

Trends in Local Government Finances

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Census Data

Local data used for this project comes from the United States Census Bureau (Census Bureau). The Census Bureau produces this by collecting data from multiple local Montana sources as well as conducting surveys of local governments every second and seventh year of the decade. After collection the Census Bureau cleans and groups these data. The result of this is a data set going back decades that allows the Legislative Fiscal Division (LFD) to analyze trends within local government revenue and spending. While general trends can be seen with these data, the Census Bureau process of grouping the data, as well as some inconsistencies in local reporting, can make it difficult to tie this data set back to local entity financial reports or allow LFD to ensure that all entities are consistently reported. Due to these issues the level-of-detail of questions that can be answered will be mixed, and additional supplemental data sets may be needed, such as property tax data, to answer certain questions. If it is the desire of the legislature to go to a deeper level of local government data ability, a review may be needed of what local government data is currently collected as well as what additionally would need to be collected for a specified product.

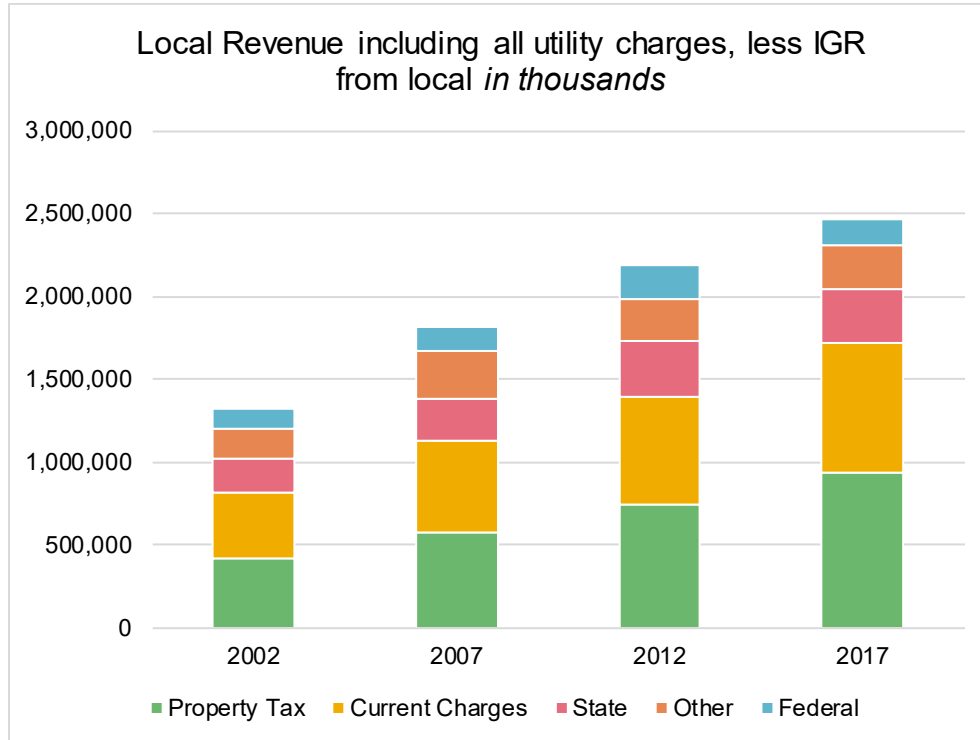
INTRODUCTION AND EXECUTIVE SUMMARY

Over the 15-years analyzed, total local government revenues have increased by an average of 4.3% annually while the costs of services have increased by 5%. The disparity in the growth of revenues and costs is substantially related to the growth in the costs of capital outlay, which is significantly financed with bond proceeds. For capital outlay, the costs are recorded in the year they occur, but revenues are delayed as fees are collected for the payment of the bonds. Public safety, consisting of police, fire, and correctional services, is the highest cost service provided by local governments and is funded with a combination of the local governments' "limited" property taxes and the proceeds of public safety mill levies. Public safety is the highest cost service, followed by capital outlay, utility services, and social services and income maintenance. Additional details are included in the Local Government Cost of Services section of this report.

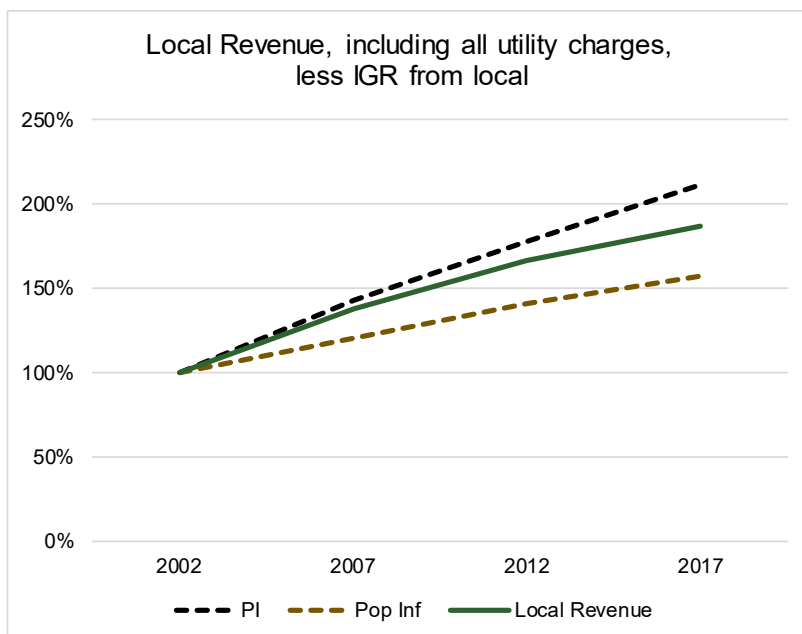
The local analysis includes counties, municipalities, consolidated county/city governments, and special districts. In this section of the analysis, schools as a local government entity, are omitted from the data. To avoid the double counting of revenues and expenditures between the various local entities included, local to local intergovernmental revenues (IGR) and expenditures, generally made up of transferred funding from one local entity to another and the associated costs, are omitted from the data. The service costs of special districts are discussed separately, as an addendum to the local services costs analysis.

Local Revenues

Local government revenue was reported at \$2.5 billion total in 2017. This includes revenue for all local governments, including special districts, excluding schools except for the countywide school levies that are transferred to schools.

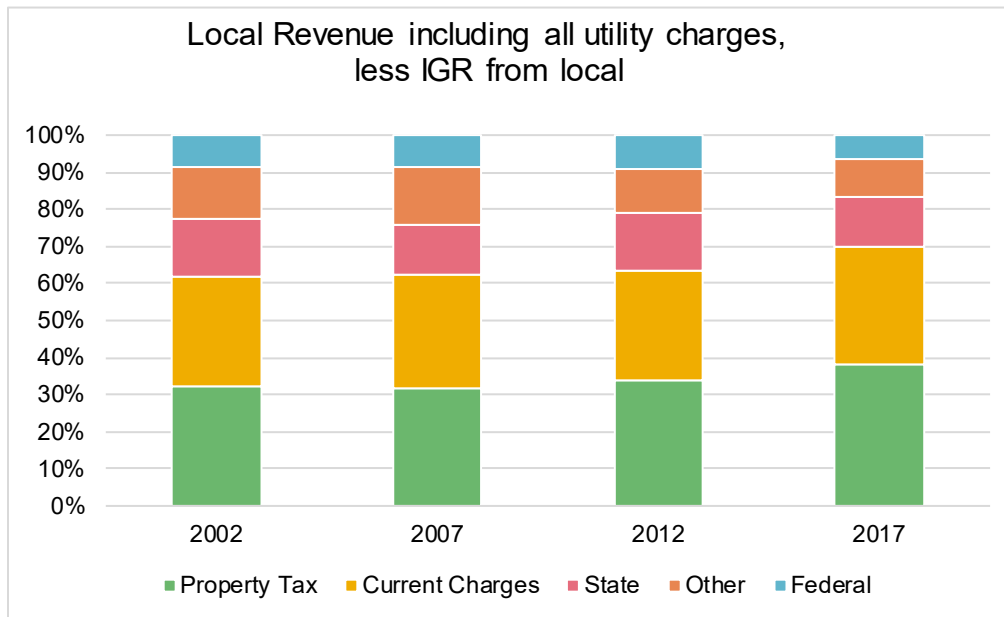


Since 2002, revenue has grown 87% in the fifteen-year period at an annual average rate of 4.3%. This rate has been greater than inflation adjusted for population but lower than the rate of growth in economy, as shown in the following figure.



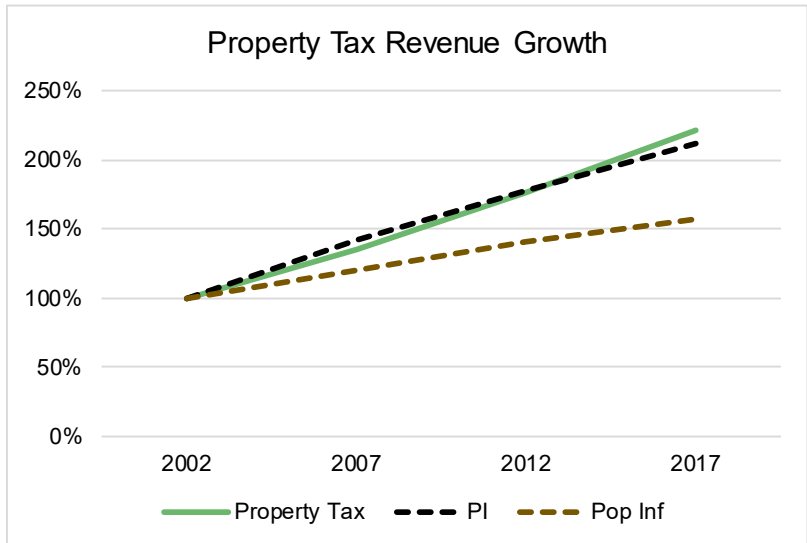
The following economic benchmarks were used for analysis of growth trends: growth in economy as measured by personal income and the combined rate of population and inflation. These are used as measurements of comparison related to Montana's economy. The growth of these indicators is indexed to 2002, and the source of data used to calculate these benchmarks is IHS Markit.

The next chart shows the percentage of revenue by type that makes up the total revenue for each Census year. For all revenue sources, these percentages are including reported data from all local government types, except schools. On an individual entity basis, these percentages may be different, depending on factors such as urban versus rural, population, and growth. For intergovernmental revenue, federal revenue is that which is received directly from the federal government. Federal revenue that passes through state agencies is included as state intergovernmental revenue.

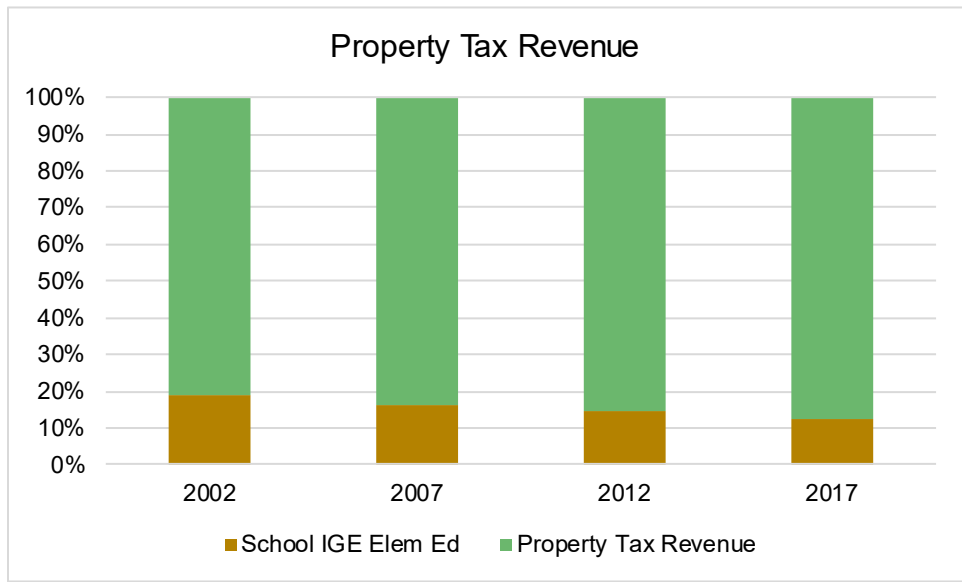


Annual average growth for property taxes (including existing property, new property, and voted levees) and current charges was 5% during the fifteen-year period¹; growth in federal intergovernmental revenue was 2%; and growth in state intergovernmental revenue was 3%. The growth percentage in property taxes again is cumulative for all reporting entities and may be different on an individual basis; the following chart shows the growth in property taxes in comparison to growth in economy and the combined rate of inflation and population. The growth rate aligned with growth in personal income and began to slightly exceed that growth in 2017.

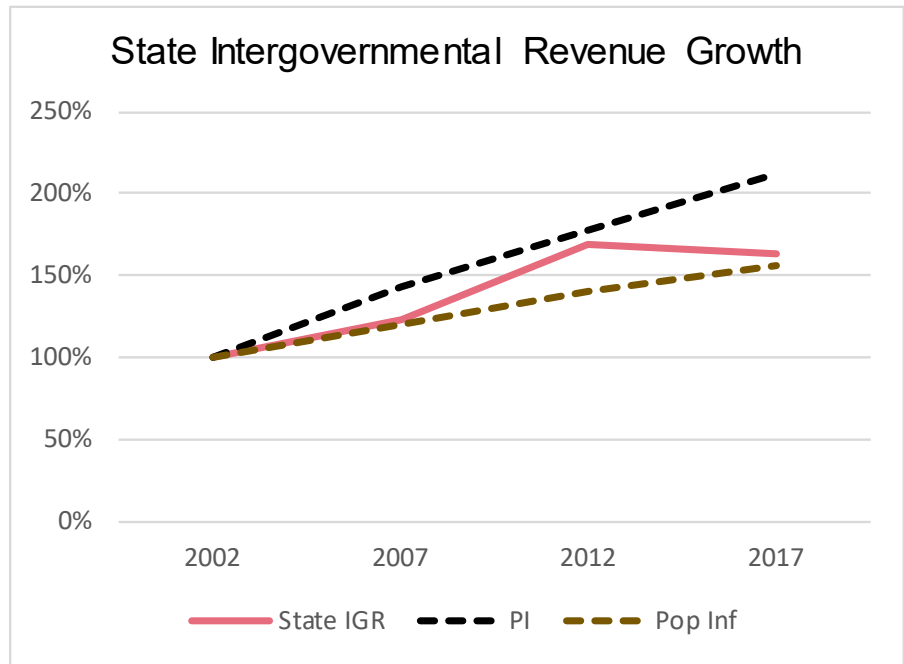
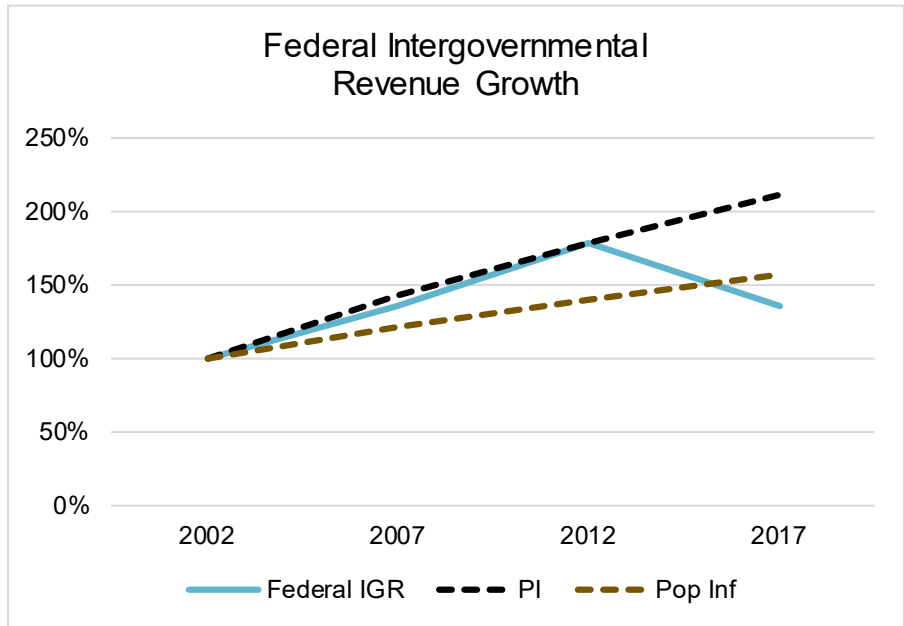
¹ For further detailed information about property taxes, please see the LFD property tax report.



Census data includes revenue that the counties collect on behalf of schools in the Property Tax category, like the countywide school levies. This revenue is then transferred to schools, and that transfer is classified in the Census data as an intergovernmental expenditure for education. This school-related revenue accounts for an average of approximately 15% of the property tax category in these figures, and it has an annual average growth rate of 2%. The following chart shows the Census property tax revenue and the percentage of that revenue which is the funding being transferred to schools. The transfer amounts have grown over time at the average 2% rate, but as property tax revenues have grown, this expenditure in the data comprises a smaller percentage of the overall property tax revenue, which is why the school transfer appears to decline in the chart.

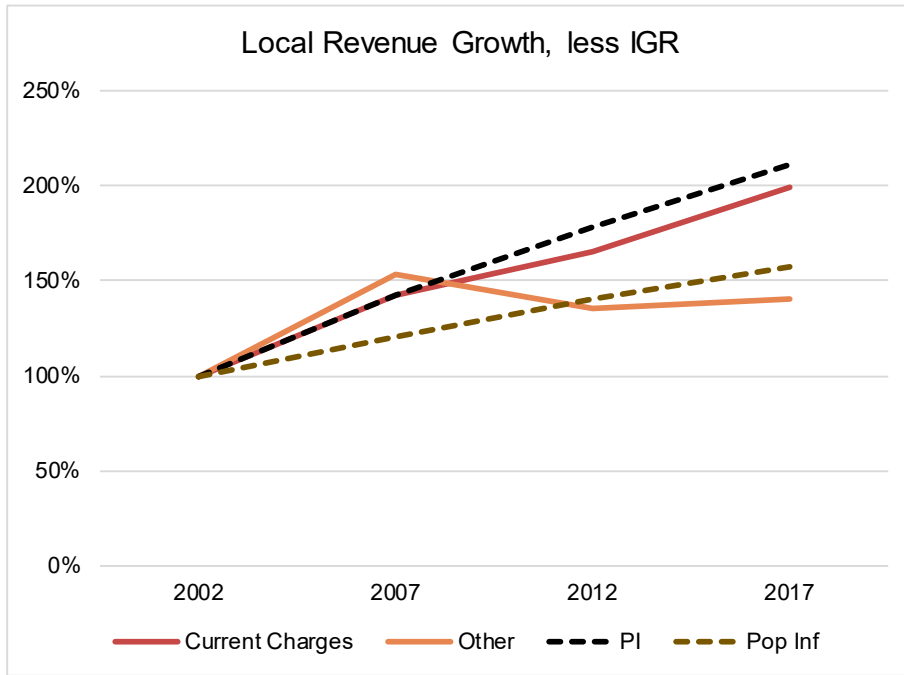


In 2012, there was an influx in state and federal intergovernmental revenue due to funding through the American Reinvestment and Recovery Act (ARRA), as shown in the spike in growth in that year in the following charts. Once that funding expired, federal intergovernmental revenue declined and did not keep pace with inflation in 2017. State intergovernmental revenue also declined due to a combination of the expiration of ARRA funds and the decline in oil and gas tax revenues.



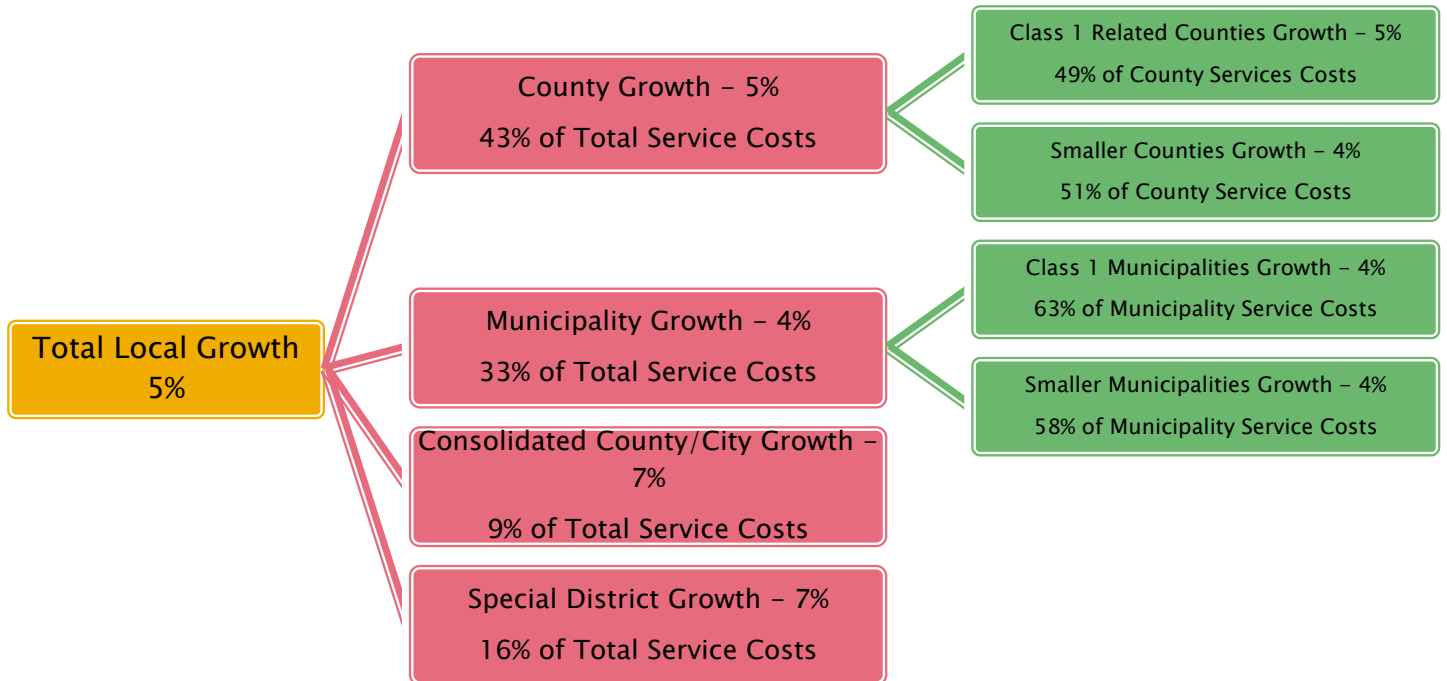
In looking at local revenues exclusive of federal and state intergovernmental revenue, aside from property taxes which were reviewed previously, growth in current charges generally kept pace with growth in economy, while the Other² category in the data showed decline after 2007 and did not keep pace with inflation. Within the Other category, the decline is primarily in the area of special assessments, which the Census defines as compulsory contributions and reimbursements from property owners who benefit from specific public improvements and impact fees to fund the extension of infrastructure facilities in new developments.

² Other revenues consist of special assessments, interest earnings, fines and forfeits, rent and royalties, sale of property, and miscellaneous general revenue not elsewhere classified.



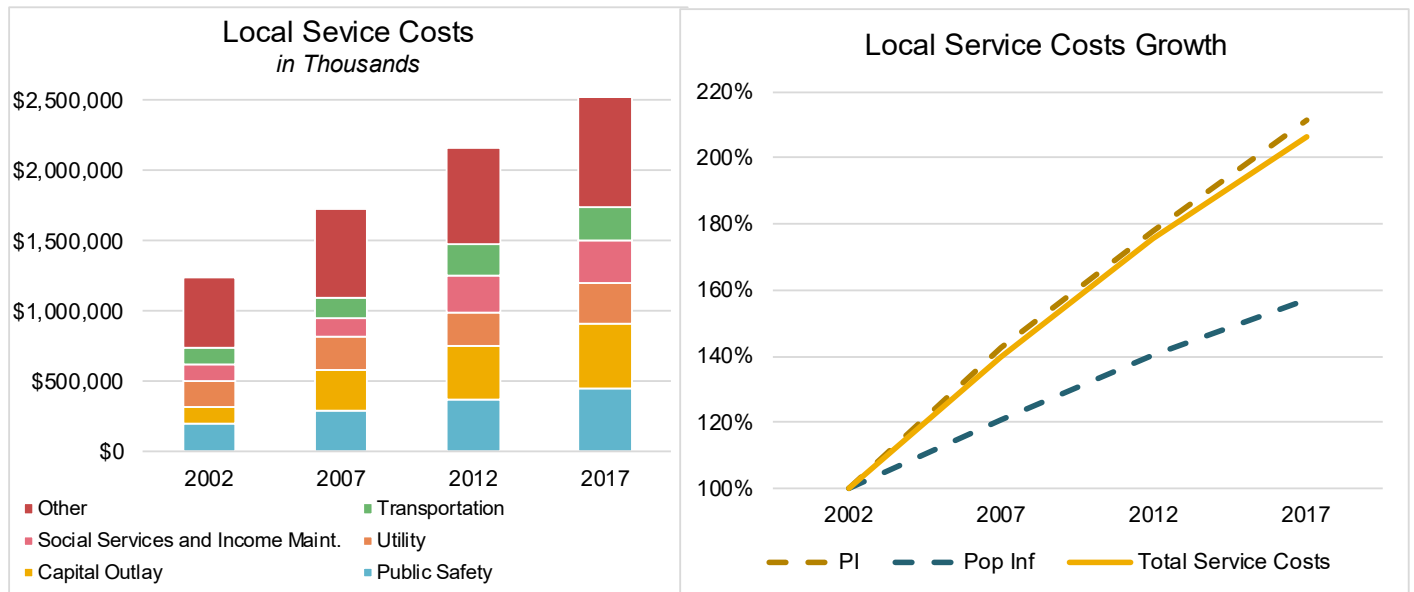
Local Government Service Costs

Growth in Service Costs by Entity



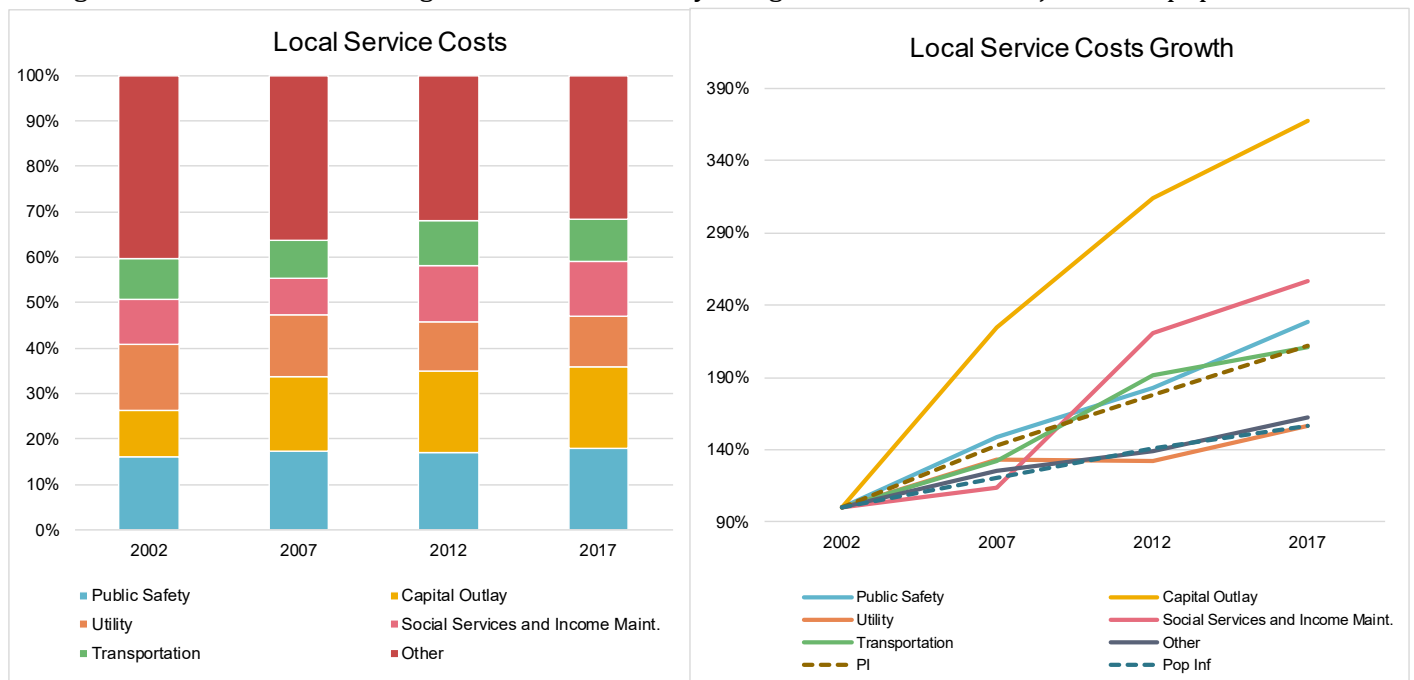
Based upon the census data, the total cost of local government services has grown by an average of 5% per year over the 15 years of the analysis. However, as demonstrated in the figure above, the rates of growth in services costs differ between the four types of local government entities analyzed. Furthermore, rates of growth are greater in Class 1 counties (counties that contain Class 1 municipalities) than in smaller population counties. The same cannot be said for municipalities, where both Class 1 municipalities and the smaller municipalities have experienced similar growth in the costs of services. Costs of services has escalated more quickly in the

consolidated county/city governments and special district entities. The impact of these faster growth entities, accounting for approximately 25% of all service costs, leads to a higher overall rate of growth.



Local service costs, including all forms of local governments except schools, are measured in the census data at \$2.5 billion in 2017. Since 2002, the total costs of services have grown by 106% in the fifteen-year period, or an average growth of 5% per year.

As seen in the following figure at the left, the mix of local service functions have changed, with the greatest change related to capital outlay. The constant in the mix is public safety services, having the highest level of costs in local government budgets. The figure at the right, compares cumulative growth of the various costs of local government services to the growth in the economy and growth in inflation adjusted for population.



The total local service costs have increased at an average annual rate of 5%, a rate just slightly less than the growth of the economy (Montana personal income). The following are attributes of the mix of services:

- **Public safety services** include law enforcement services, fire services, and the administration of correctional facilities
 - Public safety service costs averaged 17% of the total costs
 - Public safety services are funded through the local general revenues, primarily general property taxes and public safety mill levies
 - Public safety service costs have grown at an average of 6% per year (blue line), a rate that is demonstrated to be constant
- **Capital outlay** is the construction and/or purchase of local government assets such as buildings, water/wastewater systems, land, and other types of local government facilities
 - Capital outlay averages 16% of local service costs
 - Higher cost capital outlay, generally infrastructure investments like the construction of buildings and water and wastewater facilities, are most often funded through the issuance of bonds and loans that are repaid through fees
 - Other capital outlays are funded through capital reserves, and when available/appropriate general property tax revenues
 - Capital outlay costs have grown from 10% of total costs in 2002 to 18% in 2017
 - Capital outlay costs have grown at an average annual rate of 9% (gold line), and costs have escalated more quickly than other service categories shown
- **Utility services** include water, wastewater, solid waste, electric, and transit operations and average 12% of the costs of local services
 - Utility services costs were 14% of the total costs of services in 2012, but declined to 11% by 2017
 - Utility services are funded through a variety of fees charged on the services
 - Utility services costs have experienced growth at a rate lower than other services, with average growth of 3% annually (orange line), lower than the combined rate of population and inflation
- **Social services and income maintenance** services include the costs of hospital and health center functions and the provision of aid to individuals (a relatively small component with most costs paid at the state level) and account for an average of 11% of total costs
 - The costs of social services and income maintenance increased by 94% between 2007 and 2012 due to the increased costs of providing hospital and health center services. In March 2010, the federal Affordable Care Act was signed into law. Additionally, the Community Health Center Fund was created to support the expansion and operation of community health care centers, providing health services for medically underserved populations. Some of this grant funding was

Community Health Center funding is provided through the federal Health Resources and Services Administration. In the mid-1990s, a federal grant program allowed Montana counties to receive funding for community health care centers. In FY 2010, an authorization act was passed creating the Community Health Center Fund with five-years of mandatory funding authorized in addition to discretionary funding. Since the expiration of the authorization act in FY 2015, funding has been appropriated through continuing resolutions, creating funding uncertainty. Recently, some counties have begun transferring these health care centers to non-profit organizations.

- directed to health care centers in Montana³
- Social services and income maintenance services are funded with insurance payments and charges for healthcare services and income maintenance is state and federal funding
- This category, has grown at an average pace of 6%, however there was a shift of over 90% between 2007 and 2012
- **Transportation services** include the costs of airports and air transportation; parking services; and road, bridge, and highway maintenance and services
 - Transportation services costs have historically been 9% of total service costs
 - Transportation services are funded through fees, fuel tax distributions as collected by state and federal sources, county road levies and rural improvement assessments
 - Transportation services have grown at an average rate of 6%⁴ annually (green line) with a spike in 2012 presumably related to additional transportation services funding through the American Recovery and Relief Act of 2009

In 2017, the Montana legislature approved HB 473, referred to as the Bridge and Road Safety and Accountability Act (BaRSAA), which raised the state fuel tax rates and created the local government road construction and maintenance match program (15-70-130 MCA). The fuel tax rate will increase incrementally through FY 2023.

Aside from initial distributions, 35% of these funds are for use by the Montana Department of Transportation (MDT), and the rest of the funds are allocated to cities, towns, counties, and city-counties. To receive their allocations, local governments must identify the road or bridge projects for which the funds will be used and then request the funds from MDT in accordance with the process identified in statute and rules. Local projects for which BaRSAA funds have been requested and MDT projects are listed on MDT's website:

<https://app.mdt.mt.gov/barsaa/agency/project/list>

- **Other services** costs are a compilation of a variety of services provided by local governments including (but not limited to) administrative, educational, judicial and court, library, environmental, parks, recreation, natural resources, housing and community development services. Other services also include costs that could not be allocated to the categorized classifications
 - Over the 15-years of this analysis, the other services have increased collectively by 62%
 - The largest cost group included in other services, making up 35% of the total, are the local government administrative costs which have increased by an average of 7% per year and that includes staffing and judicial and court services
 - Making up 22% of other services and growing at an average rate of 2% per year, educational services include library services, the costs of the county school administrators, and transfers to school districts

³ <https://data.hrsa.gov/>

⁴ Corrected from 3% in initial report

- 84% of educational services are in county transfers of property tax revenues to school districts for the purposes of school employee retirement payments and transportation services, making up 18% of the other services category
- While counties do not consider this a direct cost of services, the Census has historically included it as a county cost, and county revenues include a corresponding amount in property taxes
- The school transfers have experienced average growth of 2% annually, a rate consistent with the population and inflation growth factor
- Other services are funded through a variety of sources including property taxes, general revenues, fees, and charges
- Collectively, the other local services have grown at an average, and consistent, rate of 3% annually (grey line)

Special Districts

Note: The analysis of special districts is a subset of the data included in the local government analysis.

The 2009 Legislature created the Uniform Act for Special Districts to provide both uniformity and flexibility in the creation, governance, financing, alteration and abandonment of special districts created for a special purpose. Under the Uniform Act (Title 7, chapter 11, part 10 MCA), a "special district" is a unit of local government authorized in law to perform a single function or a limited number of functions. Special districts included in the Uniform act include, but are not limited to: cemetery, museum, park, fair, solid waste, local improvement, mosquito control, multijurisdictional, road, rodent control, and television districts, as well as districts created for any public or governmental purpose not specifically prohibited by law. The term also includes any district or other entity formed to perform a single or limited number of functions by interlocal agreement. Revenues and expenditures for these districts should be reported as city or county revenue.

According to Uniform Act special districts do not include: business improvement, cattle protective, conservancy, conservation, water and sewer, planning and zoning, drainage, grazing, hospital, irrigation, library, livestock protective, parking, resort area, rural improvement, special improvement, lighting, rural fire, street maintenance, tax increment financing, urban transportation, water conservation and flood control, and weed management districts. These districts are largely autonomous from cities and counties. The Census does include some of these entities as special districts and those represent a significant part of special district financials. However, these entities may also be included in the county, municipality, and consolidated county/city revenues and service costs.

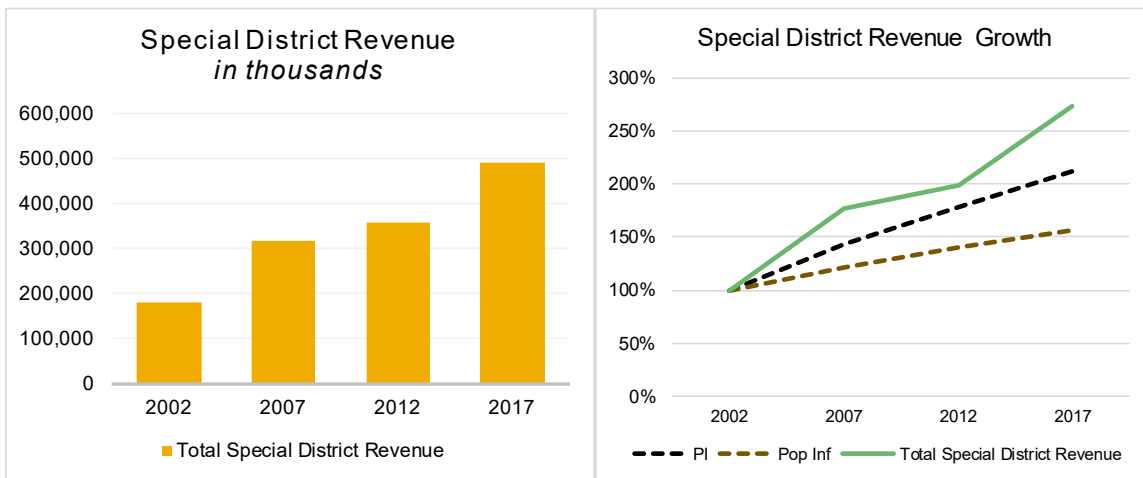
The entities excluded in the Uniform Act as special districts provide administrative and funding mechanisms for services and some are not autonomous. Examples include planning and zoning districts, street maintenance districts, tax increment financing districts, rural improvement districts, parking districts, special improvement districts and lighting districts. Revenues and expenditures for these should be included in city and county revenues and expenses.⁵

⁵ The Census data attributes some revenues and costs to special districts and others within the city and county data. While there is no direct evidence apparent in the data, some revenues and costs may be accounted for in both. Where known, double counting is eliminated through the use of Census coding. In such cases revenues are only counted at the point of revenue receipt and service costs are only counted at the actual point of the cost. However, full segregation of the data cannot be achieved without classifying each special district entity by the types listed in the report and thoroughly reviewing the finances at the entity level of both the special district and municipality/county level. While beyond the scope of this analysis, the associated work will be considered for future analysis.

Note: The team of the LFD and the local government analysts have identified some anomalies and uncertainties in the special district data.⁶ Consequently, the special district analysis is provided only at a higher level and only to add a layer of detail to the overall local government analysis. However, the Census data is the only source offering data for special districts. The team will continue to work on this data over the 2019-2020 interim with the goal of providing more detail to this component of the local government analysis.

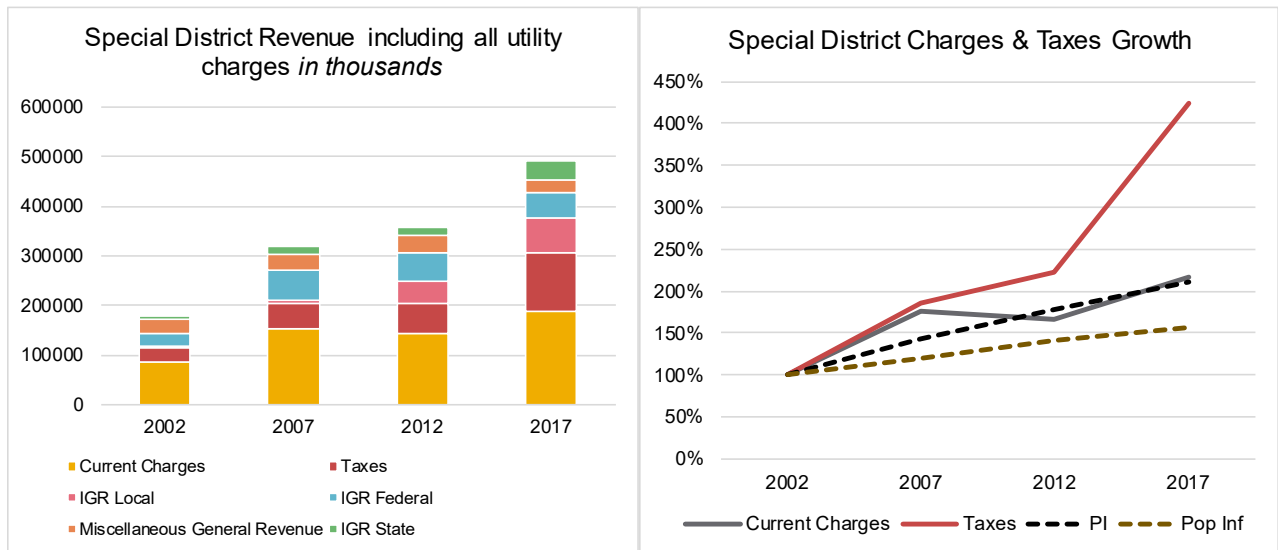
Special District Revenue

Reported special district revenue comprises 17% of overall local government revenue, excluding schools. As shown in the following chart, total revenue for special districts was reported at \$179 million by 580 special districts in 2002 and approximately \$491 million reported by 678 special districts in 2017. Between 2002 and 2017, this revenue grew at an annual average rate of 7%; total percent growth was 174% in that timeframe, which was higher than growth in economy as measured by personal income, indexed to 2002. The slower growth for 2012 may be due to fewer districts reporting revenue in 2012 compared to 2007.



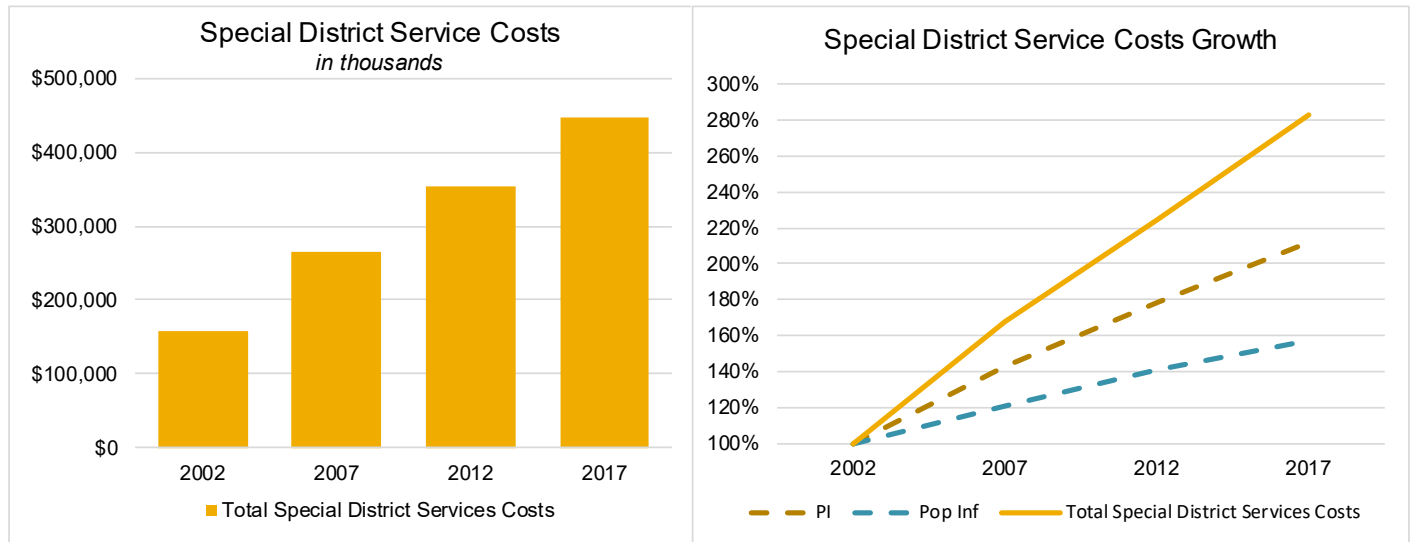
The following figure shows a breakdown of reported revenue by Census category. The category comprising the largest percentage of total revenue for Census years is current charges (or charges for service) at 42%, followed by taxes at 19%. The Census data shows average annual growth for current charges was 5%; the revenue reported for this category grew 118% between 2002 and 2017. Taxes in the data grew at an average annual growth rate of 10%; reported revenue grew 324% between 2002 and 2017. Property taxes constitute 88% of the reported revenue in the Taxes category.

⁶ There are uncertainties associated with the reporting of special districts, based on visible instances of non-reporting. While financial reporting has been mandated in law for years, there were no substantial non-reporting penalties until the passage of SB 304 in the 2019 Legislative Session. With penalties imposed, including the right for any local entity to be sued for non-reporting, there is expected to be improvements in the reporting and the accuracy of reporting by special districts.



Special District Services Costs

Special districts make up 16% of the costs of services in local government entities, excluding schools. Census data shows a 17% increase in special districts reporting between 2002 and 2017, where there were 580 and 678 districts reporting respectively.



As measured by the Census, special districts costs were \$446 million in 2017. Since 2002, the total costs of services have grown by 183% in the fifteen-year period, or an average growth of 7% per year.

Special districts provide a variety of services such as, but not limited to, the following:

- Water, wastewater, solid waste, and drainage services
- Airport services
- Fire protection services
- Hospital services
- Irrigation services

- Insurance services
- Housing and community development services

Cumulative growth, as shown in the figure at the right, compares of the various costs of special district services to growth in the economy and growth in inflation adjusted for population. The total local service costs have increased at an average annual rate of 7%, a rate higher than the growth in the economy. There are a variety of reasons for the growth in special districts, which include but are not limited to:

- Providing services to growing populations residing outside of incorporated municipalities
- Advantages gained by economies of scale, or local governments combining costs of services to obtain better rates
 - A primary example of this type of growth is seen in a municipal insurance entity where municipalities have chosen to make use of this service instead of carrying insurance on their individual accounts
 - The increased use of this service is a major driver in the overall growth of special districts, increasing 352% between 2002 and 2007 or an average of 11% per year as municipalities shifted the costs from a direct cost within their budget to a cost within a special district
- Escalating costs of services, such as exhibited in health and medical services
- Provision of services in instances where the county and municipality caps on property taxes may not fully cover necessary costs

Conclusion

Local government finances have increased over time, which is expected given the growth of population and inflation over the 15-years analyzed in this report. Costs have grown faster than revenues, but much of the growth is centered in the capital outlay activities of the local governments where there are timing differences between the point when the costs are realized and the revenues are generated. The work of this analysis will continue throughout the remainder of the 2020 interim and is planned to be ongoing into the future. Some of the areas of future work/research and analysis include improvements in the provision of local government data, the disaggregation of property tax data to better define the magnitude of the limited mills levied, voted mills, and various forms of special assessments, and improvements and classifications of special district data.