Iowa's State Fiscal Crisis and Its Impact on Local Government

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Preface

This report is the fourth in a series of reports on Iowa's fiscal crisis prepared by the Iowa Fiscal Partnership. The principal authors of this report were Peter Fisher, Research Director of the Iowa Policy Project (cities); Victor Elias, of the Child and Family Policy Center (counties), and Jeremy Varner, intern with the Iowa Policy Project (city case studies).

We would like to gratefully acknowledge the assistance of Jim Nervig and Steve Ford of the Iowa Department of Management, Susan Judkins of the League of Iowa Cities, William Peterson and Jay Syverson of the Iowa State Association of Counties, and the officials of the cities and counties chosen for detailed analysis.

The report relies on primary data sources throughout: the city and county budget forms and annual financial reports that are submitted to the state. We analyzed both the state databases that contain selected items from these reports and, for the 34 largest cities, the full set of budget forms for each city for fiscal years 2001, 2003 and 2005.

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Executive Summary

The State of Iowa has experienced severe revenue shortfalls every year since fiscal 2001, creating budget problems that have impacted Iowa's local governments as well as state government. The capacity of Iowa's 99 counties and 949 towns and cities to provide basic local public services — police and fire protection, parks and recreation, planning and zoning, street and secondary road maintenance, and public health services — has been compromised. Cities and counties have been forced to lay off workers and increase service fees. They have spent down fund balances and increased property tax levies, in many instances to the maximum levy allowed by law.

One of the reasons that local governments have struggled is that the State of Iowa has passed them its own financial problems. The state has cut support for local governments by 42 percent — or $119 million — since FY01. The financial troubles of cities and counties were compounded by another problem: sluggish growth in the property tax base. Total non-TIF valuation rose just 6.5 percent between FY01 and FY05 (1.6 percent per year), while inflation in the cost of state and local government services was 9.4 percent (2.3 percent per year). With a stagnant tax base, rising costs, and reduced revenue from the state, many cities and counties increased property tax rates to maintain services. Between FY01 and FY05, the number of counties that had reached or exceeded their general fund levy limit increased from 70 to 97, and the percent of cities at the general fund limit rose from 71 percent to 78 percent. Seventeen counties now exercise their authority to exceed levy limits due to unusual circumstances, while only one county did so in FY01.

The spiraling cost of heath insurance has increased the cost of doing business for all employers, and local governments are no exception. From FY01 to FY04, the cost for county health insurance premiums increased by 78.4 percent. With general fund levies constrained, cities and counties turned to special levies to finance the rapidly increasing cost of health insurance. While other city property tax rates changed very little between FY01 and FY05, the average tax rate for employee benefits grew 32 percent. Meanwhile, the number of counties using the general supplemental levy rose from 72 to 92. On average, about three-fourths of the increase in overall city property tax rates is attributable to employee benefit levies.

More cities and counties have adopted local option sales taxes. This has not solved the financial problems facing local governments. Sales tax revenue has grown much more slowly than property taxes over the past four years. The local option sales tax, like the state tax, suffers from an eroding base due to the rising share of untaxed services and the shift to untaxed internet sales.

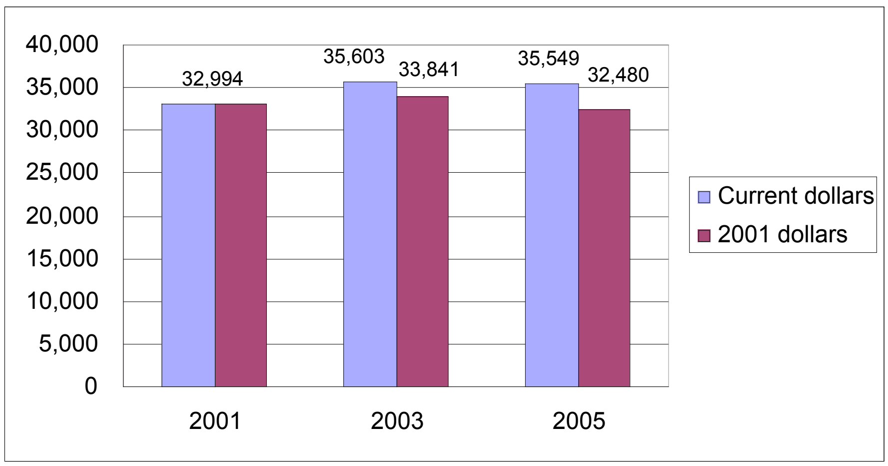
The Property Tax Base

Real property (land and buildings) remains the principal tax base for local governments in Iowa, despite the growth in local option sales taxes. While population and income growth drives increased demands for city and county services, and inflation in the cost of providing public services increases revenue needs, the property tax base has not generally grown commensurately. This is primarily due to the state

system of rollbacks, which has had the effect of reducing residential valuation to less than half its market value, and to the system of agricultural valuation (based on productivity rather than market value).

Overall gross taxable valuation in the state increased 8.3 percent between FY01 and FY05. Residential taxable value increased 16.4 percent over this period despite the rollback, and commercial and industrial property value grew almost 28 percent. Other classes of property — primarily agricultural land and buildings, and utility property — decreased. The fastest growing component of gross valuation was Tax Increment Financing (TIF) valuation, which grew in part because of the creation and expansion of TIF areas. TIF valuation grew by almost 50 percent over the four-year period (though it still accounted for just 5.7 percent of total value). Much of TIF valuation is dedicated to economic development or rebated to the property owner. Non-TIF valuation, which is a better measure of the tax base available to local governments to fund general city and county services, grew more slowly than total gross valuation — just 1.6 percent per year. The growth in total non-TIF valuation — 6.5 percent for the four years—is well below the rate of inflation as measured by the federal government's index for the cost of state and local government purchases, which increased 9.4 percent over that four-year period.

Per Capita Property Tax Base, Statewide

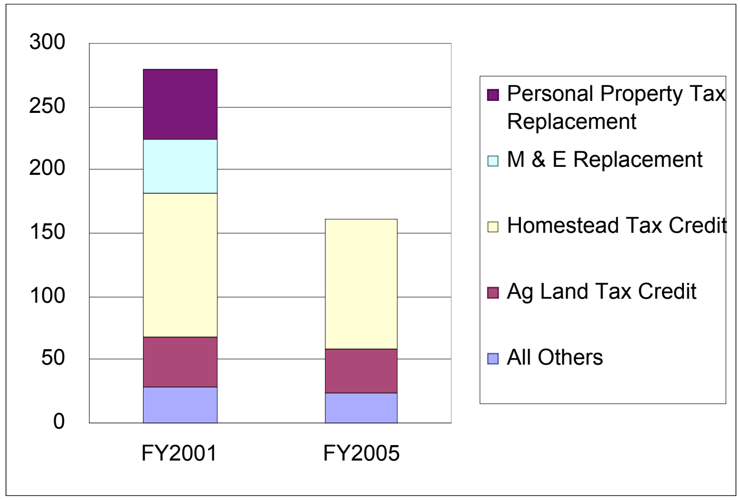


Combined with the tax rate limits, this slow growth in taxable valuation has clearly constrained the ability of cities and counties to finance services. For tax rates to remain constant while costs rise and population expands, taxable property values must increase enough to maintain a constant valuation per capita, after adjusting for inflation. Real (inflation-adjusted) per capita taxable valuation statewide did increase from FY01 to FY03, but has declined each year since, and in FY05 was 3.6 percent below its 2001 level.

Property Tax Replacement Funds

All local governments, including cities, counties, school districts, and community colleges, rely to a significant extent on state property tax replacement funds as a source of revenue. These replacement funds represent state revenue provided to local governments to compensate them for the state eliminating a local source of revenue (such as the property tax on machinery and equipment, livestock, or personal property) or to compensate them for state mandated property tax relief programs (homestead credit, military credit, and elderly and disabled credit). In FY01 these property tax replacement funds accounted for $280 million in revenue to all of Iowa's local governments. By FY05 these replacement funds from the state had been reduced by 42.4 percent to $161 million, a loss of $119 million in revenues to Iowa's local governments. By FY05, the only remaining property tax replacement money provided to local governments was to compensate for state mandated property tax relief. The state addressed its own revenue shortfalls by transferring the problem to local governments.

Total Property Tax Replacement Funds to Local Governments ($ millions)

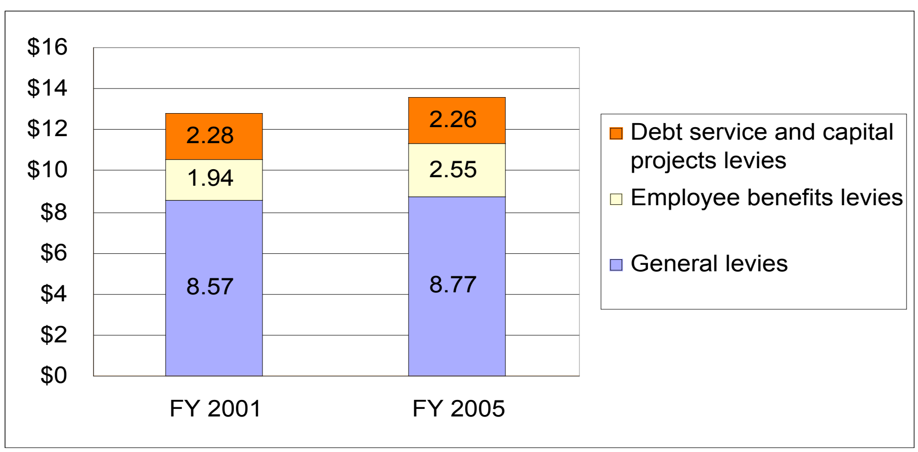


The City of Keokuk was probably the hardest hit by the elimination of machinery and equipment from the property tax base (and now the elimination of the reimbursement), losing over 10 percent of total valuation. This contributed to budget problems that led Keokuk to eliminate 10 full-time positions, or 9 percent of the city's workforce. Among counties, Clinton lost 12 percent of its property tax revenue (second only to Monroe County's 26 percent loss). Scott County lost $3.1 million in state tax replacements between FY03 and FY05, making up for the lost revenue by increasing property taxes $3.2 million.

City Revenues

One measure of the stress that the fiscal crisis has put on city governments is the actions that cities have taken to raise additional revenue. In Iowa, the property tax levy used to support the bulk of services, which are financed out of the city's "general fund," is effectively limited to $8.37 per thousand dollars of assessed valuation (the general fund levy of $8.10 plus the 27 cent emergency levy). In FY01, 71 percent of Iowa municipalities were at the $8.10 limit, and 23 percent also levied all, or nearly all, of the allowable emergency levy. By FY05, those proportions had increased; 78 percent of cities are now at the $8.10 limit, and 31 percent use at least 90 percent of the emergency levy.

Average City Property Tax Levies



Most cities have had little room to raise tax rates to offset the declining real per capita tax base, since most have been at the general fund levy limit for some time and many are using the entire emergency levy as well. Still, average property tax rates increased 6.2 percent from FY01 through FY05. However, 78 percent of that increase was attributable to the employee benefits levies, which are not subject to limit. These levies fund health insurance coverage and pension fund contributions. The City of Guttenberg, for example, has experienced increases in health insurance costs of 12 percent to 14 percent every year for the past several years, and has had to increase employee contributions, in addition to raising the property tax rate, to pay for these increases. Employee benefit costs have increased in Council Bluffs by 24 percent to 35 percent each of the past four years. Other cities have also passed on part of the cost increase to employees in the past two years: Cedar Rapids and Mason City are two examples. On average for all cities, the employee benefits levy was raised almost 32 percent over the past four years. General levy rates, in contrast, increased only 2.3 percent over this period.

Despite an increase in the number of cities employing the local option sales tax, budgeted real per capita local option tax revenue increased just 3 percent from 2001 to 2005 for all cities. Among Iowa's 34 largest cities, local option tax revenue actually grew more slowly than the cost of producing services, so that actual real per capita revenues declined from FY01 to FY03, and were expected to decline further in the next two years. These trends reflect two factors: (1) the long-term decline in the sales tax base as purchases shift from goods to services (which are less likely to be subject to the sales tax) and as consumers rely more and more on mail order and internet purchases, on which state sales tax is rarely paid; and (2) the effects of the recession, which reduced consumer spending, particularly on goods subject to the local sales tax.

Intergovernmental aid also fell during the past four years. As a result, cities turned to increases in property tax rates and increases in fees, fines and charges to make up for the lost revenue. In percentage terms, the largest revenue growth was in the category of fees, which increased 41 percent per person from FY01 to FY05. The City of Des Moines, for example, raised every one of the nearly 50 fees it charges.

City Expenditures and Fund Balances

In the face of declining revenues and a declining property tax base, cities have generally tried to preserve the most essential public services, such as police and fire protection. Cuts have been concentrated on public works and cultural and recreational programs. Overall, city government spending increased $10 in real per capita terms, a 1.8 percent increase, from 2002 to 2005. Most of this increase is attributable to the $14 increase in per capita spending for public safety, an area that accounts for about a third of city operating budgets. Because of rising costs, particularly of employee benefits, increased spending has often been accompanied by program cuts and elimination of positions, and many cities over this period reduced spending. Cedar Rapids cut over $3 million from its budget in the past two years, and eliminated 22.5 full-time-equivalent positions. Des Moines has eliminated 140 positions since FY02.

One means of maintaining services as much as possible and minimizing layoffs is to draw down fund balances. This is a one-time source of money and cannot be relied upon for more than two or three years in succession. When and if revenues recover, some of the increased revenue may be needed to restore fund balances as well as restore services. While cities are wary of digging too large a hole for themselves, many in the past two years have decided to deplete fund balances rather than lay off more city employees and cut services further. Council Bluffs, however, had to spend down its general fund budget from $6.8 million in FY01 to $4.6 million by the end of FY03, leaving it with little flexibility to deal with revenue shortfalls in FY04. As a result, the city eliminated eight positions that year in the fire and police departments, and cut one of the four ambulances, and then was forced to lay off eight additional workers mid-year when it was hit with $754,000 in cuts in state revenue. The city followed with further cuts in FY05: 12 more positions were eliminated, including eight in public safety.

Of the 34 cities with populations over 10,000, increasing numbers have drawn down fund balances to make up for revenue shortfalls. By FY04 and 05, about three-fourths of these cities had dipped into their fund balances. Twenty-nine had declining general fund balances in FY04, and the median change during that fiscal year among the 34 was -7.6 percent. Twenty-three of the cities project balances to decline again in FY05. During this period, the median city among the 34 largest saw its general fund balance at the start of the fiscal year decline from 27.0 percent of fiscal year expenditures in FY03 to 25.6 percent in FY04 and a projected 22.7 percent in FY05.

County Revenues

As is the case with cities, the recent economic recession has impacted the capacity of county governments to meet the needs of their residents. During an economic contraction, there is a continued demand on county services, but not a commensurate growth in property values, which is the primary source of county revenue. As a result, counties have struggled with a mismatch between revenue and services demands over the last few years.

As with city governments, state actions have exacerbated county financial troubles. Cuts in state tax replacements have put pressures on counties to draw upon their reserves or to increase property taxes. From FY01 to FY05, state tax replacement payments to counties declined by $38.6 million, or 25.4 percent. With this decline in county revenue, counties were forced to look at their major revenue source, the property tax, in order to meet continued need for county services including public safety, human services, elections and recording mortgage transactions. County property taxes increased by 19.4 percent from FY01 to FY05. In FY01, 29 counties were below their general fund levy limit of $3.50 per $1,000 valuation. Currently only two counties are below that limit. In FY01, 72 counties used their general supplemental levy. Currently, 92 of Iowa's 99 counties are using that levy. Currently 17 counties are exercising their authority to exceed levy limits due to unusual circumstances, while only one county did so in FY01.

County Expenditures and Fund Balances

Counties have worked to hold the line on county expenditures as they have dealt with declining state tax replacements and an increasing demand and cost for services. County total expenditures increased by a modest 8.8 percent between FY01 and FY05, below the 9.4 percent inflation rate as measured by the index for the costs of state and local government services. Even while trying to hold the line on expenditures, counties still saw an increase in the cost of public safety services, including law enforcement, jails, and criminal prosecution from FY01 to FY05. Over this period, county public safety costs increased by 22.9 percent, or $7.6 million. A significant portion of the increase in county cost is the increase in health insurance. From FY01 to FY04, the cost for county health insurance premiums increased on average by 78.4 percent. Winneshiek County saw its health insurance premiums for single coverage rise 240 percent between FY01 and FY04.

In an attempt to limit the need for property tax revenue, counties have spent down their balances by $31.7 million, so that in FY05 those balances are expected to be below 25 percent of county expenditures. Maintaining at least a 25 percent balance to avoid cash flow problems is considered important for good fiscal management, since county expenses occur throughout the year, while property tax revenues come in during the spring and fall.

Conclusion

Both city and county governments faced budget challenges from FY01 to FY05 that stemmed from common sources:

- An overall tax base (primarily property taxes) in which growth has not kept pace with the economy or demands upon local governments;

- Rapidly expanding health care costs for employees that represent an increasingly large part of local expenditures; and
- Declines in state property tax replacement funding, as a result of state efforts to deal with the state fiscal crisis.

While different city and county governments acted differently, in general city and county governments acted to maintain essential services, particularly police and fire protection, through:
- Raising property tax levies to the maximum rate allowed and, when necessary, adopting emergency levies;
- Spending down their budget reserves; and
- Raising fines, permit fees and charges for services.

Even with these actions, city and county budgets grew more slowly than the inflation rate, and the result has been some elimination of services and laying off of local government employees. The loss of state property tax replacement funds, totaling over $110 million, produced particular challenges. In many instances, these state actions had the effect of raising local property tax levies.

As cities and counties look into the future, many must replenish their budget reserves and seek sustainable funding bases for local services, with the current property tax base unlikely to be able to fully play that role.

Iowa's State Fiscal Crisis and Its Impact on Local Government

In this report we look at how the recession and the state's fiscal problems have impacted Iowa's local governments—its 99 counties and 949 towns and cities—over the past four years. To the extent that the availability of data permits, we look at overall trends among all 99 counties and all 949 cities. We also look in more detail at a subset of cities: the 34 cities with a population exceeding 10,000. These cities contained about 58% of the total population of cities in Iowa. Finally, we tell the stories of seven particular counties and eight particular cities—how they have coped with the budget problems of the past four years. We selected the counties and cities so as to include places from various regions of the state, urban and rural places, large and small.

We begin with a discussion of recent trends in the property tax base, as they affect all local governments dependent on property taxes— including cities, counties, and school districts. Next we review the system of property tax credits and replacements that affects local governments in Iowa. Then we focus on the particular impacts of the budget crisis on cities and counties. We look at the period from fiscal year 2000-01 (FY01 for short), before the major drop-off in state revenues, through fiscal year 2003-04 and, in some cases, through fiscal 2004-05 (FY05) budgets.

The Property Tax Base

As cities and counties grow in population, they also tend to grow in property tax base. Thus as the demands on public services increase due to the needs of a larger population, the tax base expands to support those services. Ideally, service levels can thus be maintained without raising property tax rates. A number of factors can conspire, however, to break this link. First of all, the cost of providing services increases. As long as inflation in property values equals the inflation in costs of government, the value of taxable property will rise with rising service costs, and tax rates need not change. However, over the long term, the cost of government tends to rise more rapidly than the general rate of inflation. This is because government, like services in general, is very labor intensive and the opportunities for increasing productivity are more limited than in the manufacturing sector. Technology continually reduces the cost and price of goods, but much less so with services, so services in general, and government services in particular, tend to account for an ever larger share of consumer spending and incomes over time.

Second, state constraints on the growth of taxable valuation have prohibited the tax base from expanding in concert with rising market values of property. State law limits the growth in taxable value for most classes of property to four percent annually. In addition to this four percent growth limit, state law also links the taxable value of agricultural and residential property to each other. The taxable value of agricultural property cannot grow faster than the taxable value of residential property, and the taxable value of residential property cannot grow faster than the taxable value of agricultural property. If the assessed value of both residential and agricultural property exceed four percent, then the increase in taxable value for both classes of property is restricted to the statutorily set four percent growth limit. The Iowa Department of Revenue applies these provisions by issuing an order that rolls back the taxable value of each class of property to comply with the statute. This is known as the rollback problem. While the rollback applies in theory to all the major classes of property, it has always been at or near 100% (that is, taxable value is 100% of actual value) for agricultural, commercial and industrial property. Over the past decade, however, the rollback percentage for residential property has steadily declined and such property is now assessed at less than half its market value.

Agricultural property is assessed according to its productivity as determined by a statutory productivity formula. The formula for determining productivity value is based on a five year rolling average of crop prices, crop yields, and operating expenses. In 2005 the value of agricultural land declined as a high-value year was dropped and a low-value year was added to the five year rolling average. This resulted in reducing the taxable value of agricultural property demonstrated in Table 1 below. In addition, because state law ties the taxable value of residential property to that of agricultural property, the overall taxable value available to Iowa's local governments also dropped. This presents serious problems for the future of local government revenue, especially if the state continues to reduce its property tax replacements.

Third, as incomes rise over time and as cities increase in size, residents tend to demand higher levels of public services. The tax base may or may not keep pace with rising demands, and there is thus pressure to raise tax rates.

Finally, the state legislature and governor often make tax policy for cities. In the past, taxes that cities have relied upon have been repealed or changed. The state has often provided localities with reimbursement from state revenues for the local taxes lost because of a state exemption, such as the exemption of manufacturing machinery and computers from the property tax. But these reimbursements may be for a limited time only, they may be and have been eliminated in subsequent years, and they may be underfunded when the state finds itself short of money.

Assessment limitations would not constrain city and county spending if there were no limits on tax rates. Conversely, tax rate limits are always a constraint, but they are less so if assessed values are free to rise with market value. The combination of tax rate limits and assessment limits through the residential rollback, on the other hand, can put severe constraints on the ability of local governments to raise the revenue needed to support the services the public demands.

Overall gross taxable valuation in the state increased 8.3% between FY01 and FY05, an average rate of just 2.0% per year (see Table 1). Residential taxable value increased 16.4% over this period despite the rollback, and commercial and industrial property value grew almost 28%. Other classes of property decreased.

Table 1. Taxable Valuation: Statewide Totals, 2001-2005

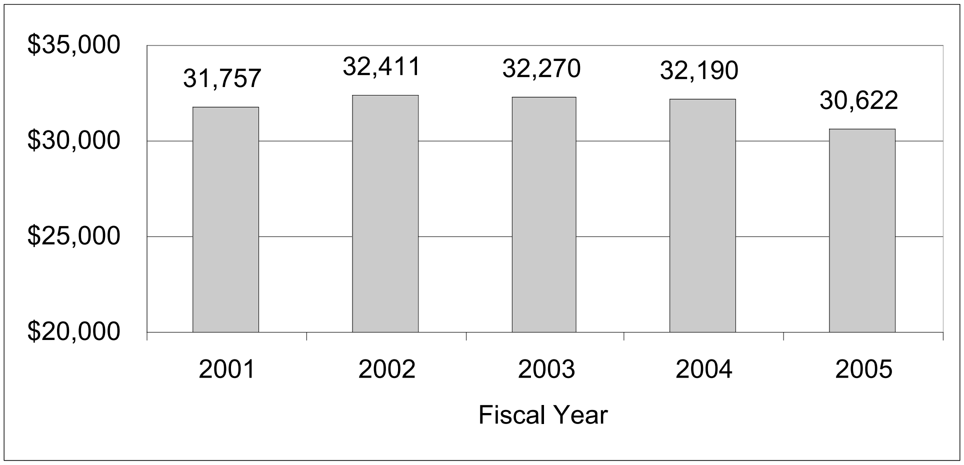
	Gross Valuation by Property Class						
Fiscal Year	Residential (less military exemption)	Agricultural Land & Buildings	Commercial & Industrial Realty	Utility, Personal, & Other*	Total Gross Valuation	TIF Valuation	Total Non-TIF Valuation
Taxable valuation, billions							
2001	38.8	23.9	23.9	10.0	96.6	4.0	92.6
2002	41.3	24.9	25.5	9.5	101.2	4.5	96.7
2003	42.9	25.3	27.4	9.0	104.5	5.2	99.3
2004	44.0	25.3	28.8	8.9	107.0	5.4	101.6
2005	45.1	20.7	30.6	8.2	104.7	6.0	98.7
Change, 2001 - 2005							
Amount	6.4	-3.2	6.6	-1.7	8.0	2.0	6.1
Percent							
Total	16.4%	-13.5%	27.7%	-17.3%	8.3%	49.4%	6.5%
Annual	3.9%	-3.6%	6.3%	-4.6%	2.0%	10.6%	1.6%
Share of total gross valuation							
2001	40.1%	24.8%	24.8%	10.3%	100.0%	4.1%	95.9%
2005	43.1%	19.8%	29.2%	7.9%	100.0%	5.7%	94.3%

*Includes all utility valuation (including gas and electric), reimbursable and non-reimbursable industrial machinery and computers, and railroads.

The fastest growing component of gross valuation, however, is TIF value, which grew by almost 50% over the four year period. As a result, non-TIF valuation, which is a better measure of the tax base available to local governments to fund general city services, grew more slowly than total gross valuation—just 1.6% per year. The growth in total non-TIF valuation—6.5% for the four years—is well below the rate of inflation as measured by the federal government's index for the cost of state and local government purchases, which increased 9.4% over that four-year period. Combined with the tax rate limits, this has clearly constrained the ability of cities and counties to finance services.

For tax rates to remain constant while costs rise and population expands, the real (inflation-adjusted) valuation per capita would have to remain constant. Real per capita valuation statewide did increase from FY01 to FY2002, but has declined each year since, and in FY05 was 3.6% below its 2001 level (see Figure 1).

Figure 1. Real Gross Taxable Valuation Per Capita (Statewide)



State Property Tax Replacements

All local governments, including cities, counties, school districts, and community colleges, rely to a significant extent on state property tax replacement funds as a source of revenue. These replacement funds are state revenue provided to local governments to compensate them for the state eliminating a local source of revenue (such as the property tax on machinery and equipment, livestock, or personal property) or to compensate them for state mandated property tax relief programs. As the table below indicates, in FY01 these property tax replacement funds accounted for $280,176,887 in revenue to all Iowa's local governments. By FY05 these replacement funds from the state had declined by 42.4% to $161,434,306, a loss of $118,742,581 in revenues to Iowa's local governments.

Table 2. Property Tax Replacements, All Local Governments

Type of Tax Replacement	FY 2001	FY 2005	Change	Percent Change
Personal Property Tax Replacement	$56,287,557	$0	-$56,287,557	-100.0%
Livestock Credit	2,000,000	1,770,342	-229,658	-11.5
Homestead Tax Credit	113,984,257	102,945,379	-11,038,878	-9.7
Agricultural Land Credit	39,100,000	34,610,183	-4,489,817	-11.5
Elderly and Disabled Property Tax Credit	15,762,909	19,540,000	3,777,091	24.0
Military Service Tax Credit	2,617,538	2,568,402	-49,136	-1.9
Machinery and Equipment Replacement	41,631,863	0	-41,631,863	-100.0
Franchise Tax Replacement	8,792,763	0	-8,792,763	-100.0
Totals	280,176,887	161,434,306	-118,742,581	-42.4

NOTE: For SFY 2005 the Agricultural Land Credit, Homestead Tax Credit, Elderly and Disabled Property Tax Credit, and Military Tax Credit were appropriated from the Cash Reserve Fund rather than the General Fund and represent a one-time funding source

Two legislative actions must be considered in exploring the condition of local governmental revenues between FY01 and FY05. During the 2003 session the General Assembly enacted and the Governor signed recommendations by the Public Strategies Group to eliminate the personal property tax replacement, and the bank franchise tax reimbursement. They also enacted the

Public Strategies Group's recommendation to accelerate the phase-out of the machinery and equipment tax replacement. Because of the way these are applied, elimination of these state tax replacements primarily affected counties and cities. In addition, because of the way these state tax replacements are applied under state law, when they are reduced or eliminated, local governments cannot pass these state reimbursement cuts onto the property tax payer. In effect, when the state did not appropriate funds for the personal property tax replacement, the machinery and equipment tax replacement, and the bank franchise tax replacement during the 2003 legislative session, local governments were forced to absorb the cuts.

The elimination of the state personal property tax replacement, the bank franchise tax reimbursement, and the immediate elimination of the machinery and equipment tax replacement were enacted after cities and counties certified their FY04 budgets by March 15, 2003 as required by law. After local budgets are certified, local governments cannot change their property tax askings to reflect any reductions or elimination of property tax replacements enacted by the General Assembly and signed by the Governor. These cuts in replacements for FY04 amounted to $70,000,000, after cities and counties certified their budgets anticipating receipt of this revenue. Since their FY04 budgets were already certified when the cuts occurred, the loss of this state revenue is most accurately reflected in the FY05 budgets.

During the 2004 session the General Assembly did fund the agricultural land tax credit, the homestead tax credit, the elderly and disabled property tax credit, and the military service tax credit.[1] However, they did not appropriate these credits from the state general fund as they had in the past. For FY05 the General Assembly appropriated these credits, totaling $159,663,964, from the state's cash reserve fund. This represents a one time source of revenue, as the cash reserve fund is almost depleted. This raises serious questions for local governments and local property taxpayers on where the General Assembly and the Governor will find the funds for these replacements in the future. If they are not appropriated, under current state law they would automatically result in increased property tax obligations of taxpayers currently receiving those credits.

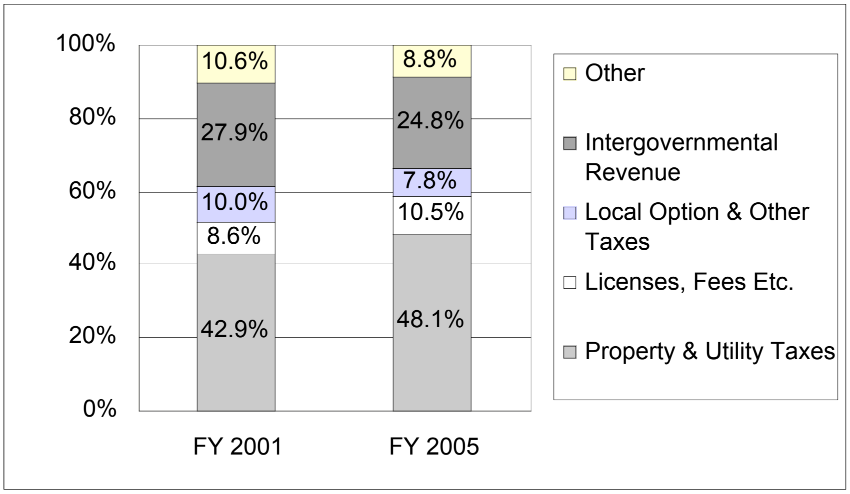
City Revenues and Budgets

Cities in Iowa are still heavily dependent on the property tax to support local services, though local option taxes, federal and state aid, and other revenue sources (fees, fines, charges, licenses, interest) together account for more than half of their revenue. Figure 2 shows the importance of the five major revenue sources for city governments: property taxes; local option taxes; intergovernmental revenue such as state and federal aids; charges for services, licenses, fines, and the like; and other sources such as interest. In the property tax category we include the gas and electric utility replacement excise tax revenue, since in earlier years such utility property was

[1] While it may be reported that these credits were "fully funded," it is worth noting that "full funding" of the ag land credit compensates local governments for only 25% of the property tax relief provided to taxpayers, and "full funding" of the military service credit covers less than a quarter of the tax relief provided to veterans, on average. Also, the funds provided by the legislature for the homestead credit for FY05 were sufficient to fund only about 81% of the credits. Starting in fiscal year 2005 local governments are actually required to pass on to taxpayers any shortfall in state funding below the "full" amount (see Ch. 25B.7 of the Iowa Code); thus taxpayers will receive only 81% of the full homestead credit.

part of the property tax base. We exclude revenues for city enterprises (self-supporting utilities) or trust funds.

Figure 2. Sources of Revenue for City Governments, Fiscal Years 2001 & 2005



There has been a substantial increase in reliance on property taxes. Property taxes (including Tax Increment Financing revenue) and utility replacement taxes grew from 43% to 48% of city revenue in just the past four years. Cities have also raised local fees, fines, charges, licenses and the like; these revenue sources grew from 8.6% to 10.5% of revenue. Despite some increase in the number of cities using the local option sales tax, revenue from this source and other local taxes actually declined from 10.0% to 7.8% of total revenue. Intergovernmental revenue declined in importance as well, as the state cut aids to local governments in order to balance the state budget.

In Iowa, the property tax levy used to support the bulk of services, which are financed out of the city's "general fund," is effectively limited to $8.37 per thousand dollars of assessed valuation. The general fund levy limit is $8.10, but cities at that limit may adopt by council vote an "emergency levy" of $.27, and the revenue from that levy can be transferred into the general fund. In Table 3 we show how many cities were at the general fund levy limit, and how many used all or most (90%) of the emergency levy. Here, as in other charts and tables, we divide the cities into four size classes based on population. In Fiscal year 2001, 71% of Iowa municipalities were at the $8.10 limit, and 23% also levied all, or nearly all, of the allowable emergency levy. By fiscal year 2005, those proportions had increased. In the current year, 78% of cities are at the $8.10 limit, and 31% use at least 90% of the emergency levy. Of Iowa's ten cities over 50,000 population, all but two are at the $8.10 limit, and half used all of the emergency levy.

Table 3. Cities at General Fund Levy Limit and Cities Using Emergency Levy

	City Population Size				
	50,000 or more	**10,000 - 49,999**	**2,500 - 9,999**	**Under 2,500**	**All Cities**
Number of Cities	10	24	93	822	949
Total Population (Est. July 2003)	851,727	489,094	472,076	475,396	2,288,293
Percent of Total Population in Cities	37%	21%	21%	21%	100%
Percent of Cities at $8.10 General Fund Levy Limit					
FY 2001	80%	75%	83%	70%	71%
FY 2005	80%	75%	91%	76%	78%
Percent of Cities Using at least 90% of emergency levy					
FY 2001	30%	25%	32%	22%	23%
FY 2005	50%	33%	44%	29%	31%

Average property tax rates increased for all four city size classes from FY01 through FY05 (see Table 4). In all classes, the bulk of the increase was attributable to higher employee benefit levies. Overall, total city property tax rates increased 6.2% over this period, and 78% of that increase was attributable to the employee benefits levies. Most of this increase is probably due to rising employee benefit costs, though some may be attributable to cities shifting employee benefits out of the general fund (if that is at its levy limit) and putting them under the unlimited employee benefits levy. At any rate, it is clear that most cities have had little room to raise tax rates to offset declining real per capita tax base, since most are at the general fund levy limit and many are using all of the emergency levy as well. On average, the employee benefits levy was raised almost 32% over the past four years.

Cities over 50,000 have the highest average tax rates, cities under 2,500 population have the lowest average rates. This no doubt reflects both the higher costs (higher wages reflecting higher housing and other living costs) and a wider range of public services in the largest cities. The largest cities also increased rates the most, the smallest cities the least, though it was the smaller cities that increasingly bumped up against the levy limits.

Table 4. Property Tax Rates in Iowa Cities by Population Size

Fiscal Years 2001 and 2005

	FY 2001	FY 2005	Change	Percent change
Cities over 50,000				
General levies*	$8.99	$9.15	$0.16	1.8%
Employee benefits levies	2.59	3.28	0.69	26.7%
Debt service and capital projects levies	2.41	2.48	0.07	2.9%
Total levy	$13.99	$14.91	$0.92	6.6%
Cities of 10,000 - 49,999				
General levies*	$8.13	$8.32	$0.19	2.3%
Employee benefits levies	1.34	1.97	0.63	47.5%
Debt service and capital projects levies	2.40	2.26	(0.14)	-5.9%
Total levy	$11.87	$12.55	$0.68	5.7%
Cities of 2,500 - 9,999				
General levies*	$8.46	$8.71	$0.25	3.0%
Employee benefits levies	1.89	2.53	0.63	33.5%
Debt service and capital projects levies	2.37	2.28	(0.09)	-3.6%
Total levy	$12.72	$13.52	$0.80	6.3%
Cities under 2,500				
General levies*	$8.19	$8.46	$0.27	3.3%
Employee benefits levies	1.04	1.34	0.29	28.1%
Debt service and capital projects levies	1.62	1.57	(0.05)	-2.9%
Total levy	$10.85	$11.36	$0.51	4.7%
All Cities				
General levies*	$8.57	$8.77	$0.20	2.3%
Employee benefits levies	1.94	2.55	0.61	31.6%
Debt service and capital projects	2.28	2.26	(0.02)	-1.1%
Total levy	$12.79	$13.58	$0.79	6.2%

Note: Property tax rates are weighted averages; for example, total employee benefits tax levies collected by cities over 10,000 population are divided by the total taxable valuation in those cities to arrive at an average employee benefits tax rate.

*Includes the regular general fund levy, all other voted and non-voted levies that go into the general fund, and the emergency levy.

Overall Revenues

While the property tax base has been declining, in real per capita terms, other revenue sources available to cities have not filled the gap. Despite an increase in the number of cities employing the local option sales tax, real per capita local option tax revenue declined 3.4% from 2001 to 2003, and declined, or is expected to decline, in each of the next two fiscal years as well, at least among Iowa's 34 largest cities (see Table 5). This drop reflects two factors: (1) the long term decline in the sales tax base as purchases shift from goods to services (which are less likely to be subject to the sales tax) and as consumers rely more and more on mail order and internet purchases, on which state sales tax is rarely paid; and (2) the effects of the recession, which reduced consumer spending in general and hence sales tax revenues. While the local option sales tax can generate significant revenue, it requires a referendum, and votes have failed in several instances (Des Moines, Cedar Rapids, Iowa City).

Intergovernmental aid also fell during the past four years. As a result, cities turned to increases in property tax rates and increases in fees (license and permit fees, fines and charges for services) to make up for the lost revenue. Fees in particular have grown rapidly as cities look for revenue sources over which they have more control.

Table 5. Changes in Real Per Capita Revenues, FY01-2005

34 Cities Over 10,000 Population

	Fiscal Years	Median Percent Change	Number of Cities Where Revenue: Decreased	Increased
Property taxes (excl. TIF) & utility repl. taxes	2001-03	2.9%	7	27
	2003-04	0.6	12	22
	2004-05	2.3	14	20
Local option taxes	2001-03	-3.4	19	14
	2003-04	-1.5	18	15
	2004-05	-1.3	22	12
Licenses, permits & charges	2001-03	1.9	14	20
	2003-04	2.0	10	24
	2004-05	4.0	10	24
State intergovernmental revenue	2001-03	5.7	15	19
	2003-04	-15.5	26	8
	2004-05	-4.4	24	10
Total revenue*	2001-03	0.5	16	18
	2003-04	1.0	16	18
	2004-05	2.1	12	22

*Sum of all taxes, licenses & permits, uses of money and property, intergovernmental revenue, charges for services, special assessments and miscellaneous, for all funds. Does not include transfers in, proceeds of debt, or capital asset sales.

Table 5 shows the trends in revenue for all Iowa cities over 10,000 population. The declines in state intergovernmental revenue and local option taxes are clear, with the majority of cities showing decreases in all three time periods. On the other hand, real per capita property taxes and fees and charges have increased for the majority of cities. Overall, there was a very slight increase in per capita revenue from 2001 to 2003; both these figures represent actual revenue. Revenue increased again in 2004; these represent re-estimated revenue figures prepared in February and March, a few months before the end of the fiscal year, and thus reflect the budget cuts adopted mid-year in response to cuts in state funding. Here as elsewhere in the table, the revenue increases for 2005 should be viewed with caution as they represent city forecasts as of March 2004 for the fiscal year ending June 30, 2005.

We saw above that the increases in property tax rates were attributable mostly to rising employee benefit levies. In Table 6 we see that employee benefits levies increased much more rapidly (50.5%) between 2001 and 2005 than overall property tax revenues (21.2%), in current dollars. As a result, employee benefits levies rose from 14.9% to 18.6% of total property tax levies. Employee benefits also increased much more rapidly than the overall cost of state and local government services.

Table 6. Employee Benefit Levies and Total Levies in All Cities, FY01 and FY05

	FY 2001	FY 2005	Pct. Change FY 01 - 05	Percent of Total Levy FY 2001	Percent of Total Levy FY 2005
Employee Benefit Levies					
Retirement	53,825,456	75,484,517	40.2%	8.0%	9.2%
Other	47,273,304	76,662,173	62.2%	7.0%	9.4%
Total	101,098,760	152,146,690	50.5%	14.9%	18.6%
Total levies	676,368,831	819,822,850	21.2%		

Note: Retirement includes the police and fire retirement levy plus the levy for FICA and IPERS (Iowa Public Employee Retirement System). The latter levy can be used only if the city is at the general fund levy limit.

If we look at budgeted revenues in four city funds (enterprises and trust funds excluded), we see that overall per capita revenues increased about 16% from FY01 to FY05 (see Table 7). Property taxes and fees recorded increases of about 25% and 41%, respectively, while local option taxes grew 12% and other revenues declined. However, these figures should be corrected for inflation in the cost of producing government services by expressing them in constant (2001) dollars). Table 7 shows the result: real overall per capita revenues increased just 6% during this period. Property tax increases and fee increases offset declines in intergovernmental and other revenue.

Table 7. Per Capita Revenue for All Cities, Fiscal Years 2001 and 2005

General, Special Revenue, Debt Service, and Capital Projects Funds

		In Current Dollars			In Constant 2001 Dollars		
	FY2001	FY2005	Change FY 01-05	Percent Change	FY2005	Change FY 01-05	Percent Change
Property & Utility Taxes*	$344	$431	$86	25%	$393	$49	14%
Local Option Taxes	62	69	8	12	63	2	3
Intergovernmental Revenue	214	222	8	4	202	-12	-5
Licenses, Permits, & Charges for Services	66	94	27	41	85	19	29
Other **	81	78	-3	-4	72	-10	-12
Total Revenue	768	894	126	16	817	48	6

*Includes TIF property tax revenues, mobile home taxes, and the utility replacement excise tax

**Use of money and property (interest, rent), special assessments, and miscellaneous revenue.

Expenditures

In the face of declining revenues and property tax base, cities have generally tried to preserve the most essential public services, such as police and fire protection. Cuts have been concentrated on public works and cultural and recreational programs (see Table 8). While the FY02 and 2003 figures are actual spending, and FY04 figures are re-estimates (including the effects of mid-year cuts in state funding), the FY05 numbers are budget projections. Overall, city government spending increased $10 in real per capita terms, a 1.8% increase, from 2002 to 2005. Most of this increase is attributable to the $14 increase in per capita spending for public safety, an area that accounts for about a third of city operating budgets. The largest percentage increase was for health and social services, though this area is not a major responsibility of city governments, accounting for just 5% of total operating expenditure. Many cities show no expenditure in this category.

Table 8. Per Capita Expenditure in All Iowa Cities, FY02 - FY05

Governmental Operating Expenditures, in Constant 2001 Dollars

	Actual FY 2002	Actual FY 2003	Re-Est. FY 2004	Budget FY 2005	Change FY 2002-05 Amount	Percent
Public Safety	$185	$189	$198	$199	$14	7.6%
Public Works	134	127	125	131	-3	-2.1
Health and Social Services	23	25	27	31	7	30.2
Culture and Recreation	97	98	94	93	-5	-4.9
Community and Economic Devel.	67	67	69	65	-2	-2.9
General Government	69	66	72	67	-1	-1.9
Total Governmental	575	572	586	585	10	1.8

Note: Expenditures for debt service and capital projects, and for proprietary or enterprise funds, are not included. Due to a change in reporting format, FY 2001 data could not be included

Fund Balances

One means of maintaining services as much as possible and minimizing layoffs is to draw down fund balances. Obviously, this is a one-time source of money and cannot be relied upon for more than two or three years in succession. When and if revenues recover, some of the increased revenue will then have to be devoted to restoring fund balances as well as restoring services. While cities are wary of digging too large a hole for themselves, many in the past two years have decided that dipping into fund balances is preferable to laying off more city employees and further cutting services.

Of the 34 cities with population over 10,000, the majority were able to increase slightly the balances in their general fund from the end of fiscal year 2001 to the end of fiscal 2002. Most were also able to increase the combined balance in all governmental funds that year (the general, special revenue, debt service, capital projects, and permanent funds combined). But beginning in fiscal year 2002, increasing numbers were drawing down fund balances to make up for revenue shortfalls (see Table 9).

Table 9. Percent Change in Fund Balances

34 Cities over 10,000 Population

	From July 1:	To June 30:	Percent Change Median	Wtd. Average	Number of Cities Where Balance Decreased	Increased
General Fund	2001	2002	2.6%	2.4%	14	20
	2002	2003	0.2	-0.9	16	18
	2003	2004*	-7.6	-11.5	29	3
	2004*	2005**	-5.5	-4.9	23	9
	2002	2005**	-14.9	-16.6	24	10
All Governmental Funds	2001	2002	3.9	11.1	15	19
	2002	2003	1.5	5.6	16	18
	2003	2004*	-9.9	-23.0	25	9
	2004*	2005**	-14.8	-17.1	29	5
	2002	2005**	-26.1	-32.6	30	4

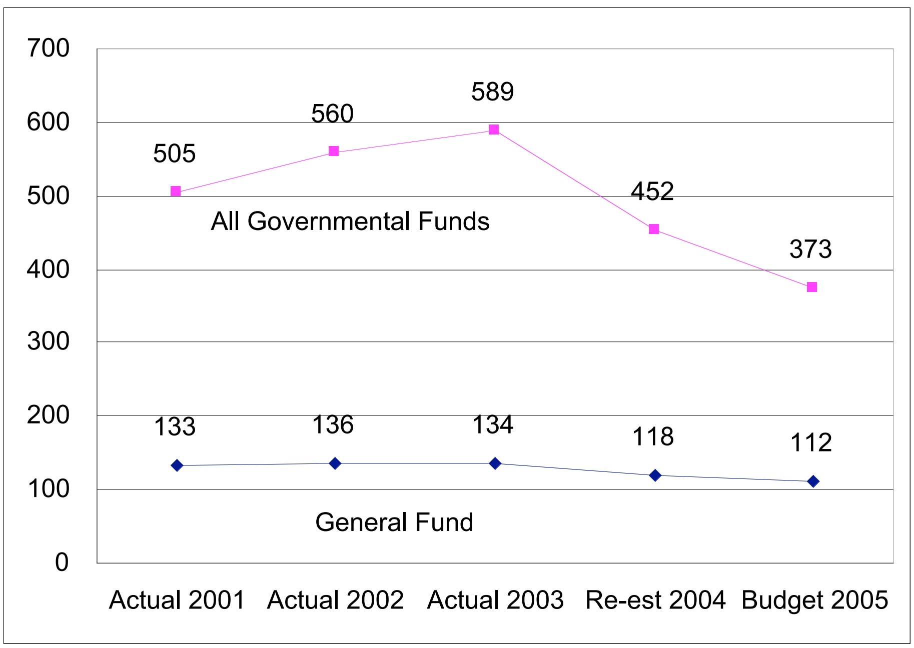
* Re-estimated balance

** Balance projected in the budget

By Fiscal year 2004 and 2005, about three fourths of these large cities were drawing their fund balances down further each year. Twenty-nine had declining general fund balances in FY2004, and the median change during that fiscal year among the 34 was -7.6%. Twenty-three of the cities project balances to decline again in FY05. When we look at all governmental funds, the pattern is similar. The median drop in FY04 was 10%, with 25 of the 34 showing a decline, and the median projected decline for FY05 is almost 15%. During this period, again considering the median among the 34 largest cities, general fund balances at the start of the fiscal year declined from 27.0% of fiscal year expenditures in FY03 to 25.6% in FY04 and a projected 22.7% in FY05.

The general trend can be seen more clearly in Figure 3. Here we show the per capita fund balances for the 34 cities, calculated as the total fund balances among all 34 cities divided by the combined population of those cities.

Figure 3. Per Capita Fund Balances: 34 Largest Cities Combined



Case Studies of Eight Cities

Eight cities were sampled to show the fiscal trends of individual communities in varying situations and the impact of changes in greater detail. The sample cities were selected based on whether or not they are located in a metro area, are growing or declining in population, and economic indicators. The cities selected include: Cedar Rapids, Council Bluffs, Des Moines, Guttenberg, Keokuk, Mason City, Osceola, and Sergeant Bluff.

Keokuk

The state legislature and governor often make tax policy for cities. In the past, taxes that cities have relied on have been repealed or changed. This lost revenue has had a large impact on many cities, especially those with troubled economies including Keokuk.

In FY04, the city lost utility tax replacement revenue totaling nearly $235,000 because of a settlement between the Iowa Department of Revenue and Interstate Power and Light Company (a subsidiary of Alliant Energy). The settlement required local governments to credit IP&L $3 million gradually FY04-2006 and reduces the tax rate IP&L is charged when delivering electricity and natural gas. Compounding the revenue loss was the fact the settlement was reached after city and county budgets were certified. Additionally, FY04 was the last year for "true-ups" which allowed more revenue to be levied if utility excise tax revenue fell short of what would have been generated through utility property taxes.[2]

Keokuk suffered other revenue reductions as well, including bank franchise tax revenue which had totaled more than $200,000. Reductions in machinery and equipment tax revenue hit Keokuk especially hard because of its relatively large industrial base.[3]

"We were probably the hardest hit [by M & E reductions] in the whole state," Keokuk City Clerk Donna Eilers said. "Our valuations went down about $46 million."

The cuts in FY04 came after the city's budget was already certified. The city adjusted by spending down its general fund reserve and other reserves. The city had already begun spending down its general fund reserve prior to the state cuts, from $1.9 million at the end of FY01 to $1.1 million at the end of FY03. However, by the end of FY04, the general fund balance had been spent down to a mere $471,000.[4] Other reserves, including the fire department equipment fund and insurance fund, were also spent down.[5]

In an effort to balance the budget, the city cut a total of ten full-time positions – roughly 9% of the city's full-time workforce. Three police officer positions were cut, two through early retirement. The remaining seven positions were eliminated by holding them vacant after

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[2] Iowa State Association of Counties. Available at: http://www.iowacounties.org/FiscalInfo/Articles/UtilityTaxProgram.htm
[3] Interview with Keokuk City Clerk Donna Eilers. The analysis and conclusions reached in this report are not necessarily those of Donna Eilers.
[4] Department of Management, Form FBW, FY03 and FY05
[5] Interview with Eilers.

employees retired or left city their jobs voluntarily. The reductions meant increased workloads for staff in the police department, parks and recreation, city hall, street department, sanitary sewer, and bridge department, Eilers said. The quality of city services was reduced as a result.[6]

As each department's budget was reduced, equipment purchases were deferred. The municipal library's budget was reduced; however, the council avoided sharp decreases that would have jeopardized its accreditation. Other cuts were made to parks and economic development.[7]

"We've kept a very tight rein on our expenses," Eilers said. "We're not buying anything [departments] don't need immediately."

Like many other cities, Keokuk has paid for increased costs associated with the Municipal Fire and Police Retirement System with reserve funds it had built up. However, Eilers said the reserves will soon run out adding another burden to the city's budget. While the Iowa Public Employee Retirement System (IPERS) has not seen such large increases, Eilers expects costs to increase in future years.[8]

At the start of the FY05 budget process, the city faced a $1.2 million deficit. The city had attempted to use $155,000 in Local Option Sales Tax (LOST) revenue earmarked for property tax relief to supplement its general fund, however, the State Appeal Board ruled the transfer illegal in March 2004. While the city has attempted to balance the budget through a combination of spending down reserves, deferring equipment purchases, and cutting expenses, it has yet to fully adjust to permanent state funding reductions.

"We're hoping our tax base will improve," Eilers said.

The property tax rate in Keokuk has increased from $11.71 per $1,000 of assessed valuation in FY01 to nearly $13.96 in FY05. However, decreases in property valuations (down 15% FY01-2003) and decreased state appropriations have led to reductions in total revenue.[9] Keokuk has been at the $8.10 general fund limit, and has used all of the 27 cent emergency levy for the past several years.

"To stay afloat with where we were last year, we had to raise all our levies because our valuations were down so much," Eilers said.

If revenue from the state does not increase, Eilers said the council will have to consider raising taxes even further, increasing fees, or further cutting employees and services.

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[6] Ibid.
[7] Ibid.
Keokuk city council meeting minutes, 2003-2004
[8] Interview with Eilers
[9] Department of Management, Form 635.1, FY01-2005
Department of Management, Form 631.1, FY01-2005

Des Moines

Reductions in state appropriations impacted every city in Iowa, including its capital and largest city, Des Moines, during the period FY01-2005. With cuts amounting to roughly $4.6 million annually, the city has adjusted by seeking additional revenue through fees and reducing expenditures by cutting employees and services.

Through FY01 and FY02, the impact of state funding reductions was relatively small. However, budget constraints in the following years pressed city officials to eliminate 140 positions paid for from the general fund and make significant reductions in the level of services provided.[10]

"The key thing with the state budget cuts is the timing as much as anything," Des Moines Finance Director Merrill Stanley said.

In FY04, cuts in revenue from the state came after the city budgets were already certified, exacerbating the problem, Des Moines Chief Budget Officer Allen McKinley noted. He said the city could not address the cuts in their budgets by raising tax revenue, even if it was politically palatable.

Stanley said that, in response to the budget cuts, "[the city] raised every fee." He noted the city council has raised property taxes only slightly over the past four years.

"We did very aggressive fee increases," Stanley said. "The people who pay are the people who use the services."

While the city did not charge more than the cost of the services being provided, he said the city attempted to bring user fees in line with the cost of the services. Among the nearly 50 fees increased were admission to swimming pools and ambulance fees, impacting their accessibility, especially for lower income families.[11]

Commercial license fees and franchise fees were also increased. While gas and electric franchise fees were set at only 1% of gross revenues in FY01, since the state eliminated its 5% tax, the city attempted to pick up a portion of that revenue by increasing their rates to 3%.[12]

Many city employees have been shifted from the general operating fund to various enterprise funds that are paid by fees instead of property taxes. While the city's general fund balance was not spent down, other fund balances saw significant reductions. The city's enterprise fund balances are expected to fall from $113 million at the beginning of FY04 to about $63 million at the end of FY05.[13]

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[10] Interview with Des Moines Finance Director Merrill Stanley and Des Moines Chief Budget Officer Allen McKinley. The analysis and conclusions reached in this report are not necessarily those of Merrill Stanley or Allen McKinley.
[11] Ibid.
[12] Ibid.
[13] Department of Management, Form FBW, FY05.

However, despite fee increases, revenues fell well short of expenditures and cuts were required. Dozens of employees were laid off and many vacant positions were held vacant or eliminated. No departments were spared though police and fire avoided the sharpest reductions, with the former losing staff in animal control and the latter accepting hiring delays. Office and administrative positions saw the largest cuts, most notably in human resources, community development, human rights, and finance.[14]

About 25% of the city's street lights were turned off to generate a savings of approximately $800,000 and parking and library fines were increased. Employee contributions were phased in to partially compensate for reduced pension fund earnings because of lower interest rates. While employee benefits have changed little, those in nonunion management positions have found themselves paying higher contribution rates for health insurance as well.[15]

"Health insurance inflation has been dramatic – well into the double digits," McKinley said.

This has been devastating to cities because of the pressure to keep tax rates even while the state revenue stream is squeezed, he said. McKinley noted those middle and lower management positions have also found themselves carrying heavier workloads in recent years.

"[City employees] are overworked and they don't feel a lot of job security," Stanley added.

Many city employees fear future cuts, especially with the possibility of a city-county merger on the horizon, he said. If the state should stop funding homestead credits, Stanley said another $4 million would be lost, devastating city services. The homestead credits are the only remaining operating support the city receives from the state.[16]

"The state tells us what we can and can't do [to generate revenue] and the list of what we can't do is ridiculous," Stanley said.

For example, the state-mandated maximum parking fine was only $5 prior to FY04, less than the cost of parking in a ramp, he said.

"They don't want us to raise property tax rates but they cut everything," McKinley said arguing the tax credits are state programs and should be funded by the state, not the cities.

City officials are continuing to search for other ways to generate revenue, Stanley said, noting gambling is one possibility. Recently, Des Moines agreed to a profit-sharing plan with Prairie Meadows Racetrack and Casino (owned by Polk County) that could draw $13 million over the next two and a half years and at least $7 million each following year. In exchange, the city council agreed to oppose any new casino in Des Moines.

"Anywhere we can have an effect, we're working to get our revenues up," Stanley said.

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[14] Interview with Stanley and McKinley.
[15] Ibid.
[16] Ibid.

Guttenberg

While the number of vacation homes in the Mississippi River community of Guttenberg has increased, its population has declined in recent years and the town has struggled with high unemployment following the closing of one of its largest employers.

With reduced revenue from the state, the city has managed to balance its budget by transferring money from proprietary funds, including water, sewer, and, most notably, from the city's electric utility. Guttenberg City Manager Tom Blake said funds were transferred from the electric utility to the general fund in FY04 to balance the budget deficit created when the state cut appropriations to cities after their budgets were already certified. While the city had transferred funds from its electrical utility in the past, they have increased substantially over the past two years, Blake said. To balance the FY05 budget, $142,000 was transferred from the electrical utility to the general fund. An additional $5,000 was transferred from both the water and sewer utilities.[17]

"We will likely increase our utility charges," he said.

However, with growing costs, the city has also needed to implement new levies and raise other levies to balance its budget. Property taxes have risen steadily from $11.79 per $1,000 of assessed valuation in FY01 to $13.68 in FY05. New levies were implemented to draw in revenue for insurance, local emergency management commission support, and employee benefits.[18]

"The city has done what it can to hold [down] taxes," Blake said noting cuts have been made and revenue has been transferred from proprietary funds. "We've also had some moderate cash reserves that we've been dipping into."

Among the areas cut was the city's police department, which sustained a 5% budget reduction in FY05, Blake said. Both the police and volunteer fire departments have seen their equipment purchases deferred and funds for the police dispatch were reduced.[19]

"We've spent less money on repairs and improvements," Blake said noting police vehicles purchases and flood control equipment maintenance have been deferred.

The city's administrative budget was reduced about 10% by having fewer audits and consulting with attorneys less often. Other city services, including the pool, have seen funding and staff cuts and the library has cut back its hours. Blake said he has worked with departments to keep their budgets in line with decreasing revenues.[20]

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[17] Interview with Guttenberg City Manager Tom Blake. The analysis and conclusions reached in this report are not necessarily those of Tom Blake.
[18] Department of Management, Forms 631.1 and 635.1, FY01-2005.
Interview with Blake.
[19] Interview with Blake.
[20] Ibid.

"The thing that really impacted us is the increase in benefit costs," he said.

Health insurance costs have increased at 12-14% each year drawing funds away from other needs, Blake said. To compensate for the increases, the city has increased employee contribution rates. The city currently has 18-20 full time employees year-round and 20-30 seasonal staff.[21]

"We have reviewed cutting a position or two and probably will if the trend [of decreased state revenue] continues," Blake said.

The city has also looked to utilizing prison inmates from the nearby Yellow River facility to offset the decrease in general fund revenue. Blake said that while the program has yet to supplant anyone, the inmates mow and work on special projects that the city would not otherwise be able to afford to do.

Sergeant Bluff

Two provisions in the Iowa Code have significantly restricted cities' ability to generate sufficient tax revenues to cover on-going expenses. Property tax rollback provisions restrict the growth in the taxable value of each property class (allowable growth) to 4% annually. Secondly, the taxable value of residential property is further limited because its total assessed value is tied to the total assessed value of agricultural property in the state. Essentially, residential and agricultural values are coupled so that statewide growth in one class cannot exceed the growth in the other.[22]

The suburb of Sioux City has seen substantial growth in terms of population and valuation. City Manager Lane Danielzuk added that the linking of residential and agricultural valuations has had a big impact on the city as well.[23]

"We're a lot better off than municipalities that aren't growing but we are not able to take full advantage of the growth," he said.

Other cuts including the loss of state shared revenues and bank franchise tax revenue totaled nearly $40,000, he said. While the cuts were put in place after the FY04 budget was already certified, the city was not hit hard because it had budgeted $50,000 for a position that was dependent on a referendum which later failed. In FY05, the city budgeted for reduced levels of service. All property tax funded services including police, fire, inspections, library, museum, parks and recreation and administrative departments received small budget reductions. However, no layoffs or hiring freezes have been needed.[24]

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[21] Ibid.
[22] Interview with Sergeant Bluff City Administrator Lane Danielzuk. The analysis and conclusions reached in this report are not necessarily those of Lane Danielzuk.
[23] Ibid.
Department of Management, Form 635.1, FY01-2005.
[24] Interview with Danielzuk.

"We were already lean," Danielzuk said noting the city's 28 full-time employees have seen their workloads increase.

Because the city is growing rapidly, there is pressure to increase services. In FY02, a new swimming pool was added, dramatically increasing the number of seasonal city employees. Much of the pool's operation was funded through the city's hotel/motel tax and a portion of its LOST revenue which has grown considerably. A new storm water utility was also created, however, it was paid for with user fees.[25]

In addition to the rising demand for services and reduced state revenue, costs have increased – especially in the area of health insurance. Sergeant Bluff is partially self-funded and mitigated double-digit percentage increases in health coverage costs by assuming greater risk. Thus far, the city has avoided passing on costs to employees or reducing benefits.[26]

Despite the rising cost of providing employees with benefits, the city has not needed to implement special levies. Property taxes rose from $7.45 per $1,000 of assessed valuation in FY01 to $11.09 in FY05. Only in FY04 did the city reach the $8.10 general fund levy limit. The city's debt service levy made up the balance of the tax rate increase.[27]

"We've tried to keep property tax increases fairly constant," Danielzuk said.

One of the primary ways the levies were held down was through the spending down of fund balances. The city's general fund balance fell from $457,000 at the end of FY03 to a mere $10,393 budgeted for the end of FY05.[28]

Council Bluffs

As with most cities in Iowa, Council Bluffs did not experience any significant budget problems during FY01 and FY02. However, in the course of the following three fiscal years, the city had to make sharp cuts in services as significant deficits emerged.

The spiral downward began in FY03 when the state cut the percentage of exemptions that were funded, Council Bluffs Finance Director Terry Mauer said. Pottawattamie County opted to fund these exemptions for one year costing the city roughly $106,000 in anticipated revenue. Additionally, a settlement with Mid-American Energy cost the city $124,000 each year FY03-2006. The settlement came after the city's FY03 budget was certified and property taxes were already set.[29] The city made up for the lost revenue by spending down its general fund balance from $6.8 million in FY01 and FY02 to $4.6 million at the end of FY03.[30]

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[25] Ibid.
[26] Ibid.
[27] Department of Management, Form 635.1, FY01-2005.
[28] Interview with Danielzuk.
Department of Management, Form FBW, FY03 and FY05.
[29] Interview with Council Bluffs Director of Finance and Personnel Terry Mauer. The analysis and conclusions reached in this report are not necessarily those of Terry Mauer.
[30] Department of Management, Form FBW, FY03.

In FY04, the city lost additional revenue as a result of the rollback on residential valuations. In addition to the spending of general fund reserves, a variety of cuts were made. Eight positions were eliminated through attrition including four in each the fire and police departments which had 113 and 116 authorized positions respectively. Additionally, one of the city's four ambulances was cut.[31]

After the city's budget was balanced and certified, the city lost $754,000 in revenue from the state. The city reacted by continuing to spend reserves and eliminating eight additional positions – this time through layoffs. The parks and recreation department was hit the hardest, losing four employees.[32]

Council Bluffs' significant gaming revenue has helped it absorb much of the deficit. Totaling about $4.3 million each year, the gambling revenue had been earmarked for infrastructure projects, Mauer said. However, after the state cuts hit, the revenue started to be used for operating expenses impacting the city's bond rating. In FY05, about a quarter of the gambling revenue was devoted to supplementing the general fund with the balance being used for property tax relief.[33]

"I don't know how some of these cities without gaming money make it," he said. "We could do so much with it, but we can't now because of the state cuts."

In FY05, the city's valuations actually decreased despite the addition of a $40 million shopping mall to the tax rolls.[34]

"[The coupling of residential and agricultural valuations] is dragging down the residential value," Mauer said noting that cities with a high percentage of residential property are hit the hardest. "It's one of our biggest problems."

Mauer said it's hard for the city to provide necessary services for residential areas as they grow when they don't generate enough revenue. Revenue shortfalls in FY05 meant further cuts. Twelve more positions were eliminated including eight in public safety. Since FY01, the police department staff has been reduced by 6% and the fire department staff has been cut 8%.[35]

While revenue from the state has been reduced, city costs have continued to rise. The cost of health insurance and other benefits has hit Council Bluffs the hardest. The annual average cost per employee rose 31% in FY01, 24% in FY02, 35% in FY03, and 24% in FY04. Police and fire pension fund costs have also risen sharply.[36] The substantial growth in these costs has resulted in increased property tax levies. Property taxes have risen from $15.72 per $1,000 of assessed valuation in FY01 to $17.77 in FY05 primarily through employee benefit levies. The city began using its 27 cent emergency levy in FY03.[37]

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[31] Interview with Mauer.
[32] Ibid.
[33] Ibid.
[34] Ibid.
[35] Ibid.
[36] Ibid.
[37] Department of Management, Form 635.1, FY01-2005.

By the end of FY05, the city expects its general fund balance to be down to $3.2 million – 53% lower than in FY01.[38]

"It looks bad to bond rating agencies," Mauer noted.

Council Bluffs has attempted to bring in new revenue wherever it can. It systematically reviewed all of its fees and raised many including parking meter, pool, golf course, and permit fees. However, the amount of revenue generated was relatively small. The city's LOST revenue has increased, however, it is entirely devoted to sewer projects.

The city has attempted to shift some costs to enterprise funds paid by fees to free up more general fund revenue. For example, a percentage of mechanics' positions were shifted to water and sewer funds and a health inspector is now paid out of the sanitary fund. However, Mauer said city officials can only be so creative and eventually they run out of ways to shift costs to enterprises. He added that healthy utility fund balances have allowed Council Bluffs to make the shifts without rate increases, however, if the current fiscal trends continue, rates will likely rise.[39]

Mason City

Located in north central Iowa, Mason City is a regional center where retail stores have concentrated in recent years. A 1% local option sales tax generates revenue from consumers throughout the region which drive an hour or more to the city's large retail outlets. This has made the city somewhat of a budgetary anomaly with significant option sales tax and hotel/motel tax growth offsetting much of the $476,000 deficit caused by state cuts. Other cities of comparable size including Burlington, Clinton, Fort Dodge, Ottumwa and Marshalltown, have faced more serious budget shortfalls.[40]

"We had the good fortune of having our retail sales help offset the impact of [state] budget cuts," Mason City Manager Tim Moerman said. "We were able to maintain the same level of service because of our strong sales tax growth."

However, new revenue from the LOST (half of which is used for property tax relief), hotel/motel taxes, and rising valuations were not able to entirely make up for decreased state assistance and inflation. Mason City Finance Director Kevin Jacobson said the salaries of city employees have been growing faster than inflation and benefit costs have soared. The city has used reserves to hold down the rising cost of health care coverage, Moerman said. While benefits have not been reduced, in FY04 the city began asking its employees to make contributions of $15-20 each month depending on their department.[41]

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[38] Department of Management, Form FBW, FY01-2005.
[39] Interview with Mauer.
[40] Interview with Mason City City Manager Tim Moerman and Finance Director Kevin Jacobson. The analysis and conclusions reached in this report are not necessarily those of Tim Moerman or Kevin Jacobson.
The state cuts included: $291,000 in lost state municipal assistance, $185,000 in lost personal property tax replacement funds, and lost bank franchise tax revenue.
[41] Ibid.

With a population of over 14,000, Mason City is required to participate in the state's police and fire retirement program. The growing cost of this program has placed an increased burden on the city's budget, Moerman said. Property taxes in Mason City have risen about 3% FY01-2005 with retirement and other benefit levies making up the bulk of the increase.[42]

Mason City has also increased building permit rates, made small cuts in several departments, and increased parking fines. However, these revenue gains have been relatively small, Jacobson said.[43]

"In general there is a higher demand for resources, but not more available," Moerman said.

Jacobson said the city has not needed to hold positions vacant or layoff any of its 255 employees but expenses have been reduced where possible. The city expects to have spent down 17% of its general fund balance between the end of FY01 and the end of FY05. Other city funds have also seen their balances shrink.[44]

While most cities are deferring maintenance, Mason City is currently undergoing an aggressive capital improvement program, Moerman said. In the past the city's infrastructure was neglected and city officials are currently working to catch up (deferred maintenance).

Cedar Rapids

Balancing municipal budgets has been a difficult endeavor for officials in cities both large and small in FY04 and FY05. Cedar Rapids had more than $3 million permanently cut from its budget. Among the funds lost were $2.3 million in state replacement funds, $800,000 in utility replacement tax revenue, and $110,000 in bank franchise tax revenue.[45]

"We had to scramble to make ends meet," Cedar Rapids Finance Commissioner Lyle Hanson said noting the bulk of the cuts were implemented in FY04 after budgets were certified.

While the cuts were significant, the city council resisted raising taxes, Hanson said. From FY03-2005, taxes rose 2.9% to $13.12 per $1,000 of assessed valuation mostly due to increases in benefit levies.[46] Health insurance costs were relatively stable prior to FY04, however, in FY04 and FY05 they increased 20% each year and in FY06 Hanson is expecting an even larger increase. As a result, employee participation was increased, but the city (which is self-insured) did not decrease benefits.[47]

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[42] Department of Management, Form 635.1, FY01-2005.
[43] Health insurance contributions were expected to generate about $34,000. Increased building fees were expected to generate $60,000.
[44] Department of Management, Form FBW, FY01-2005.
[45] Interview with Cedar Rapids Finance Commissioner Lyle Hanson. The analysis and conclusions reached in this report are not necessarily those of Lyle Hanson.
[46] Department of Management, Form 635.1, FY01-2005.
[47] Interview with Hanson.

Large increases in costs from the Municipal Fire and Police Retirement System have been funded by both increasing property taxes and dipping into reserve funds.[48]

"The impact [of increased pension costs] was huge … it made a difference on the budget," Hanson said.

Hanson said the city is trying to wean itself off of its reserve funds as they diminish by slowly raising the corresponding benefit levy. However, he noted many cities are using reserve funds unsustainably and will have large shortfalls when they are depleted in coming years. Thus far, the cost of IPERS has not increased as quickly as the police and fire retirement system.[49]

To balance the budget, the city has cut a variety of expenditures. A total of 22.5 full-time equivalent positions were cut as the result of a 5% across-the-board budget cut, Hanson said. While many of the cut positions were vacated voluntarily, some layoffs occurred, he said. The cut positions generated approximately $1.25 million in savings, he said.[50]

"We've tried our best to minimize the impact on the public but there are some areas that will be noticed," Hanson said.

Responding to the public takes longer, street maintenance is less effective, and parks are going longer without being mowed, he said. While Hanson hopes most of the cuts aren't be noticeable, he said they are incremental and employees are picking up greater workloads in many departments.

"[Balancing the budget] continues to be a challenge," he said noting the city has dealt with some of the state cuts but has yet to come to terms with some of the others.

In FY06, Hanson said the city may need to lay off employees, raise taxes, and possibly use reserves as a stop gap measure to make up for lost revenue from the state. Shifting costs to enterprise funds and raising fees and is not a viable option since the city has a formula for handling the funds in a fair and equitable way, Hanson said.

The city has no LOST or gambling revenues, but has managed to maintain a relatively low property tax rate in comparison to other large cities in Iowa.[51]

Osceola

State constraints on the growth of assessed valuation (in the form of residential rollbacks) have prohibited cities' tax bases from expanding with the rising market values of property. Osceola was no exception.

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[48] Ibid.
[49] Ibid.
[50] Ibid.
[51] Ibid.

“For those communities that are basically residential, [the rollbacks] have hurt bad,” Osceola City Administrator Ralph Lesko said. “We’re struggling to give services and we’re being pushed into a hole.”

Other cuts in revenue from the state were less serious but nonetheless significant. Unfunded or under-funded property tax credits, lost bank franchise tax revenue, and other lost revenue has totaled as much as 4-5% of the city’s general fund budget, Lesko said.
Many of the cuts, most notably those in FY04, were put in place after the city’s budget was certified. Lesko said Osceola managed to avoid sharp cuts by dipping into reserves. Because of legislative uncertainty, the city has budgeted conservatively and maintained healthy fund balances.[52]

“[The state legislature is] trying to manage the cities instead of setting policies,” Lesko said.

He said the state has put an unfair burden on cities since they can’t raise revenue to absorb inflationary costs. Osceola had reached its general levy limit prior to FY01 and has since increased property tax rates only through increased benefit levies.[53]

Like many cities, Osceola has been struggling with high unemployment – especially since the closure of the Siemens’ plant, one of the city’s largest employers, in 2002. However, unlike most cities, Osceola has a casino within its city limits that generates substantial revenue for the town of 4,700. Lesko said the city has tried to avoid using revenue from the casino for operating costs, instead earmarking the funds for city infrastructure improvements. However, if the budget outlook weakens further, he said the city may need to use gambling revenue to supplement the general fund to avoid significant cuts.[54]

Thus far, no layoffs have been needed to balance the budget, Lesko said. However, all 24 non-utility positions are evaluated if they open up and, at times, they are temporarily held vacant or replaced by part-time positions. Lesko said many cities are increasingly utilizing part-time employees to avoid rising health care costs. While they were expected to rise significantly in Osceola, the city managed to hold them stable FY01-2005 (in current dollars) by increasing deductibles and creating a new lower-cost plan. Employees who voluntarily joined the new plan had their contributions reduced for two years.[55]

Lesko noted it is common to shift employees from being paid by the general fund to enterprise funds if they have responsibilities associated with utilities. However, Osceola has avoided raising utility fees in lieu of property taxes since all employees completing tasks associated with utilities are already paid with utility revenue.[56]

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[52] Interview with Osceola City Administrator Ralph Lesko. The analysis and conclusions reached in this report are not necessarily those of Ralph Lesko.
Department of Management, Form FBW, FY03 and FY05.
[53] Department of Management, Form 635.1, FY01-2005.
[54] Interview with Lesko.
[55] Ibid.
[56] Ibid.

County Revenue and Budgets

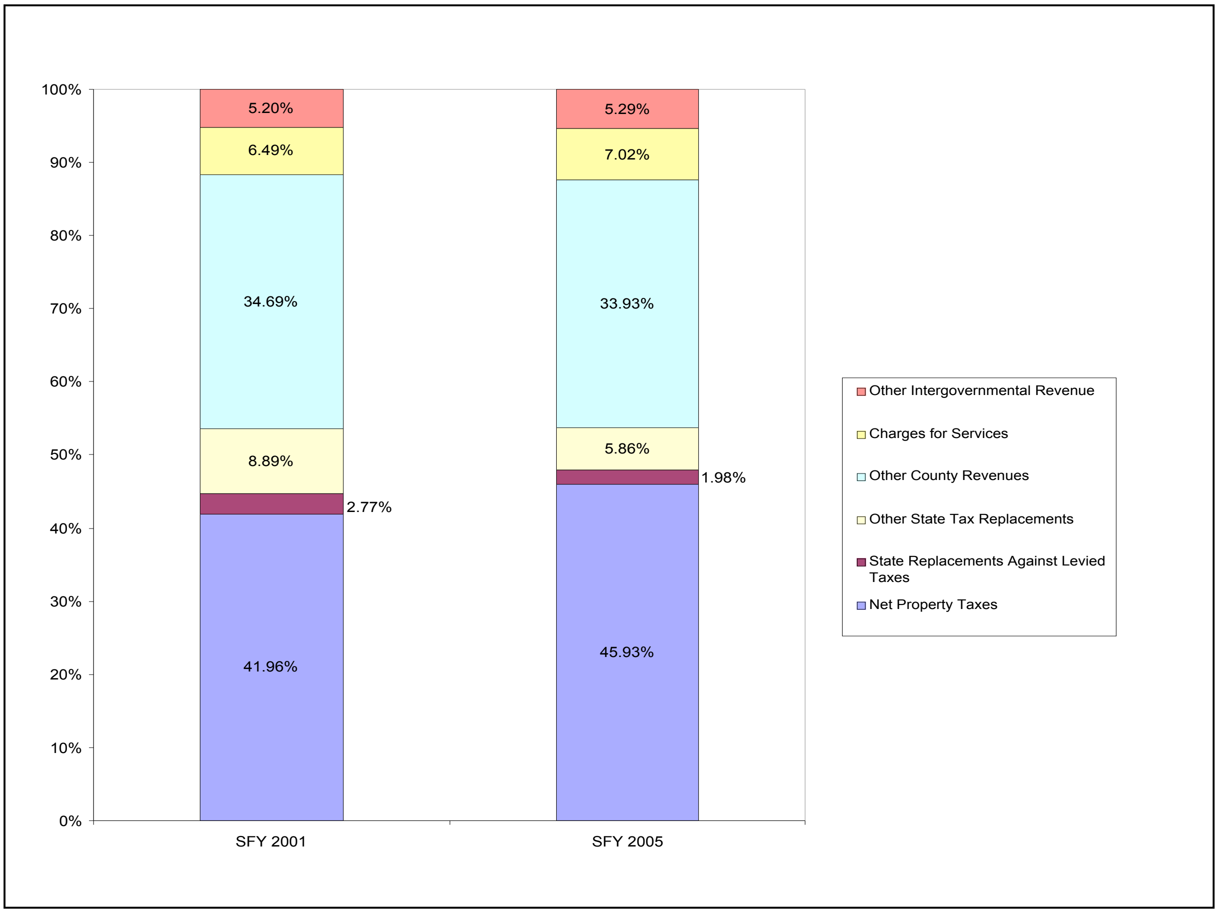
The purpose of this section is to examine the effects of the recession and state fiscal decisions on county governments by reviewing county revenues and budgets since FY01. This section looks at changes in county property tax rates, revenues, expenditures and fund balances for all of Iowa's 99 counties. In addition it takes a more in-depth review of seven counties and how they have dealt with recent fiscal problems.

This analysis is based upon the Department of Management's summaries of county budgets for FY01. The Department of Management's summaries of county FY05 budgets were not available at the time of this report. For FY05 we used a summary of county budgets collected from the counties by the Iowa State Association of Counties.

County Revenues

Counties rely on property taxes as their largest source of general revenue. They also receive state replacements against levied taxes, other tax replacements, other county revenues, charges for services, and other intergovernmental revenue. The county general fund levies property taxes throughout the county, both in urban and unincorporated areas, to support county wide services. The rural levy is applied only in the unincorporated area of the county to support only rural services, primarily roads and bridges in the unincorporated area. Figure 4 below illustrates the counties' reliance on these major revenue sources.

Figure 4. Major Sources of County Revenues FY01-2005



In Table 10 below, net property taxes are countywide property taxes levied after being adjusted by state replacements against levied taxes and uncollected delinquent taxes. The table includes taxes received from both the countywide and rural tax levies. The state replacements against levied taxes include: the homestead tax credit, the elderly and disabled tax credit, the agricultural land tax credit, and the family farm tax credit. Between FY01 and FY05 these state replacements against levied taxes were reduced by $7,532,274, or 20.8%. As opposed to the other state tax replacements, funds received from the state as replacements against levied taxes reduce the amount paid by the taxpayer. In other words, the state pays part of the property tax bill of the homeowner, or the elderly, or owners of farm land.

Table 10. Major County Revenue Sources Changes FY01-2005

Revenue Source	2001 actual	2005 budgeted	Change 01-05	Percent Change
Net Property Taxes	$547,937,685	$665,542,054	$117,604,369	19.4%
State Replacements Against Levied Taxes	36,169,517	28,637,243	-7,532,274	-20.8%
Other State Tax Replacements	116,054,524	84,939,492	-31,115,032	-26.8%
Other Intergovernmental Revenue	452,976,290	491,623,596	38,647,306	8.5%
Other County Revenues	84,753,958	101,781,173	17,027,215	20.1%
Charges for Services	67,966,599	76,605,596	8,638,997	12.7%

Other state tax replacements to counties were reduced by $31,115,032, or 26.8%, between FY01 and FY05. These other state tax replacements include: mobile home replacement, military service replacement, mental health property tax relief, industrial machinery and equipment replacement, and personal property tax replacement. Unlike state replacements against levied taxes, counties cannot directly reduce their property tax askings for these other state tax replacements. If, as happened in FY04, the state reduces or eliminates more of these other tax replacements after budgets are certified, counties cannot make up for the loss of this revenue by changing their property tax askings.

Other intergovernmental revenue received by counties increased by $38,647,306 or 8.5%, between FY01 and FY05. By far the largest source of this other intergovernmental revenue is the counties' allocation from the road use tax fund for secondary roads and bridges. The other intergovernmental revenue category also includes state and federal pass-through funds and grants such as public health nursing, FEMA, Maternal and Child Health grants, payments for care of prisoners, and MH-DD funds. These other intergovernmental revenues are generally "earmarked" by state or federal law for specific purposes. Therefore, they are not flexible funds for counties and are not available to make up for losses in other revenue categories.

Counties also receive revenues by charging for services. This category of revenues increased by $8,638,997, or 12.7%, between FY01 and FY05. This category includes fees charged by the county Recorder, Treasurer, and Sheriff, along with zoning fees, public safety fees, recreational fees, health fees (nursing services, client care services, etc., usually charged on a sliding fee scale), and landfill and recycling fees. The largest portion of this revenue category is from Recorder, Treasurer, and Sheriff fees. These fees are mostly established in state law and cannot be adjusted by the county to increase revenues to offset revenue losses from other sources. The real growth in this category can be attributed to the increased volume of services to residents provided by the Recorder and Treasurer, such as auto registration fees and fees for recording of instruments. The recent home refinancing boom brought on by lower mortgage rates has resulted in an increase in Recorder's fees, especially in larger counties. As home mortgage rates level out or start to rise, these recording fees will likely start to decline and return to historical growth levels that reflect more normal patterns of real estate development and home sales, rather than reflect the large number of mortgages refinanced during recent years.

Other county revenues increased by $17,027,215, or 20.1%, between FY01 and FY05. Among the items accounted for in this category are: earnings from investments and rents, special assessments, sale of commodities, fines for ordinance violations, unclaimed property, operating transfers, proceeds from debt and fixed asset disposition. This category also includes licenses and permits such as alcohol and tobacco permits, building permits (if a county is zoned and has building codes), and water well permits.

The combined 25.4% ($38,647,306) reduction in state tax replacement revenues between FY01 and FY05 was a significant revenue loss to Iowa's counties, especially as their costs continued to rise along with public demand for services. One place counties have looked to replace these lost state funds is from its largest revenue source, property taxes.

County Property Taxes and Levy Rates

The amount of property tax revenue a county receives is based upon a combination of taxable value and tax levy rates. The gross taxable value of real estate available to counties increased by 6.1% between 2001 and 2005, considerably less than the 9.4% increase in the federal government's index of cost for state and local governments over the same period. To make matters worse, the gross taxable value of real estate actually declined by 3.3% from 2004 to 2005, demonstrating the effect of the rollback problem discussed earlier. This means that if counties are going to meet the increased cost and demand for services while at the same time adjusting to cuts in state tax replacements, counties will have to increase their levy rates.

Counties have three major tax levies that are applied to property in both the incorporated and unincorporated areas of the county: the Basic Levy for General County Services, the Supplemental Levy for General County Services, and the Mental Health-Developmental Disabilities (MH-DD) Levy. Two other major property tax levies are applied only to property in the unincorporated area of the county: the Basic Levy for Rural County Services, the Supplemental Levy for Rural County Services.

The Basic Levy for General County Services has a levy limit of $3.50 per thousand dollars of taxable valuation. The Basic Levy for Rural County Services has a levy limit of $3.95 per thousand dollars of taxable valuation. These limits may be exceeded if either of the following two conditions are met:

(1) If a special levy election is passed.

(2) If a county has unusual circumstances and includes additional information in the notice of public hearing on its county budget. This additional information must include:

- A statement that the budget requires a levy rate above the legislated limit.
- A comparison of the proposed levy rate with the limited rate, and the dollar amount of that difference.
- A statement of the major reasons for the difference between the proposed levy rate and the limited rate.

Counties may use supplemental levies for General County Services and for Rural County services under certain conditions. There are no statutory limits on these supplemental levy rates; however, they can be used only if the county is at the statutory maximum levy rate for the associated fund.

The General County Services Supplemental Levy can be used only for the following purposes:

- Substance abuse admission, commitment, transportation, or care and treatment costs at Oakdale, a State Mental Health Institute, or a community based facility.
- Care of children admitted or committed to the Iowa Juvenile Home at Toledo.
- Foster care and related services under court order.
- Elections and voter registration.
- FICA, IPERS, and unemployment compensation premiums for personnel providing general county services.
- Joint county and city building authorities.
- Tort liability, property, and other necessary insurance.
- Costs for maintenance and operation of the courts.
- Establishment and maintenance of a joint count indigent defense fund.
- Maintenance and operation of a local emergency management agency.

The Rural County Services Supplemental Levy may only be used for FICA, IPERS, and unemployment compensation premiums for personnel providing rural county services, and for county contributions to an aviation authority.

Table 11 illustrates the counties' certified General and Rural levy rates for FY01 and FY05. Twenty-nine of Iowa's 99 counties were below the Basic Levy for General County Services limit in FY01. By FY05, only two counties were below that limit. In FY01, there was only one county above the Basic Levy for General County Services limit; by FY05 there were 17 counties above that limit. In FY01 there were 69 counties at the Basic Levy for General County Services limit; by FY05 there were 80 counties at that levy limit. In FY01, 72 counties used the General County Services Supplemental Levy; in FY05 that supplemental levy was used by 92 counties.

A significant portion of the taxable value available for the rural services levies is assessed as agricultural property. The recent decline in agricultural property value as determined by the productivity formula has placed increased pressure on the rural levy rate

In FY01 there were 89 counties below the Basic Levy for Rural County Services limit; by FY05 there were six fewer, or 83 counties below that limit. In FY01 there were no counties above the Basic Levy for Rural County Services limit; by FY05 there were two counties above that limit. In FY01, nine counties were at the Basic Levy for Rural County Services limit; by FY05 there were 14 counties at that levy limit. In FY01, seven counties used the Rural County Services Supplemental Levy; by FY05 10 counties used that levy.

Table 11. County Levy Rates

	FY 2001	FY 2005	Change 01-05
General Basic Levy rate below limit	29	2	-27
General Basic Levy rate above limit	1	17	16
General Basic Levy rate at limit	69	80	11
Counties using Supplemental General Basic Levy	72	92	20
Rural Basic Levy rate below limit	89	83	-6
Rural Basic Levy above limit	0	2	2
Rural Basic Levy at limit	9	14	5
Counties using Supplemental Rural Levy	7	10	3

As Table 11 demonstrates, some counties were able to increase their general basic levy rates to the rate limit to address declining taxable value, reduced state tax replacement, and/or the increase in demand and cost for services. Some counties also shifted allowable costs from their general basic levies to their supplemental levies in order to have greater flexibility in using their property tax revenue to meet county needs. In fact, some counties even took advantage of the statutory provisions allowing them to levy beyond their general fund levy limits to meet unusual circumstances. Counties cannot continue to exceed their general fund levy limits on an ongoing basis, however, and with only two counties below the general fund levy limit in FY05, the likelihood of growth in property tax revenue is questionable. This is especially true if the value of agricultural land continues to decline, and its effect on the rollback continues to restrict increases in the taxable value of agricultural and residential classes of property. The county revenue problem is further exacerbated if the state continues to underfund, or completely eliminate state tax replacements. With additional revenues being questionable, counties are also adjusting their expenditures as they attempt to resolve their budget dilemma.

In short, counties faced new challenges in budgeting during the 2001-2005 due in significant measure to state actions that eliminated or reduced property tax replacements to counties. In order to meet their budget needs and replace lost state funds, counties increased their overall property tax collections. Many counties did so through increasing their property tax levies to the maximum and, in some instances, exceeding it. By the end of 2005, almost all counties were at least at their basic general levy limit, and have limited options to raising levies in the future.

County Expenditures

The county budget summary documents available from the Department of Management were used to determine how county expenditure decisions changed over the FY01 to FY05 time period. Counties use a chart of accounts adopted under statute by the County Finance Committee to budget and account for their expenditures. The chart of accounts is organized on a functional rather than a departmental basis. The table below illustrates county expenditures for FY01 and budgets for FY05, by chart of accounts program areas. Because the chart of accounts changed in 2002, the program areas of Public Safety and Legal Services, Physical Health and Social Services, and County Environment and Education are approximations based upon combining similar program areas from the previous chart of accounts.

Table 12 below shows that county expenditures increased by 8.8% between FY01 and FY05, or $135,389,463. This increase is below the 9.4% inflation rate of over that same period as measured by the federal government's index for the cost of state and local government purchases.

The largest dollar increase in county expenditures between FY01 and FY05 occurred in the Public Safety and Legal Services program area. This program area increased by $57,585,872, or 22.9% between FY01 and FY05. The Public Safety and Legal Services program area includes expenditures for law enforcement by the sheriff's department, legal services including criminal prosecution by the county attorney, emergency services, detention facilities, assistance to the district court system including physical facilities, court costs and law libraries, and juvenile justice administration including court appointed attorneys and court costs for juveniles. The increase in this program area reflects the cost of increased incarceration and criminal prosecution, as well as heightened security concerns as a result of September 11.

The next largest expenditure increase was in the Interprogram Services - Administration program area. (The name of this program area was changed from “Interprogram Services” to “Administration” in the 2002 county chart of accounts.) This program area increased by $19,769,445, or 13.3% between FY01 and FY05. The Interprogram Services – Administration program area in the table below relates to policy and administration, central services, and risk management services. This includes general county management under the Board of Supervisors, the County Auditor functions related to property tax administration, accounting, budgeting, and financial reporting, and the County Treasurer functions related to property tax collection, accounting, debt management, investments, and financial reporting. It also includes data processing, unemployment compensation, tort liability and property insurance, and other general county services that cannot be directly allocated.

The State and Local Government Services - Services to Residents program area represents a name change for this program area in the 2002 chart of accounts, but the services accounted for in this program area did not change. The State and Local Government Services - Services to Residents program area in the table includes costs of elections administration and local elections, township officials’ compensation, the duties of the County Treasurer concerning motor vehicle registration and licensing, and issuing drivers licenses. It also includes the County Recorder’s responsibilities for recording documents. This program area increased by $11,660,885, or 25.3% between FY01 and FY05. Over this time period there have been significant efforts to improve elections administration. There has also been a significant increase in recording documents as a result of the large amount of mortgages that have been refinanced.

The Roads and Transportation program area increased by $28,214,989, or 8.0% between FY01 and FY05. This program area includes secondary roads administration and engineering, roadway maintenance, and roadway equipment acquisition and operation. It does not include expenditures related to roadway construction which is accounted for under the Capitol Projects program area.

It should also be noted that the Interprogram Services—Administration program area, the State and Local Government Services—Services to Residents program area, and the Roads and Transportation program area are labor intensive. It is here that the increasing cost of health insurance for county employees will be best demonstrated. As part of its annual county employee/salary survey, the Iowa State Association of Counties asks about health insurance rates for county employees. From FY01 to FY04, the health insurance rates for a single employee increased by 78.4%. This translates to almost a 20% increase in health insurance rates for each of those four years. This is large contributing factor to the growth in county budgets for these program areas.

The Physical Health and Social Services program area included educational services in FY01, but these services were moved to County Environment and Education in the 2001 chart of accounts. The Physical Health and Social Services program area increased by $9,547,826, or 6.1% between FY01 and FY05. This program area includes physical health services such as home nursing, maternal, newborn, and infant care, sanitation, the local board of health, support of hospitals, general welfare services, veterans services, support of persons in RCF facilities who are not diagnosed MH/MI/DD, children and family services, services to the elderly, and treatment and preventive chemical dependency services. The increase in this program area reflects increased health care costs, and an increase in the elderly population and their need for services. It also reflects a significant portion of new homeland security funds that are applied to services through the county board of health. However, the 6.1% increase in spending was well below inflation in the cost of government services, suggesting that some service levels were actually reduced.

In part, counties have dealt with reductions in state credit replacements and slow taxable valuation growth by reducing expenditures in three program areas, and reducing their ending fund balances.

The County Environment program area was changed by the 2002 chart of accounts to include education services, which had previously been part of the Physical Health, Social Services, and Education Services program area. Now called County Environment and Education, this program area declined by $1,546,672, or 1.6% between FY01 and FY05. County Environment and Education provides for environmental quality, including flood and erosion control, rural water systems, air quality programs, solid waste disposal, and environmental restoration including clean up of underground storage leaks. The program area also funds county conservation board activities including administration, maintenance and operations, and recreation and environmental education. In addition, the County Environment and Education program area is used to fund county development which includes land use and building controls, housing rehabilitation and development, and economic development. The educational services that were moved to this program area in the 2002 chart of accounts includes support of libraries, historic preservation, fair and 4-H clubs, fairgrounds, memorial halls, and other educational services such as art centers, museums and other facilities open to the general public.

The Nonprogram Current program area declined by $2,770,334, or 41.6% between FY01 and FY05. This program area includes county farm operations, interest on short term debt, and pass through grant monies to other governments or organizations.

The Capital Projects program area declined by $6,006,587, or 3.9% between FY01 and FY05. This program area includes roadway construction, county conservation land acquisition and capital improvements, and other county capital projects. Counties are clearly delaying these capital projects in trying to reduce expenditures and avoid or limit property tax increases as they respond to cuts in state tax replacements and a restriction in taxable value.

The Debt Service program area accounts for redemption of general obligation bonds and other long term debt. This program area also includes interest and other financial charges related to such debt. The Debt Service program area increased by $4,635,476, or 13.2% between FY01 and FY05.

Between FY01 and FY05, counties considerably reduced their ending fund balances as a way to cope with declining state funds and slow growth in taxable values. Counties reduced their ending fund balances by $31,710,611, or 7.3% between FY01 and FY05. In FY01, county ending fund balances were 28.1% of total expenditures, while in FY05 they were 24.0% of expenditures.

Table 12. County Expenditures, FY01 – FY05

Program Area	FY 2001	FY 2005	Change	Percent Change
Public Safety and Legal Services	$251,492,084	$309,077,956	$57,585,872	22.9%
Physical Health and Social Services	157,218,198	166,766,024	9,547,826	6.1
Mental Health MR,DD,CD	295,163,097	309,461,660	14,298,563	4.8
County Environment and Education	96,183,292	94,636,620	-1,546,672	-1.6
Roads and Transportation	351,282,465	379,497,454	28,214,989	8.0
Interprogram Services - Administration	148,710,804	168,480,249	19,769,445	13.3
State & Local Government Services - Government Services to Residents	46,110,856	57,771,741	11,660,885	25.3
Nonprogram Current	6,666,663	3,896,329	-2,770,334	-41.6
Debt Service	35,005,287	39,640,763	4,635,476	13.2
Capital Projects	154,147,699	148,141,112	-6,006,587	-3.9
Total Expenditure	1,541,980,445	1,677,369,908	135,389,463	8.8
Total Ending Fund Balances	433,930,788	402,220,177	-31,710,611	-7.3

In short, counties have worked to hold the line on county expenditures as they deal with declining state tax replacements and an increase in the need and cost of services. This is especially evident in the areas of public safety, human services, and other services to residents such as elections and recording mortgage transactions. Counties significantly reduced their fund balances in responding to this situation. County total expenditures increased by a modest 8.8% between FY01 and FY05, below the 9.4% inflation rate as measured by the federal government index for costs of state and local government services.

Implications for the Future

The recession that has occurred in Iowa has had an effect on county government as well as state government. There are continued strains on the need for county services, but not a commensurate growth in property values, a primary source of county revenue. Counties have struggled with serious revenue problems over the last few years.

In addition, however, state actions have exacerbated county challenges. State tax replacements for personal property tax and machinery and equipment were eliminated in FY04. The timing of this decision meant it was too late for counties to adjust to the lost revenue by adjusting their tax askings. Other losses of state tax replacements have put pressures on counties to draw upon their reserves or to increase property taxes. Currently, all but two counties are at or above their maximum general fund levy rate. Counties have been spending down their balances so that in FY05 those balances are below 25% of county expenditures. Maintaining a 25% balance is considered good fiscal management, especially as county expenses occur throughout the year, while property tax revenues come in during the spring and fall.

State actions in 2005 and beyond will determine how well counties are able to continue to provide services and whether they will have options other than increased property taxes in providing them. As a whole, counties have spent down their reserves and increased their levies while holding down spending during the period from 2001 to 2005. Even with an economic recovery, however, counties have depleted their options to sustain current spending patterns without additional state support. This is the picture for counties as a whole. Each of the ninety-nine counties is different, and counties have been affected in different ways by the recession and by state policy actions. The next section describes the experiences of seven counties.

Case Studies of Seven Counties

Seven counties were sampled to examine their responses to the recent financial situation. They were selected in order to provide a range of population and geographic area. The counties selected are Buena Vista, Cerro Gordo, Clinton, Polk, Scott, Wapello, and Winneshiek. Unlike cities, county departments are not centrally administered. To a large extent each elected official, the County Attorney, County Auditor, County Recorder, County Sheriff, and County Treasurer manages its own department within the operating budgets approved by the County Board of Supervisors.

Buena Vista County

Buena Vista County has increased its total revenue from $9 million in FY01, to $12.6 million in FY05. This is an increase of 40.6%, or about $3.7 million. The county has relied heavily on increased property taxes in meeting its budget needs. Its property tax revenue increased from $3.8 million in FY01, to $5.6 million in FY05. That is an increase of $1.8 million, or 46.9% over that period. Despite reductions in state tax credit replacements, Buena Vista County's intergovernmental revenue increased by $1.6 million, or 46.5% over the period from $3.5 million to $5.1 million. The major portions of this increase are road funds, and care of prisoners in the county jail from other counties. Buena Vista County also reduced its fund balances over this period by 6.4%, or about $227,000.

On the expenditure side, Buena Vista County has increased funding for public safety and legal services by about $420,000, or 25.2%, from FY01 to FY05. The county spent $1.7 million on public safety and legal services in FY01, and is budgeting $2.1 million for FY05. It has kept MH/DD expenditures under control during this period where there was a decrease in county spending of about $203,000, or 3.1%. The county's physical health and social services spending rose slightly at about 5%.

Buena Vista county had a significant increase in nonprogram current expenditures in 2004. There was also a significant increase in capitals (roadway construction) in 2003 that was unbudgeted.

Cerro Gordo County

Cerro Gordo County's total expenditures increased by about $5 million, or 22.4%, from $10.3 million in FY01 to a budgeted $12.4 million for FY05. The largest increases were in capital projects, public safety, health and social services, and county environment. Cerro Gordo did spend down its fund balances by about 10% from FY01 to FY05. Cerro Gordo increased its property taxes from $8.3 million in FY01 to $9.4 million in FY05. This is an increase of about $1 million, or 12.2%. Total county revenue increased from $20.4 million to $24.9 million, an increase of 21.9%, or about $4.5 million.

Cerro Gordo county was below the levy limit in its Basic General Fund levy in FY01, with a rate of $3.29 per thousand dollars of taxable value. However in FY05 it is levying at the rate limit of $3.50 per thousand dollars, and is using the General Supplemental levy at a rate of $1.50 per thousand dollars of taxable value. Cerro Gordo has also increased its levies for the Rural

Services fund, from $3.20 per thousand in FY01, to $3.40 in FY05. In addition Cerro Gordo's taxable valuations increased over this period. Cerro Gordo's intergovernmental revenues have also increased. Revenue from other intergovernmental units almost doubled between FY04 and FY05. In addition, state grants and entitlements doubled from FY03 to FY05.

Clinton County

Total Clinton County expenditures increased somewhat between FY01, at $22.2 million, and an FY05 budgeted $23.5 million. This amounts to a 5.8 % increase in total county expenditures, significantly below the 9.4% inflation rate as measured by the federal government's index for costs of state and local government purchases over the same period. Clinton County's total revenue over this period increased by 19.8%, from $18.4 million in FY05 to $22 million in FY05, an increase of $3.6 million. Most of this increase can be attributed to the county's increasing property taxes. In FY01 Clinton county levied $7 million in property taxes, as compared to FY05 when its budgeted levy is $10 million, an increase of $3 million, or 43.5%.

Clinton County was one of the counties hit hardest by the state's elimination of personal property tax replacement, and the accelerated elimination of the machinery and equipment property tax replacement. Between FY01 and FY05, Clinton County saw only an 8.3% increase in Intergovernmental Revenues, including road use tax funds.

Before the elimination of the property tax on machinery and equipment in 1993, Clinton County trailed only Monroe county in its reliance on the property tax on machinery and equipment. In 1993 machinery and equipment property taxes accounted for 12.0% of Clinton County's total property taxes. Only Monroe County, at 25.6%, was more reliant on machinery and equipment property taxes.

Clinton County has seen no increase in its taxable valuation over this period; in fact, it saw a slight decline of almost $5 million, or 0.3%. Clinton County has been very dependent on spending down its fund balances to offset its slight need to increase its budget. In FY01 its fund balance was $12.5 million, by FY05 it was budgeted for $4.8 million, a decline of $7.7 million, or 61.7%.

On the expenditure side, Clinton County has reduced its budget for physical health and social services by more than 15% since FY01. It has also reduced its annual capital projects budget by about 55%, or $1.1 million over the same period.

Polk County

Polk County lost almost $2 million in revenue as a result of the elimination of the personal property tax replacement. Since this took effect after Polk County had already certified its FY04 budget, the county made up for the lost revenue by using its cash reserves. For its FY05 budget the county decided not to further deplete its reserves, but built the loss of this revenue into their budgeting decisions. Absent a state policy change, this will be a permanent revenue loss to Polk County. Polk County did increase its property taxes by about 10% between FY03 and FY05

Polk County saw an increase of about $4 million from other intergovernmental units for care of prisoners at the Polk County jail. It also reduced its capital expenditures by $9 million having paid for a new senior center and juvenile detention center.

While trying to hold down property taxes in the face of declining state revenues, Polk County made extensive efforts to maintain services and limit administrative costs. It reduced its administrative costs of services to the poor by 46% between FY03 and FY05, while only slightly reducing its general welfare services. A reorganization of the county's community and youth services departments eliminated 20 positions. In addition, a two-year agreement between the county and its unions has resulted in no base wage increases since FY04. Because Polk County has a self-funded health insurance program it was able use its reserves in order to limit increases to less than 13%. On the other hand, the state's limits on the allowable growth for Mental Health/Mental Retardation/Developmental Disabilities services resulted in the county's having to institute a services waiting list for the first time. This waiting list was later eliminated when the federal government increased its match rate for Medicaid service.

Scott County

The revenue picture for Scott County has been tight since FY03. It has seen a $3.1 million loss, or 42.8% decline, in state tax replacements, along with a significant loss of revenues from other intergovernmental units. In trying to meet service demand, Scott County has increased its property taxes by $3.2 million over the same period, a 13.6% increase. Scott County has been able to avoid additional service cuts and property tax increases by spending down its balances. Between FY03 and FY04, Scott County reduced its ending fund balances by $3.5 million, or a reduction of 18.1%.

During this period Scott County has seen increased costs in its public safety program, with an increase of 17.5%, or $2.4 million. Much of this is a $1.5 million increase in county jail costs between FY03 and FY05. The other major areas of expenditure increase were in roads and transportation, with an increase of 29.4%, or about $891,000. Most of this increase was in roadway maintenance, including about $170,000 for snow and ice control alone. There is also a one time expenditure of almost $300,000 for new equipment budgeted for FY05. Scott County has kept it administrative costs under control by limiting its "services to residents" line item to just under 10%, despite a 28% increase in health care insurance costs over the FY03 to FY05 period.

Wapello County

Wapello County has seen significant reductions in both county expenditures and total county revenue since FY01. Total county revenue declined from $19.2 million in FY01 to $15.5 million in FY05. That is a decline of 19.6%, or about $3.8 million. Over that same period total county spending declined by about $5 million, or 23%, from $21.7 million in FY01, to a budgeted $16.6 million in FY05. Wapello County also saw a significant decrease in its local option sales tax revenue, from $3.1 million in 2003 to a budgeted revenue of $1 million in FY05

Wapello County saw a significant loss in intergovernmental revenue over this period, from $9.5 million in FY01, to $6.1 million in FY05. This amounts to a 35.5%, or $3.4 million reduction in intergovernmental revenue over the period..

Even with its decline in county spending, Wapello County had to increase its property taxes from $5.1 million in FY01, to $5.9 million budgeted for FY05 in order to meet its funding obligations. This amounts to a 17.1% property tax increase, or about $865,000.

Wapello County reduced its MH/MR/DD funding by 9.7%, or $412,000. Roads and transportation were reduced by $684,000, or 18.1%. The largest reductions were in the following areas: Nonprogram Current, $2.3 million, or 95.9%, Debt Service, $2.1 million, or 90.6%, Capital Projects, $419,000, or 19.6%. Wapello County also doubled it General Welfare budget between FY03 and FY05.

Winneshiek County

Winneshiek is the smallest county sampled, with a total budget of $14.3 million in FY05. It has seen significant loss of revenue as a result of state tax replacement cutbacks. Between FY03 and FY05 state tax replacements to Winneshiek County dropped by $300,000, or 23.1%. In addition, the county also lost about $253,000 in revenues from other intergovernmental units over the same period. In addition, the county's taxable value remained virtually flat with only a 1.6% increase in valuation between FY03 and FY05. In fact, Winneshiek County levied $300,000 less in property taxes in FY05 than it did in 2003, a drop of 5.6%. Fortunately, the county saw almost a 24% increase in local option tax revenues of $231,000. In addition, its federal pass-through revenue increased by $935,000 or 140%.

Winneshiek County tried its best to hold down expenditures over this period. However, costs for public safety increased, including a 27.9% increase for law enforcement officers, and a 40% increase in jail costs. Costs for government services to the public increased by about 42%, including an increase in elections cost of 70%. Winneshiek County found it difficult to hold down personnel cost as it faced a 240% increase in health care premiums for single coverage between FY01 and FY04.