming my city is doing better.' And it's not."

What's happening in Michigan is happening, one way or another, in different parts of the country. Revenue sharing laws are full of loopholes. In Maine, the 1971 law calls for 5 percent of state income and sales taxes to go to local governments. Last year, that amounted to $158 million. But another provision in the law allows the state to spend less in order to balance the budget, so local governments got only $62 million, or about 2 percent of the tax receipts. And they considered themselves lucky to receive even that much. In Augusta, the debate isn't about restoring cuts; it's about whether to preserve the aid that's left.

In his first two budget proposals, Maine Gov. Paul LePage has called for eliminating the revenue sharing program altogether. In part because of effective lobbying by municipalities, the legislature has met him only part of the way. But in nearby Rhode Island, the state has stopped sending any of its designated $130 million a year in general revenue sharing to localities, and nearly all of the $120 million a year in motor vehicle excise taxes. At the same time, as in Maine and Michigan, Rhode Island's municipalities are hampered by state restrictions on what they can tax.

In Ohio, the shift away from state funding for localities began with a 2005 law eliminating tangible personal property taxes. Six years later, facing a nearly $8 billion budget shortfall, Gov. John Kasich initiated sizable reductions to the state's tax revenue sharing program. The Local Government Fund, while only a small percentage of cities' revenues, has since been cut nearly in half. The legislature then eliminated the estate tax, dealing another blow to municipal finances.

While the economic downturn was largely responsible for the initial cutback in Ohio's local funding, more recent changes have been part of a broader reevaluation of how resources should be distributed, says budget director Tim Keen. A crucial factor driving the state's policies, he says, was the capacity of local governments to bring in money on their own. "State law provides them substantial options to raise local revenue," Keen says. "We took that into account when we made our decisions about what reductions to make." Ohio is one of the few states where localities can levy both income and property taxes.

In Springfield, state revenue and aid accounted for 4.7 percent of its general fund last year, down from 13.3 percent a decade earlier. So the city has trimmed its staffing over the years through attrition, layoffs and doubling up on positions. With the failure of last November's tax levy, officials expect further layoffs, along with the closure of two public safety substations. "Cuts from the state have been devastating to us," says City Manager Jim Bodenmiller. "We're past the point where additional reductions can easily be absorbed."

Nearby Dayton, Ohio's sixth largest city, has shed roughly 30 percent of its workforce since 2007. In all, the city reports that it has lost out on approximately $10 million annually in state funding since 2010. Officials have sought new revenue by raising fees, such as an assessment for street lighting improvements. Shelley Dickstein, Dayton's city manager, says she doesn't foresee new funding from the state anytime soon. "We're just hopeful we can continue to manage through the next two or three years," she says.

One way local leaders in Ohio are managing, if reluctantly, is by raising their own taxes.

Last year, 291 new tax levies and 134 replacement levies ended up on Ohio ballots. A review of election results shows about 68 percent passed. Cleveland voters approved a 0.5 percent increase, which is expected to raise about $80 million a year. The city had already cut back on street sweeping, reduced the frequency of mowing abandoned lots, left police vacancies unfilled and consolidated two departments. "We had no more rabbits [to pull out of a hat]," says Cleveland City Council President Kevin Kelley. "No elected official likes to be involved in something that raises taxes, but in the state of Ohio, whether it's the state or the city, people need to pay more for services. Stuff doesn't happen for free."

Dayton passed its own tax increase, which included funding for a new pre-kindergarten program. Emphasizing the state cuts wasn't a major part of the city's pitch. Mayor Whaley says the need for additional revenue was visible to voters with such noticeable neglect as peeling paint on the sides of police cruisers. It wasn't as visually apparent in Springfield, which likely hurt the levy's chances.

Even as they have created serious problems with cuts to local government funding, some states are trying to provide relief in other ways. In Michigan, Gov. Rick Snyder came into office in 2011 seeking to consolidate the functions of local government. Since 2012, the Snyder administration has awarded about $44 million in grants "to stimulate smaller, more efficient government." In practice, that has meant more than 86 communities combining services, from trash collection to building inspection. Other states, such as New Jersey and Ohio, have also encouraged local governments to enter into shared services agreements.

Massachusetts has been something of an innovator in dealing with local revenue losses. Unlike most states, it has given municipalities new taxing authority. Though the state has restored some of its recession-era cuts, last year's revenue sharing program disbursements were still about $200 million below what they were a decade ago, not accounting for inflation. So the state passed a law allowing cities and towns to tax meals and increase their local hotel taxes. Last year, municipalities generated an additional $181 million through the taxes.

Localities in Massachusetts have portrayed the funding of municipal services as an investment strategy for the entire state. "If communities aren't succeeding, there's no way the state's going to compete economically," says Geoffrey Beckwith, the executive director of the Massachusetts Municipal Association. "What business is going to locate into an area if the class sizes are out of control, if the test scores are going down, if the roads are not in good shape and there is one police cruiser on duty at night? You're not going to attract business investment."

But even in Massachusetts, state relief has been uneven. Not every town has enough restaurants and hotels to make the new taxes worth implementing. In some places that could generate revenue that way, local leaders have decided to forgo the tax hikes because they believe residents couldn't bear the higher food bills.

Although revenue sharing to localities has rebounded lately in a few states with strong economic gains, these are the exceptions. The National League of Cities' past two annual surveys of finance officers indicate more localities experienced cuts in state aid than increases. And state budgets themselves are showing new signs of weakness.

Ohio's recent tax collections came in well below forecast, and state Office of Management and Budget estimates released in January indicated receipts were down 1.3 percent from last year. "Anybody that expects a significant inflow of new resources is going to be in for a rude surprise," says Keen, the state's budget director.

Many taxpayers wanting to take advantage of anticipated federal tax revisions will push income out of tax year 2016 into 2017, lowering states' tax receipts for fiscal 2017, says the feller Institute of Government's Don Boyd. On top of that, states will face greater pressures to spend more on health care and pension plan contributions. "It's going to be very strained over the near-term period," Boyd says. "It's not an environment in which

you should expect states to restore aid cuts to localities."

In Springfield, the city government has adapted as best it can. Some agencies have opted to cancel contracts with private vendors and bring work in-house to save money. Instead of paying a contractor to mow all of the city's abandoned lots, Springfield turned to mapping software to deploy its own crews more efficiently, and city employees now complete most of the work themselves.

But there's a limit to how far a government can go with less, and Springfield officials contend they're past that point. Chris Moore, who oversees public works for the city, says attracting and retaining employees is increasingly difficult as most city workers, already saddled with a bigger workload, have gone several years without a pay raise. "We do everything we can to make sure the citizens see zero reduction in service," Moore says. "Unfortunately, one day the charade will end."