



# State of Main Street 2021: Careful Balancing Act

## Summary

Minnesota's cities and counties faced a difficult balancing act in 2020, and on average, stayed on their feet.

Each year, the Office of the State Auditor (OSA) uses data to share a picture of local government finances. Our "State of Main Street" is designed to help decision makers with choices to help keep local governments strong. This year, we used our finance and budget data to analyze the fiscal health of cities and counties in light of the COVID-19 pandemic. The OSA found that a mix of stimulus, spending reductions, and use of fund balances balanced lower revenue growth of Minnesota's cities and counties.

The Office of the State Auditor recently released the 2019 city finances report and will soon release the 2019 county finances report. The numbers in these reports show that for both cities and counties, pre-pandemic revenues and expenditures, specifically from 2018 to 2019, grew at levels above six percent. In contrast, the trend in the 2021 budgets show flat or decreased levels of overall revenues and expenditures.

We see that the pandemic is playing a major role, as it should, in city and county budget decisions. At the time most entities created their budgets, there was no assurance of future CARES Act funding and that seemed to impact the 2021 projections made by cities and counties on fund balance, property taxes, other taxes, and expenditures.

Local governments that plan for and maintain healthy fund balances and map out long term financial plans are generally able to weather unexpected situations better. The relative good financial health, in aggregate, of cities and counties pre-pandemic was a major stabilizing force in 2020. When added to that stability and conservative budgeting choices, the Federal Coronavirus Aid, Relief, and Economic Security (CARES) funding and state stimulus softened the financial impacts of COVID-19.

Below are some items of significance based on a comparison of 2020 original budgets to 2021 proposed budgets. There are a number of things to remember when analyzing budget numbers, including but not limited to: budget numbers have not been audited; the numbers are only for funds that have budgets (generally the governmental funds including the general, special revenue, debt service, and capital projects funds); and budgets for enterprise funds are not included.

## City and County Budgets Overview

- **Approaching 2021 with caution:** The general trend in both city and county budgets are flat to decreased total revenues and expenditures. In contrast to the most recent city and county reports where actual revenues and expenditures increased by more than 6 percent between 2018 and 2019, the lack of dramatic change in budgets reported for 2021 reflect caution and uncertainty.
- **Controlling expenditures:** Counties and cities are controlling what they can in 2021 and that is expenditures. In the aggregate, local government budgets reflect reduced total expenditures with the largest percentage decrease in capital outlay.
- **Utilizing fund balance:** Counties and cities plan to use fund balance to help balance their budgets. The COVID-19 pandemic is an example of the importance for local governments to set aside funds to help them weather unexpected events. The Office of the State Auditor has a useful Statement of Position on fund balance and related policies.
- **Being moderate with property taxes:** Property taxes are the largest revenue source for both counties and cities. Property taxes have remained a relatively stable 44 to 45 percent of counties' total revenue budgets, even as projected for 2021. For cities, property taxes have become a larger percent of their total revenue budget, going from 49 percent to 51 percent between 2020 and 2021. This is the result of other budgeted revenue sources decreasing as a percent of the total revenue budget. Counties and cities are budgeting property tax increases of 4.3% for cities and 1.3% for counties.
- **Cities bracing for reduction in all other taxes:** Other taxes representing local option city taxes such as sales, liquor, and hotel/motel showed significant decreases between 2020 and 2021 budgets. This indicates that cities expect on-going impacts on activities generating these taxes through 2021. For cities, all other taxes decreased 26.9 percent from the original 2020 budget to the 2021 proposed budget.
- **Larger and metro local governments seeing more significant impacts:** In general, the lasting effects of the COVID-19 pandemic projected in 2021 budgets had a greater negative impact on larger cities and metro counties. For large cities, budgeted total revenues and total expenditures decreased 1.5 percent and 2.7 percent, respectively, while small cities budgeted an increase of 3.8 percent in total revenues and 4.7 percent in total expenditures. For metro counties, budgeted total revenues and total expenditures decreased 2.4 percent and 4.3 percent, respectively, while greater Minnesota counties budgeted an increase of 0.3 percent in total revenues and 1.6 percent in total expenditures.

## Recommendations

The balancing act for local government entities in Minnesota is not over. Because cities, counties, and townships in Minnesota rely heavily on property taxes for their revenue, there is often a lag between major economic events and their impact on local revenues. Because the effects of COVID-19 have not yet fully affected property values, the pandemic will still need to be a factor in local decisions for the time being.

Decision makers at the state and federal level can celebrate the stabilizing effects of their stimulus efforts, and should consider similar efforts in the future. In the same vein, they should be extremely cautious about making changes to any current revenue streams that impact local government entities. This is not the time to make major reductions to intergovernmental aids or add significant costs to doing business for local governments.

## The State of Main Street Process

The Office of the State Auditor is the constitutional office that oversees nearly \$40 billion in local government finances for Minnesota taxpayers. The Office of the State Auditor helps to ensure financial integrity and accountability in local government financial activities. We accomplish that mission with examinations like audits and investigations; education and training; technical support and oversight; and data collection and analysis.

A key role of the Office of the State Auditor is to collect and analyze local government data to aid Minnesotans in making decisions based on clear facts presented in context. To serve that purpose, our Government Information Division produces a number of reports that analyze the data we collect from local governments throughout the year. This budget overview reflects a comparison of budget data from 2020 to 2021 and a first glance at the impact of the COVID-19 pandemic on local government financial projections.