

Illinois' Financial Forecast Forum:

A Multi-perspective of the Road Ahead for Local Government Finance

On January 30th, 2009, NIU's Center for Governmental Studies (CGS), the Illinois Government Finance Officers Association (IGFOA) and the Illinois City/County Management Association (ILCMA) co-sponsored their inaugural Illinois Financial Forecast Forum at NIU Naperville where presenters with diverse backgrounds discussed industry specific perspectives of what may be in store for local governments' finances over the next year or two. The Forum's healthy attendance of more than 145 public and private sector professionals demonstrated the relevance of and the concern for local government finance in the midst of an unprecedented, global economic downturn.

Colin A. Robertson, Senior Vice President and Managing Director of Fixed Income at Northern Trust, was responsible for paving the way for the Forum's sobering mood. The gloomy atmosphere was the nature of the beast (poor economy). The gravity of the economic situation mixed with the news that there was no clearly identified end in sight or quick fixes for the problem was disheartening but no surprise. Robertson provided a clear picture of where we've been and where we *may* be heading. There was no denying that the road ahead would be rough for local governments. Robertson primarily spoke of our nation's fiscal distress and its implications to both the private and public sectors from an economist's perspective. He emphasized the fact that U.S. economy is already two years into the recession and the instability is not just striking the U.S. economy but reaches across the world. Robertson identified the U.S. credit market, with its highly leveraged and illiquid balance sheets, as one of the originators of the economic downturn. The current mortgage crisis' finger prints are all over the economic downturn, with unprecedented levels of foreclosures. On the upside, those with cash on hand looking for good deals are in a great position to purchase recently devalued properties. The high unemployment rate was another issue discussed by Robertson. To demonstrate the severity of the unemployment conditions, Robertson compared 2008's unemployment rate which was twice the rate of 2006's unemployment rate. Robertson ended his presentation with the same serious tone

by which he began...the downturn may be characterized as the longest recession in history that is affecting virtually all industries, globally with the exception of a few (e.g., energy & medical industry). Furthermore, it is difficult to speculate when the recession will end since we are in uncharted waters. Robertson claims President Obama's stimulus and recovery plan has received some mixed reviews among public administration professionals due to the necessary refinements to targets of assistance, along with greater clarification on how the stimulus provisions are to be communicated and carried out. Nevertheless, he believes, given the severity of the situation, the federal government is the only entity that can stimulate the recovery.

The next speaker of the forum, Jim Terrell, Vice President of Real Estate from Sears Holding Corporation, shared his perspective of upcoming retail sector trends that may have an impact on local governments. Not surprising, his prognosis for local governments' sales tax revenues was bleak and warned that other sources of revenues must be relied upon. A traditional offsetting source of revenue has been property taxes, but even property taxes are at risk of declining given the drop in property values. Furthermore, development and acquisitions will be dramatically reduced over the next 18 months, also reducing transfer taxes. In these conditions, Terrell recommends local governments, lenders and retailers work together to creatively position the landscape for revenues streams in the coming 2010 horizon. Terrell claims it is better to collaborate on real estate developments than to leave banks stuck with foreclosed properties and local governments ending up with shells of buildings that are no longer producing sales taxes.

Scott Watkins, third to present, discussed the automotive perspective in light of the current economic downturn. Watkins, a Senior Consultant with Anderson Economic Group, LLC, clearly illustrated the global decline in auto sales. He mentioned the auto jobs that are currently being cut along with those that are to come from the world's most well-known car companies such as General Motors, Ford, Chrysler, Mitsubishi, Toyota, Honda, and others. This crisis is estimated to be the worst in history. In addition to the lost income tax revenues resulting from increased joblessness in the auto industry, Watkins also discussed the trickle-down effect of the auto crisis. Slow sales equates to dealerships closing which result in lost corporate business tax revenues and lost sales tax revenues. Furthermore increased expenditures for Medicaid, welfare, and unemployment benefits are anticipated as a result of the increased joblessness related to the auto industry crisis. In the case of Illinois, large lay-offs and dealership closures are

already a reality. The “bailout” stimulus program that commits financial support of \$13.4 billion for GM and \$14.0 billion for Chrysler may not be enough to allow for a full recovery.

The poor economy has certainly kept real estate professionals on edge over the past several months. Steven Wallace, a Managing Director of Cornerstone Real Estate, spoke about the commercial real estate perspective of the current economy. He also emphasized the global character of this crisis and, having heard the rest of the presenters, his depiction of the downturn cutting across all industries was nothing new. In the housing industry, the crisis impacted property values, with ultimate declines in property tax revenues for state and local governments. Only one small bit of good news - for some that is - housing prices are becoming more affordable for first-time homeowners or people with cash looking for investments. Since the beginning of the recession, the poor housing market has been reflective nationwide but some states have been hit much harder than others such as California, Florida and Washington DC. Interestingly enough, Chicago, Illinois and Texas have not been as adversely affected...yet, given their diversified revenue bases. Wallace claims the U.S. housing collapse is expected to bottom out in 2009 with job losses continuing through 2011.

Keeping with the spirit of gloom and doom, Rick Mattoon, a senior economist and economic advisor at the Federal Reserve Bank of Chicago and lecturer at Northwestern University’s Kellogg School of Management, presented the last session of the Forum with no positive short-term outlooks for local governments’ finances. According to Rick Mattoon, the current recession began in December 2007 and spread across the world, including the Eurozone (the 16 European Union states) and many other worldwide locations. The financial markets and operations are still under pressure, with spillovers to the “real” economy heavily impacting the labor market and retail sales. Although the mortgage rates have remained very low, standards for mortgage loans have tightened considerably. Over the past year employment decreased by approximately 2.6 million jobs, impacting virtually all sectors. In November and December, alone, combined job losses were over 1 million. The consumer response was to pull back on spending, dropping retail sales by 2.7% in December, and to push any extra cash into savings. Wallace reiterated the impact real estate devaluations and vacancies have had on state and local governments. Virtually all revenue sources are under pressure and risk – property taxes, sales taxes, income taxes and many others. Market problems such as investment losses impacting

pension accounts make lending difficult. As a result, any help through the stimulus plan will take time and aid will be primarily focused on states first with less direct assistance for municipalities. Any assistance is likely to support the counter-cyclical efforts through provisions to Medicaid, unemployment compensation and possibly education. One ounce of good news allowed for a little sigh of relief - inflation appears to have been diverted, energy prices are declining and productivity rates have held up.

Individual Fiscal Impact Perspectives

Kevin Dahlstrand - City of Warrenville, Finance Director

Dahlstrand stated the City is currently not suffering too badly by the recent reductions in sales taxes. The city has a strong reliance on Target, a large retailer in the region, who has, thus far, not seen any dramatic downgrades. He also noted that the City is not yet feeling the pains of the region's increased unemployment rate. However, Dahlstrand did express concern about future decreases in property taxes in light of the nearly five percent property tax revenue decreases the City has experienced since the inception of the mortgage crisis. He also said that as a take away from the Forum, he will be paying much attention to the issues of reductions in property tax revenues along with these revenues' balance to the City's overall revenue structure.

Stan Roelker - Village of Lincolnshire, Director of Financial Services

According to Roelker, the Village has already experienced a 20% drop in sales taxes over the past three months and expects even more declines in sales taxes in the months to come. Along with reductions in sales taxes, Roelker states a dramatic drop in real estate transfer taxes is anticipated. In addition to reductions in sales and property taxes, Roelker added, the Village is incurring declines in revenues from excise taxes such as hotel/motel taxes and local restaurants.

Steve Sanderson – Village of Downers Grove, Budget Officer

Sales tax reductions have produced the bulk of Downers Grove's budget woes, says Sanderson. Furthermore, Sanderson anticipates the Village's property taxes, though not currently that negatively impacted, to decline as well. As a result, the Village plans to cut expenses funded primarily by the General Fund's sales tax revenues and will also freeze the hiring process.

Brian Caputo – City of Aurora, Director of Finance/Treasurer

Mr. Caputo expressed similar concerns of a declining economy and its impacts on the City of Aurora with the primary concern being the decline in sales taxes. Property taxes are also expected to decline should Aurora's administration need to make adjustments due to declining property values. However, Mr. Caputo is optimistic that little to no reductions in service levels will be made.

Ray Bockman - DeKalb County, County Administrator

In the case of DeKalb, 2009 was a stable year from a revenue perspective. However, Bockman explains things don't look as good going forward. Property tax revenues will decline over the next two to three years. For jurisdictions like DeKalb's who are limited by PTELL this is a natural consequence of three factors; declining home sale prices will work their way into the system, CPI for 2010 is set at .01% and new construction is going to be at a multi-year low. DeKalb will also have to "make up" for market losses suffered by IMRF and SLEP from those declining property taxes. Sales tax declines will be a bit more modest DeKalb as the base is in a large part non-traditional but weaknesses are projected here also. In general almost any review of the ingredients indicates that the soup will be bitter for some time. The seminar was blunt to the point of being brutal – but very helpful.

Lew Steinbrecher – City of Moline, City Administrator

Throughout his career, Steinbrecher has worked for older Midwest cities with deteriorated infrastructure and weakened tax bases and has developed proficient fiscal management skills. He has been able to implement successful attrition strategies, maintain adequate reserves and fund balances, and has been able to absorb unfunded state and federal mandates or shared revenue cutbacks with minimal impacts on municipal services but has never had to layoff city employees until the 2009 budget year. Seven positions have been eliminated at the beginning of the year along with a selective hiring freeze because revenues are projected to come in about \$1 million short of what was budgeted last fall. Declining sales tax revenues account for about 63% of this shortfall; state-shared income contributing to about 22% of the total lost revenues. The drop in retail sales, including the noticeable decline in new car sales, continues to impair Moline's ability to maintain quality urban services for the community and its residents. Moline has three shovel-ready projects ready to go if, and when, stimulus funds are received. Also, the city continues to work with developers who have an interest in new private development projects with prospective business tenants, though more financial incentives are being requested to make commercial projects economically viable. Moline is gearing itself to survive 2009 and balance the 2010 budget while hoping the economy recovers by 2011.

NIU Public Administration Experts' Viewpoints

Kurt Thurmaier – NIU Professor, Division of Public Administration

Professor Thurmaier received his B.A. and M.P.P.A. from the University of Wisconsin-Madison and his Ph.D. from the Maxwell School, Syracuse University. He held assistant and associate professor positions at the University of Kansas before becoming MPA director at Iowa State University, 2002-2005. His research and teaching interests include budgetary decisionmaking at the local and state levels in the U.S. and other countries, comparative public administration (especially fiscal decentralization), intergovernmental relations, and e-government. His most recent work has focused on city-county consolidations and interlocal agreements among cities and counties, as well as financing state and local e-government. He and has served as a consultant and researcher with ICMA, HIID, and several US local governments. He is a lifetime member of the American Society for Public Administration (ASPA), and has served as chair of the Association for Budgeting and Financial Management (ABFM). He presently serves on the editorial board of Public Administration Review.

Recommendations: From Professor Thurmaier's perspective on the problems that local governments are facing in the light of bad economic times, he recommends local governments reduce their heavy reliance on sales tax revenues and augment their share of property tax revenues in budgeting for future expenses. He explains his thought referring to the relative stability of property taxes in their comparison with sales taxes, noting that the latter ones can be very sensitive to the economic fluctuations and instability. A poor economy can leave many people without work, which in turn impacts consumers' income and consumption. Even those who still continue to work, forced by feelings of fear of future layoffs can restrict themselves in shopping to save some money for bad times. This situation ultimately affects the sales taxes and therefore, diminishes the revenues received by local governments from this source. Even in the course of the mortgage crisis, the property taxes still more reliable source of revenue, because there is no way to avoid the property tax, although the drop in property values with constant tax rate can decrease the return.

Michael Peddle, Ph.D. – NIU Associate Professor, Division of Public Administration & Assistant Chair, Department of Political Science

Professor Peddle received his Ph.D. in economics from Northwestern University in 1984, and M.P.A. and B.A. degrees from Drake University. He taught economics at Holy Cross College (1984-90). His teaching interests include public finance, growth management policy, economic development policy, research methods, and program evaluation. His research has focused on local and regional economic development tools and policies, growth management policy, government's role in education, local public finance, and financial management. He also has directed the annual Illinois Policy Survey along with Professor Burrell for the past several years.

Recommendations: Professor Peddle emphasizes the importance of innovations in hard times as an essential factor for local governments. He notes that citizens are prone to expect the provision of the same services with the same quality notwithstanding of difficult times. And they expect this to happen without any increase in taxes or additional expenses on their side. That's why it is

so important to think about innovations in the local government, so that the local government can meet their citizens' expectations and at the same time be able to maintain a balanced budget. Professor Peddle argues that many local governments have already met the challenges of a bad economy through innovation. Successful innovations include financing of public facilities through lease arrangements, sales of naming right to public facilities, joint development of projects by local governments and for-profit development entities, and developer-financed infrastructure. From this perspective, the most successful financial innovations have tended to be those that allocate or reallocate the costs of public services and infrastructure to their beneficiaries rather than to the general public. But he also mentioned that innovation can be difficult in hard times. It requires the public managers to be strong leaders and think innovatively, which in turn means to be capable of identifying new sources of revenue and utilization of their resources in a planned and targeted fashion. This said, local governments must have a clear understanding of their responsibilities and services. To do so, he notes the importance of strategic planning during good times so as to be ready for times of extreme fiscal crisis. For those communities and local governments without these plans, the working on and developing of a financial strategic plan even during fiscal crisis itself can be an innovation.