revenues and taxes

4 Taxes and revenue-sharing shape municipal services.
uch of a city’s ability to provide needed services and to protect quality of life is tied to its fiscal health. Does the city have adequate revenues to meet the needs of its citizens? The answer to this question will differ, depending on the diversity of the economic base and the fiscal discretion allowed by the states’ constitutions and statutes. But in any event, nearly all cities are currently struggling to maintain their critical services. In a 2009 national survey of cities, 93 percent of city financial officers responding said their cities were worse off in 2009 than in 2008. Ninety-one percent of the survey respondents indicated their city cut spending in 2009. Cities surveyed in 2010 responded that they had (or would) cut an average of 8.6 percent of their workforce between the 2009-2011 fiscal years.

Revenue shortfalls have also plagued our 10 Urban West focus cities. The table on page 84 displays some general information from each of the 10 cities regarding its budgetary situation during this “Great Recession.” Each of
Examples of Budget Cuts in the 10 Focus Cities, 2010–2011

<table>
<thead>
<tr>
<th>City</th>
<th>Estimated shortfall</th>
<th>Examples of items cut</th>
</tr>
</thead>
<tbody>
<tr>
<td>Boise</td>
<td>• The City will have to trim $4 million from the FY 2011 budget. The City Council had already cut $4.9 million from the FY 2010 budget</td>
<td>• 33.5 FTE positions cut</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Employee raises eliminated</td>
</tr>
<tr>
<td>Eugene</td>
<td>• $5.7 million gap in the $384.5 million FY 2011 budget</td>
<td>• Approximately 39 positions cut</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Cuts in Animal Control, Library, Recreation, Planning and Development</td>
</tr>
<tr>
<td>Modesto</td>
<td>• Altogether, $8.6 million in cuts proposed, with a $2 million hole remaining</td>
<td>• Cuts in Police, Fire (10 FTE), Parks and Recreation, and Planning and Development staffs</td>
</tr>
<tr>
<td>Pubelo</td>
<td>• Estimated shortfall is $9 million, half to be covered by the fund balance reserve</td>
<td>• 96 FTE positions left vacant</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Unions agreed to no raises</td>
</tr>
<tr>
<td>Reno</td>
<td>• Cuts saving $26 million</td>
<td>• 387.5 FTE positions cut over last two years</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Across the board cuts in services</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Police and Fire staff cut</td>
</tr>
<tr>
<td>Salem</td>
<td>• 2010-2011 budget gap is $9.3 million + $1.7 million increase in pension obligation + $2.3 million increase in health insurance</td>
<td>• 67 FTE positions cut</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Changes in health insurance plans to save money</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Programs such as Youth Art, Parks cut</td>
</tr>
<tr>
<td>Salt Lake City</td>
<td>• Shortfall of this size ($9.8 million gap between revenues and expenses within the City’s General Fund) in 2011, on the heels of filling a $7.5 million hole to balance the budget for 2010</td>
<td>• 120 FTE positions cut</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• City trying for changes to collective bargaining agreements, Police and Fire cuts, closure of branch library</td>
</tr>
<tr>
<td>Spokane</td>
<td>• $40 million dollar reduction in budget: $401 million budget for 2011-12, $441 million just two years prior</td>
<td>• 79 FTE positions cut</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Wage freeze being negotiated with collective bargaining units</td>
</tr>
<tr>
<td>Tacoma</td>
<td>• $34 million deficit beginning in 2010-11</td>
<td>• 40 FTE positions cut, 125 transferred out of general fund</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Wage freeze, consolidation of departments, furloughs, cuts to Police and Library</td>
</tr>
</tbody>
</table>

Source: City budget documents
our focus cities has a different set of services and, therefore, different costs and expenditures as well as differently valued property tax bases. Comparing the revenue shortfalls and budget cuts across the cities should take those variations into account. The magnitude of the shortfalls and cuts may vary, but the message from the table on the opposite page is clear: all of our focus cities have been hit hard by this budgetary crisis.

As stated previously, cities are at the confluence of three major streams: (1) the global economy and the city’s place in that economy, (2) the limitations placed on the city by its state, and (3) pressures from growth. Nowhere are the pressures from those three streams more evident than in the public finance choices made by a city. City officials presume that the tax policy choices they make are going to impact the location decisions of corporations and the quality of life of their citizens. The question for cities in the global economy is whether or not they can survive and prosper in an increasingly competitive world where capital moves freely across jurisdictional boundaries. What mix of revenues and services will help sustain them? Finally, pressures from growth can lead a city to seek new forms of revenue in order to keep flagging infrastructure in pace with demand from new development as well as to maintain existing neighborhoods. Growth often forces city officials to face the question as to who should pay for growth impacts—new residents or existing residents?

• Overview of Major Revenue Sources

Cities use several major revenue sources in order to provide needed public services. The graph on page 86 displays the national breakdown of city revenue sources and the use of these revenue sources in the eight western states examined in this study. The pie charts on pages 90–92 illustrate city revenue sources for each state.

Several general observations can be made about the distribution of city revenue sources across the eight western states compared to the national averages:

• Only Idaho and Oregon rely on property taxes for city revenues at a percentage higher than the national average.
• Cities in several states have chosen to rely heavily on local sales taxes as a percentage of their city revenues. Arizona, Colorado, Utah, and Washington cities rely on sales taxes at approximately twice the national municipal rate.
• Idaho, Nevada, and Oregon fall far below the other western states in their reliance on local sales taxes as a percentage of city revenue.
- All eight western states' cities rely on charges and fees at a higher rate than the national average.
- Reliance on state shared revenues for cities varies widely across the eight states from a high of 23 percent in Nevada to a low of 3 percent in Colorado.
- Federal revenue is a small percentage of total city revenues in the eight western states and nationally.
The Property Tax

The property tax was historically the most important single source of all types of revenue for local governments in the United States. In 1902, the property tax comprised 73 percent of all municipal revenues nationwide. As the graph opposite illustrates, by 2009, this number had fallen to 16 percent as fees, service charges, federal aid, state-shared revenue, and other taxes ex-

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**Examples of Property Tax Limitations**

**Steps in how the property tax rate is determined**

1. **Estimate city budget needs (spending).** Remember that spending must equal estimated revenues (local government budgets must balance).
2. **Determine what portion of needed revenues comes from property taxes (the property tax portion of the budget or PTB).**
3. **Total city property tax revenues (PTB) = total assessed value of the city (AV) x property tax rate (TR). PTB = AV x TR. To figure the tax rate, solve for TR. TR = PTB/AV.**

   **Example One: Figuring the property tax rate**
   
   City Assessed Value = $10,000,000 x Tax Rate
   
   = $150,000
   
   Tax Rate = .015 or (1.5%)  

   **Example Two: The property tax with a rate limit of percent**
   
   City assessed value = $10,000,000 x FIXED RATE 1 percent = $100,000
   
   If the estimated portion of the budget from property taxes had been $150,000 as in Example One, the city must cut $50,000 worth of spending, raise other taxes, or a combination of the two.

   **Example Three: The property tax with a revenue limitation of 5 percent**
   
   If last year’s property tax revenues = $150,000, the maximum revenue allowed from property taxes this year is $157,500.
   
   City AV = $10,000,000 x 1.575 percent tax rate = $157,500 (PTB)  
   
   (assessed valuation stays the same)
   
   City AV = $10,500,000 x 1.5 percent tax rate = $157,500 (PTB)  
   
   (assessed valuation goes up 5 percent)

   **Note:** The tax rate will go up or down depending on changes in assessed valuation when the total revenues from property taxes are fixed with a revenue limitation.
panded total municipal revenues. The property tax still remains the single most important source of funding for most city operating budgets, but not their total budgets. Generalizations can mask significant differences within states. For example, over the past 20 years, Utah cities have shifted from primary reliance on the property tax to reliance on a 1 percent local option tax implemented by every city in the state. However, Utah’s largest city, Salt Lake City, still relies more heavily on the property tax. This is due in part to the expensive commercial properties in downtown Salt Lake and the fact that only one-half of the statewide distribution of state collected local sales taxes are allocated on a point of sale basis.

The property tax is based on the assessed value of the property and the tax rate, also known as the levy rate, established by a taxing entity. County officials typically determine a value on real and personal property for tax purposes. There may be many taxing entities collecting property taxes on any single parcel of property: a homeowner in Boise, Idaho, would pay property taxes to the City of Boise, Ada County, the Boise Independent School District, the Ada County Highway District, and any other special districts their home lies within, such as a cemetery district or a mosquito abatement district. In most states, these taxes are collected by the county government and distributed back to each of the appropriate local taxing entities.

The legal framework for the administration of the property tax is typically contained in state statutes or constitutional provisions. This includes the dates and regularity of when property taxes are due, how often and in what manner assessments of property values are re-evaluated and, perhaps most importantly, any limitations on property taxes affecting cities. Hence, the somewhat curious situation arises that one set of elected officials at one level of government (the state), establishes the rules for another set of elected officials at the local level. Of course, the citizens themselves may also determine the statutes governing the property tax through the initiative process.

The property tax has historically been judged to be among the most stable of taxes collected by government. Compared to the sales tax, for example, which is much more sensitive to fluctuations in the economy (people cut back on spending when money is tight), the property tax tends to remain relatively steady unless there is a sharp upturn or downturn in the economy as we have experienced in the Great Recession. Even with the increasing number of limitations, the property tax is still judged as providing a considerable degree of autonomy for local governments. According to tax expert David
Brunori, "the virtue of the property tax is that it is the best independent source of local revenue." The now-defunct Advisory Council on Intergovernmental Relations (ACIR) tracked public opinion about taxes from 1972 to 1991. The growing resentment toward the property tax is illustrated by the fact that in 1978, just before Californians started the property tax revolt with Proposition 13, 45 percent of westerners surveyed indicated that the property tax was the "worst tax."

A more recent reflection of public attitude is the survey of Idaho residents that indicates that the property tax remains an issue of concern. More
City Revenue Sources by State, 2009

- Property Tax
- Sales Tax
- Other
- Charges/Fees
- State-Shared Revenue
- Federal Revenue
- Income Tax
- Miscellaneous Funds

Source: U.S. Census Bureau, State and Local Government Finances, 2007

In times when property values have escalated quickly, homeowners have seen increases in their property taxes. It is likely the rapid population growth and increases in property values in the 1970s and 1980s led to the rise of the property tax revolt. The animosity toward the property tax can also be explained in part by the confusion the general public has about the complexities of the property tax process, the perceived lack of fairness in the administration of the tax, and the belief that the tax supports many services that do not benefit the property owner. Diane Paul, however, may have offered the best reason for the deep-seated emotional response to the tax. She argues that since people’s homes are the object of the tax, they deeply fear the potential of losing their homes if they cannot pay the tax.

A discussion of the property tax requires some explanation of the types of limitations. An understanding of some of the basic elements in the levy rate-setting process is useful in illustrating the operation of these various tax limitation measures. Hypotheticals illustrate how these limitations would apply to a city government’s budgeting process.

One of the first steps in the property tax rate-setting process is for locally elected officials to adopt a budget, which includes all of their jurisdiction’s anticipated revenue sources, including property taxes. The amount of the property tax portion of the municipal budget divided by the city’s assessed valuation yields a city tax rate. The property tax rate-setting process can be expressed as TR = PTB/AV where TR is the tax rate, PTB is the property tax portion of the budget (or that portion of property taxes subject to the limitation) and AV is the entity’s assessed valuation for taxation purposes.

For illustration purposes, visualize a city with a current assessed valuation of $10,000,000, a property tax budget of $100,000 and a levy of .0100 (or 1 percent). If city
officials decided that they needed to generate an additional $10,000 in property taxes for the next fiscal year, and they anticipated their new assessed valuation would increase by 10 percent to $11 million, their new property tax budget would increase by $10,000 with no increase in their current tax rate of 1 percent. However, if city officials decided they needed more property taxes, they could, depending upon what type of limitation they were operating under, increase their levy to 1.5 percent and generate an additional $65,000 in property tax dollars from their increased tax base.

As noted in the prior discussion, however, most local budgets are not set in a vacuum. Property tax limitation measures affect most budget-setting decisions. For example, a rate limit could mandate, as it does in California, that local levies shall not exceed 1 percent, regardless of the growth in tax base or increased municipal costs. A revenue limit would allow only an increase in property tax revenues up to a fixed percentage, such as 5 percent. That would mean in our hypothetical case that the local officials could increase the property tax portion of their budget by no more than $5,000 rather than up to $10,000, an amount a city could levy if it had no such revenue limit.

Assessment limitations cap annual valuation increases by a certain percentage, such as the 2 percent lid in California. In our hypothetical case, the city’s valuation will substantially increase over the current year’s valuation of $10 million. But under an assessment limit such as California’s 2 percent lid, its assessed valuation could only increase by $200,000 instead of $1 million, or, in other words increase to a total of $10,200,000 rather than $11,000,000. If local officials were operating under a 1 percent rate limit in our example, they would only be able to increase taxes by $2,000 as opposed to $10,000 under the 1 percent and no assessment limits scenario.

What may have initially seemed to be a temporary revolt against rapidly rising property values and taxes in 1978 has proven to be a sustained resistance to the property tax across the western states. State legislatures and voters (through the initiative process) have continued to periodically pass various local tax limitation measures. But most of these limitation measures apply to the property tax. All
eight of our Urban West states have some sort of property tax limitation measure in place.

- **State-Shared Revenues**

  State-shared revenues generally include sales and highway user revenues. Sales taxes are often shared with city and county governments according to a state legislative distribution formula. The formula may take into account the point of sale, or all or a portion of the sales tax generated within a particular jurisdiction. The formula may also be based in part on population. The details of the formula are critical to determining the winners and losers in the distribution. That is why, in most states, reconsideration of the formula can generate intense political battles.

  All of the above dynamics also apply to state-shared gasoline taxes. In most states, gasoline taxes are earmarked, at least in part, for highway and street construction and maintenance. The cost of building and maintaining adequate infrastructure makes the dependence on state-shared gasoline taxes a critical part of local government revenues.

  In very tough fiscal years in which overall state revenues fall far below levels needed to maintain services, the state-shared revenues become tempting targets for reallocation to reduce state fiscal deficits. Because cities rely so heavily on these revenues, any raids on these revenues can be devastating.

  In order to balance the 2009 state budget, California legislators hijacked municipal property taxes, gas taxes, and redevelopment funds. It was estimated that the City of Modesto would lose approximately $6.5 million. Modesto Councilwoman Kristin Olsen called a press conference after the legislative action and attacked this raid on city funds, calling the legislative promise to later
restore the funds as “nothing more than a Ponzi scheme.”

In response to this raid, or what legislators call “revenue diversion,” the League of California Cities, along with local transportation officials, launched a campaign to place Proposition 22 on the 2010 statewide general election ballot. Proposition 22 was designed to stop the state legislature from taking city gas taxes, property taxes, and redevelopment funds. In November 2010, California voters approved Proposition 22, which should give local governments more control over their own revenue sources and greater certainty that they can keep their own funds. In addition to the negative impacts of the revenue loss, local officials had little budgetary certainty. Long after their budgets had been set, the state legislature, desperately trying to fill a major budget gap, would take local revenues right in the middle of cities’ fiscal year. Proposition 22 was intended to prevent another similar precipitous action by the legislature. Opponents have charged, however, that the proposition is a “totally irresponsible” measure unfairly limiting the budgetary powers of state legislators. Threatened litigation may bring years of court battles.

In 2009, the Nevada Legislature took $50 million from Nevada counties’ medically indigent fund and $79 million in property taxes from Clark (Las Vegas) and Washoe (Reno) counties. No other local governments lost property tax dollars in this targeted taking of revenues from the state’s two major population centers. This raid succeeded even though local governments were well represented at the legislature and were told by a legislative leader that if they were not at the table, “it could be ugly for you.” Washoe County and its local government spent $750,000 lobbying the 2009 session. The president of the Nevada Taxpayers Association indicated that she had concerns about the amount of money local governments have spent lobbying. But she said that she understood “it better this session” when local governments were targeted.
• Fees and Service Charges

As cities adapt to new limits on the property tax and deal with a growing “anti-tax culture,” the most common new sources of revenue are new fees or fee rate increases. Fees seem to be more acceptable to a general tax-averse citizenry who believes many service costs of government should be borne by those who use the service. With fees, those who don’t use the service don’t have to pay. A 2007 survey found that 45 percent of cities nationwide were increasing their fees and charges. Since the 1980s, fees have been on the rise and now are 40 percent of cities’ “own-source” (or locally raised) revenues; property taxes have dropped, as a proportionate share, to 30 percent.

There are limits to how fee revenues can be used, however. Fees cannot exceed the cost of providing services or the costs of a regulatory activity. If they do, they’re considered a tax, not a fee, and are often subject to greater scrutiny. In short, a specific fee cannot be used to balance the city budget, but rather is tied to funding a specific utility or enterprise operation.

• Local Option Taxes

In the most common forms of a local option tax, voters approve an additional percentage (or fraction of a percentage) onto the existing state sales or gasoline tax to be assessed on purchases within the city. Some cities add those revenues to their general fund, others earmark local option tax revenues for a certain purpose; for example, the City of Pueblo earmarks its one-half cent sales tax for economic development. Recalling that “cities are creatures of the state,” however, it is important to note that not all Urban West states grant their cities the...
power to adopt local option taxes in the same way. Idaho, for example, allows its cities only very limited local option taxation authority. Currently, only some “resort cities” have the option of adopting local option taxes. Idaho cities have attempted to secure state legislative approval for increased local option taxation authority almost every year since the early 1970s, but to date the legislature has been unwilling to expand this taxing authority. The attitude of the Idaho Legislature is perhaps summarized in a recent quote from House Majority Leader Mike Moyle, who said, “Sometimes you give local governments too much control and you end up with an abuse of power.”

Other states, such as the map shows, have granted significant local option taxing authority to their cities and those cities have chosen to adopt that authority. In addition to establishing whether or not local option taxes are allowed as well as the types of local option taxes available, legislatures and/or state constitutions may also specify the level of voter approval needed: a simple majority versus a super majority (for example, 60 percent).

- Implications of Revenue Sources

Each revenue source utilized by government has its own set of costs and benefits. One common way to examine these costs and benefits is to display the revenue sources by several characteristics: (1) the revenue potential, or how much revenue a tax will produce; (2) the stability of the tax in changing economic times; (3) the progressivity or regressivity of the tax, that is the tax’s burden relative to the income level of the taxpayer; and, (4) the administrative cost to the government for collecting the tax or revenue source. The table at right compares the property tax, sales tax, income tax, common excise taxes, and user charges across these characteristics.

<table>
<thead>
<tr>
<th>Tax</th>
<th>Revenue Potential</th>
<th>Stability</th>
<th>Progressive/Regressive</th>
<th>Administrative Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property tax</td>
<td>High</td>
<td>High</td>
<td>Regressive</td>
<td>Medium-High</td>
</tr>
<tr>
<td>Sales tax</td>
<td>High</td>
<td>Medium-Low</td>
<td>Regressive</td>
<td>Medium</td>
</tr>
<tr>
<td>Income tax</td>
<td>High</td>
<td>High</td>
<td>Progressive</td>
<td>Medium-High</td>
</tr>
<tr>
<td>Cigarette/Alcohol/Fuel</td>
<td>Low-Medium</td>
<td>Medium-Low</td>
<td>Regressive</td>
<td>Medium</td>
</tr>
<tr>
<td>User Charge</td>
<td>Low-Medium</td>
<td>Low-Medium</td>
<td>Regressive</td>
<td>Very High</td>
</tr>
</tbody>
</table>

*Source: Connecticut Conference of Municipalities*
Local governments, including cities, have begun to move away from reliance on property tax toward other revenue sources. They find they are trading reliance from one tax, often perceived by the public to be the "least fair" but from the government's perspective more stable, to a less stable source, such as the sales tax or user fees. This switch makes governmental revenues more vulnerable to downturns in the economy. As noted in the graph on page 86 the western states have a high reliance on user fees and charges. As the chart on page 95 indicates, user fees have both low revenue production and low stability with high administrative costs. In spite of these potential downsides, a 2009 survey indicates that 45 percent of cities nationwide have increased their fees for services and that 27 percent have increased the number of fees altogether. The mix of revenue sources used by local governments represents a series of tradeoffs including stability, fairness, and ease of collection. The implications of moving the cost of needed services from one primary revenue source to another might be illustrated with the case of property taxes and school funding. For most of the nation's history, public schools were funded almost entirely from local property taxes. Concerns over inequity in funding, that is, districts with low property values had less revenue, led many states to move some or most of school funding to state
In many cases, this meant a switch from reliance on property taxes for school funding to a reliance on a mix of income and sales taxes at the state level. Recent downturns in the economy and the resulting negative impact on school funding illustrate how the trade from a stable, but disliked property tax to a less visible but more volatile sales tax can impact critical services. In 2010, Idaho, for example, had the first cut in public school funding in state history after switching a substantial portion of school funding (the maintenance and operations costs) from local property taxes to the state general fund in a 2006 special legislative session.

State-shared revenues are an important source of city revenue in many states. Four Urban West states rely on state revenue for more than 10 percent of their revenue. Cities in two states, Arizona and Nevada, rely on state revenue for 20 percent and 23 percent of their revenue respectively. The previously mentioned Proposition 22 in California illustrates the importance of state revenue to cities. The proposition, backed by the League of California Cities, protects funding for local governments by preventing “the state from borrowing, raiding or otherwise redirecting local government funds.” As nearly every state experiences revenue shortfalls during the current economic downturn, cities can expect more states to reconsider their revenue-sharing formulas and practices.

Fees and service charges are a growing source of municipal revenues. There are many policy questions raised by this increasing reliance on fees. Even though they are more politically palatable than new general tax increases, user fees raise fairness issues. Fees are typically regressive—flat fees are charged to all users regardless of ability to pay. Users of parks and recreation programs tend to be lower-income residents; wealthier residents tend to recreate in private facilities—golf courses, country club swimming pools, etc. Should some residents be denied access to public services simply because they cannot pay the fees to participate? There are also some general government questions concerning the unintended consequences of raising recreation fees. They could result in increased numbers of unsupervised kids in the streets rather than in public recreation activities, which could add to the cost of law enforcement and other public safety costs.

Finally, many local governments have come to rely heavily on local option taxes. These may take the form of a local option sales tax, a local option
How do they pay for that?

One of the most persistent challenges facing cities throughout the West is how to pay for large capital and infrastructure construction costs. Whether it is a new stadium, a conference center, an industrial park, or a transit system, all cities face the dilemma of financing debt to build big capital projects. Each city has a different set of tools at its disposal, depending upon the tax and financing options authorized by the state legislature and approved by voters/residents. Private bond markets and financial institutions also play a role as private financial institutions weigh the worthiness of proposed public or public-private infrastructure projects. The following is a brief summary of some of the capital financing tools used by western cities:

Tax Increment Financing: In this form of debt financing a district is created around properties that are blighted or in need of infrastructure improvements. Bonds are sold to finance the improvements. Property taxes on the property in the district are “frozen” at the initial blighted or unimproved assessments. As improvements are made, usually a combination of private and publicly financed infrastructure, the property values and the property taxes collected within the district rise. The increment between the unimproved property value tax collections and the improved property value tax collections is used to pay off the bonds. Opponents of tax increment financing often object to the fact that taxing entities such as school districts, fire districts, and city and county governments don’t benefit from the improved property values within the district until the bonds are paid off, a period that can last up to 30 years. In response to such concerns, some states ex-
empt school districts from the increment pay off, allowing them to immediately benefit from any increase in property values.

Local Option Taxes: Most states authorize some form of local option taxes. Local option taxes that are used to finance capital projects include hotel/motel taxes, taxes on rental cars, or taxes on liquor by the drink or dining in addition to existing state and local sales taxes. The preceding examples are often associated with a convention center or arena aimed at visitors to the city. Other local option taxes, such as a gasoline tax or auto registration, may be used to finance transit or road systems. Local option sales taxes may pay for specific projects, such as Pueblo's local option sales tax that is generally targeted for economic development. Local option taxes usually require approval by local voters, and are authorized by state legislatures or by city home rule charters.

Impact Fees: Impact fees can be assessed to offset the costs of roads, schools, parks, and sewer systems, to name a few examples. The fees collected must be used on infrastructure related to the growth, and are usually required to be expended for those purposes within a set period of time.

Voter-approved Special Levies: The traditional property tax can be used to finance large infrastructure costs through voter-approved levies in which voters temporarily increase their property taxes in order to finance particular projects or programs. The level of approval required for passage of a special levy varies by state.

Grants: Federal or state grants can be used alone or in combination with other revenue sources to pay for large capital projects. Recipient governments need to ensure that spending or process requirements tied to the grants are followed carefully.

Private Sector: Private investment is often key to supplementing public funding for infrastructure or to spurring development in redevelopment areas.
gasoline tax, or other specialized taxes such as a lodging or hotel tax. A local option sales tax has the same tax characteristics of a statewide sales tax, except that localized economic conditions are magnified in the revenue potential and stability of the local option version.

- **Capital Investment and City Borrowing**

Another major category of city revenue is the capital fund, or capital budget. This is the budget by which cities pay for large capital or building expenses. Capital projects can include infrastructure such as buildings, bridges, roads, parks, water or sewage treatment facilities, etc. Their large, one-time expenses define capital projects. While some cities will add money annually to either the general fund or capital budget to pay for large new infrastructure projects, most need to borrow money needed for such expensive projects.

City borrowing is most typically done with bonds, which are purchased by private investors (a tax-free investment) and paid back by the city over time. Bonds backed by the full faith and credit of the city and its general taxes are called general obligation (GO) bonds. General obligation bonds usually require approval by the voters. In some states, a simple majority of the voters is required to approve the sale of general obligation bonds. In other states, a supermajority of voters (66 percent) is required. Another type of bond is a revenue bond or a bond that will be paid off with the revenues generated by the project created with the bonds. An example is a parking garage in which parking fees are used to pay off the revenue bonds. Revenue bonds do not typically require voter approval, but they have higher costs to the city in terms of interest rates. The use of revenue bonds to finance infrastructure has been
the focus of judicial and legislative wrangling in Idaho. A suit was successfully brought against the City of Boise alleging that the use of revenue bonds for construction of a new airport facility violated the state constitution’s limit on municipal debt. This decision greatly limited the ability of Idaho cities to use revenue bonds to finance large infrastructure projects. In 2010, Idaho voters approved constitutional amendments that allow municipalities—without voter approval—to use revenue bonds for certain limited uses such as airports, electrical systems, and hospitals. Another type of a revenue bond is tax increment financing (TIF), described in more detail in the sidebar on pages 98-99. TIF is used to stimulate private investment in a designated improvement district. Once the bonds are paid off, all of the taxing entities benefit from the increased property taxes.

**Conclusion**

There is a great deal of diversity in how cities raise their revenues. The mix of own-source taxes and state-shared revenues varies from state to state, but a few conclusions can be drawn:

- Because of pervasive limitations on the property tax and citizen resistance to it, cities will continue to move away from reliance on the property tax.
- The shift to other, less stable revenue sources, such as fees and state-shared monies, means that cities will face continued challenges in funding critical local services in economically unstable times.
- Because city fiscal conditions tend to lag behind national economic conditions, we can expect cities to continue to struggle to find revenues adequate to fund services for several years.
- As cities and state legislatures struggle with finding adequate revenues to fund services, we can expect continued conflicts over budgeting and taxation issues.