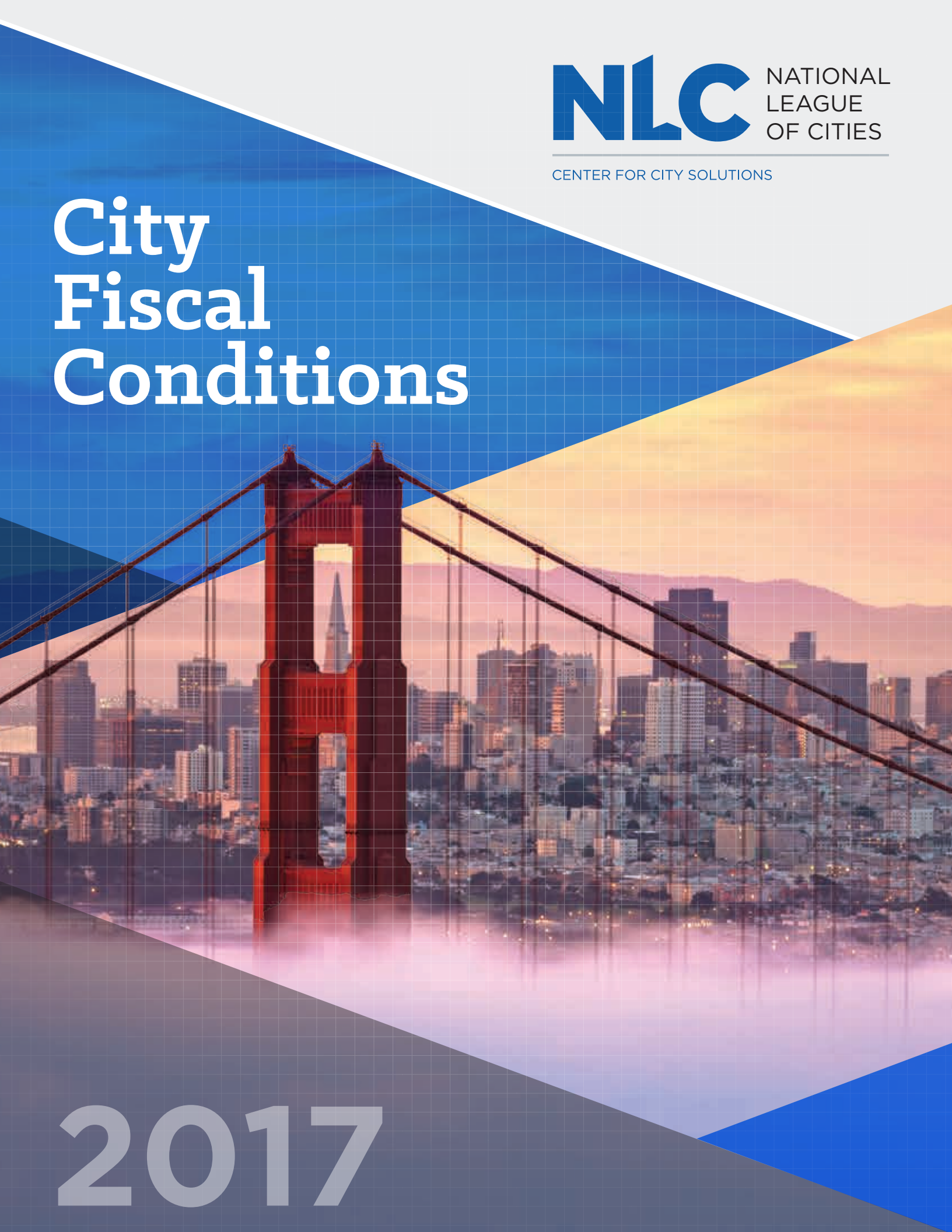


City Fiscal Conditions

2017



About the National League of Cities

The National League of Cities (NLC) is the nation's leading advocacy organization devoted to strengthening and promoting cities as centers of opportunity, leadership and governance. Through its membership and partnerships with state municipal leagues, NLC serves as a resource and advocate for more than 19,000 cities and towns and more than 218 million Americans. NLC's Center for City Solutions provides research and analysis on key topics and trends important to cities, creative solutions to improve the quality of life in communities, inspiration and ideas for local officials to use in tackling tough issues, and opportunities for city leaders to connect with peers, share experiences and learn about innovative approaches in cities.

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Acknowledgements

The authors would like to acknowledge the respondents to this year's fiscal survey. The commitment of these finance officers to the project is greatly appreciated. The authors are also grateful to Farhad Kaab Omeyr, a doctoral student in the Department of Public Administration at University of Illinois at Chicago, and Trevor Langan and Anita Yadavalli in NLC's Center for City Solutions, for their assistance in collecting General Fund data on the nation's largest 100 cities and for their overall survey and research support.

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City Fiscal Conditions 2017

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Several major findings
taken together signal
a slowdown on the
horizon.



Executive Summary

The 2017 City Fiscal Conditions survey of city finance officers reveals the start of fiscal contraction in the municipal sector following several years of post-recession growth. Several major findings taken together signal a slowdown on the horizon, including waning confidence of city finance officers, slowing local revenue and spending trends and insufficient post-recession revenue recovery.

■ Although the majority of finance officers (69%) are confident in the fiscal position of their cities, widespread optimism hit its peak in 2015.

■ General Fund revenues are slowing, with a rate of 2.61% in 2016. Expenditures followed a similar trend, with 2.18% growth rate in 2016. Revenues are projected to stagnate with just 0.9% growth in 2017. Expenditures are anticipated to increase by 2.1%.

■ Property tax revenues grew by 4.3% in 2016 owing to the strengthening real estate market in recent years. Both sales and income tax revenues also grew in 2016 (by 3.7% and 2.4%, respectively), albeit at a slower pace than property tax revenues. For

2017, finance officers have budgeted for much lower rates of growth in property tax revenues (1.6%) and project a decline in sales and income tax revenues (by -0.2% and -2.7%, respectively).

■ Cities' General Fund revenues still have not fully recovered from the recession and stand at less than 98% of 2006 levels.

These indicators of slowing local fiscal growth come on the heels of continued national economic expansion. Divergence between fiscal conditions and national economic indicators calls into question the alignment between city fiscal structures and the drivers of the economy, as well as the sustainability of the continued patchwork of solutions to cities' most pressing issues—namely, infrastructure.

What is the City Fiscal Conditions Survey?

The City Fiscal Conditions Survey is a national mail and online survey of finance officers in U.S. cities conducted in the spring-summer of each year. This is the 32nd annual edition of the NLC survey, which began in 1986.

Meeting Fiscal Needs

BINGHAMTON, NEW YORK

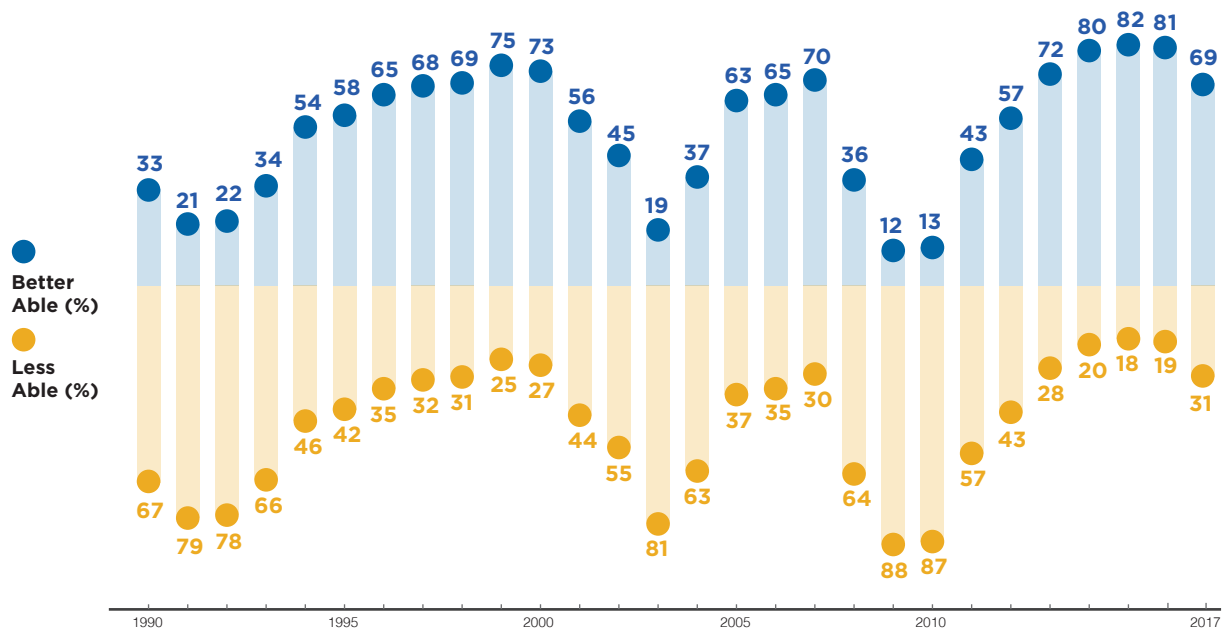
Although the majority of city finance officers are confident in the fiscal position of their cities, a downward trend is beginning to emerge. Sixty-nine percent of city finance officers report that their cities are better able to meet the financial needs of their communities in 2017 than in 2016 (see Figure 1).¹ Last year, 81% reported “better able,” and in 2015, the most widespread level of optimism in the history of the survey, 82% made the same assertion.

Finance officers see firsthand the impacts that budget decisions have on residents.

Although this is a simple perception indicator, it represents the informed opinion of those who manage budgets year-round. Finance officers see firsthand the fluctuations in revenues and expenditures and the impacts that budget decisions have on residents.

Their response to “ability to meet fiscal needs” has historically tracked well with more quantitative fiscal measures. This year’s results point to the potential start of a contraction in the municipal sector after optimism about growth hit a peak in 2015.

Figure 1 Percent of Cities “Better Able/Less Able” to Meet Financial Needs



A number of factors combine to affect the ability of cities to meet their fiscal needs. Each year, the survey presents city finance directors with a list of factors that determine revenue performance, spending levels and the overall fiscal condition of cities.² Respondents are asked whether each of these factors increased or decreased from the previous year, and which three had the most positive and negative influence on the city's overall fiscal picture.

Those factors that represent costs to the city—employee wages (93%) and infrastructure needs (92%)—have increased

most broadly, whereas those factors that represent revenues—federal aid (28%) and state aid (27%)—have decreased most broadly (see Figure 2).

When we examine the magnitude of these changes, we find that, consistent with recent years, the overall value of the local tax base (83%) and health of the local economy (77%) have had the most favorable impacts on city budgets (see Figure 3). Infrastructure needs (55%) weigh most negatively, followed by public safety needs (48%) and the cost of employee/retiree pensions (45%), health benefits (45%) and wages and salaries (44%).

Figure 2 Change in Selected Factors

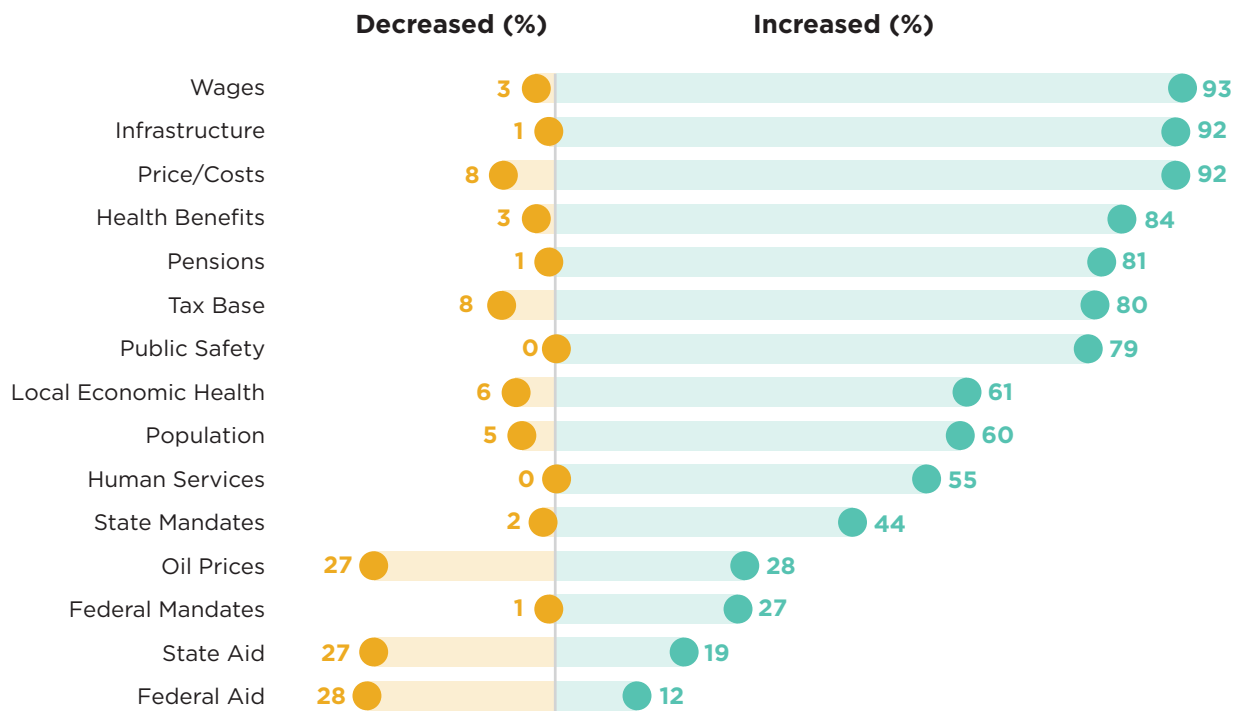
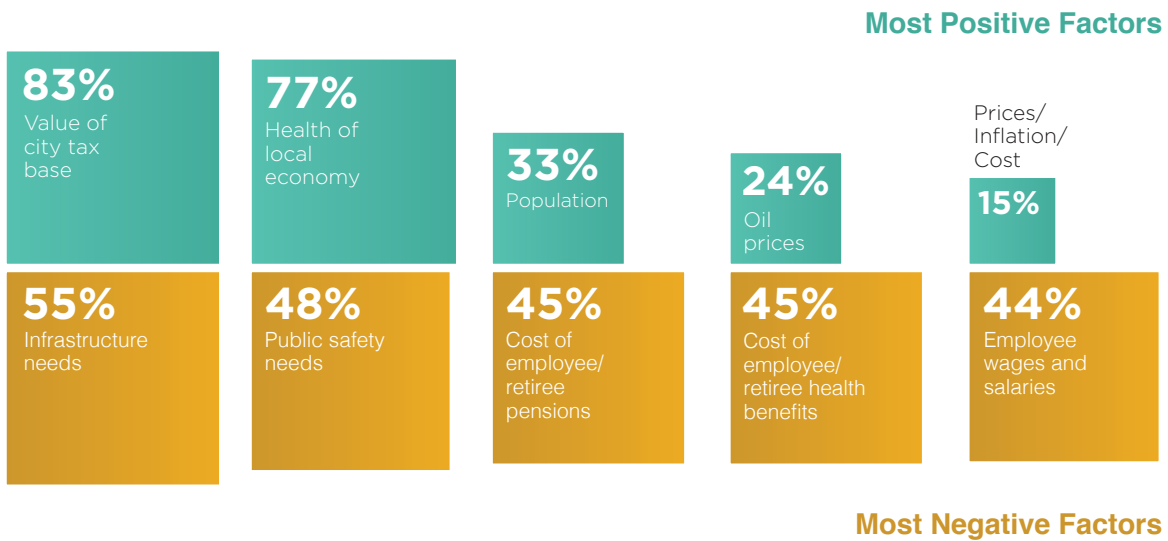


Figure 3 Most Positive and Negative Factors

Percent of cities selecting factor as one of three most positive and negative factors impacting their city's budget.



Revenue and Spending Trends

TULSA, OKLAHOMA

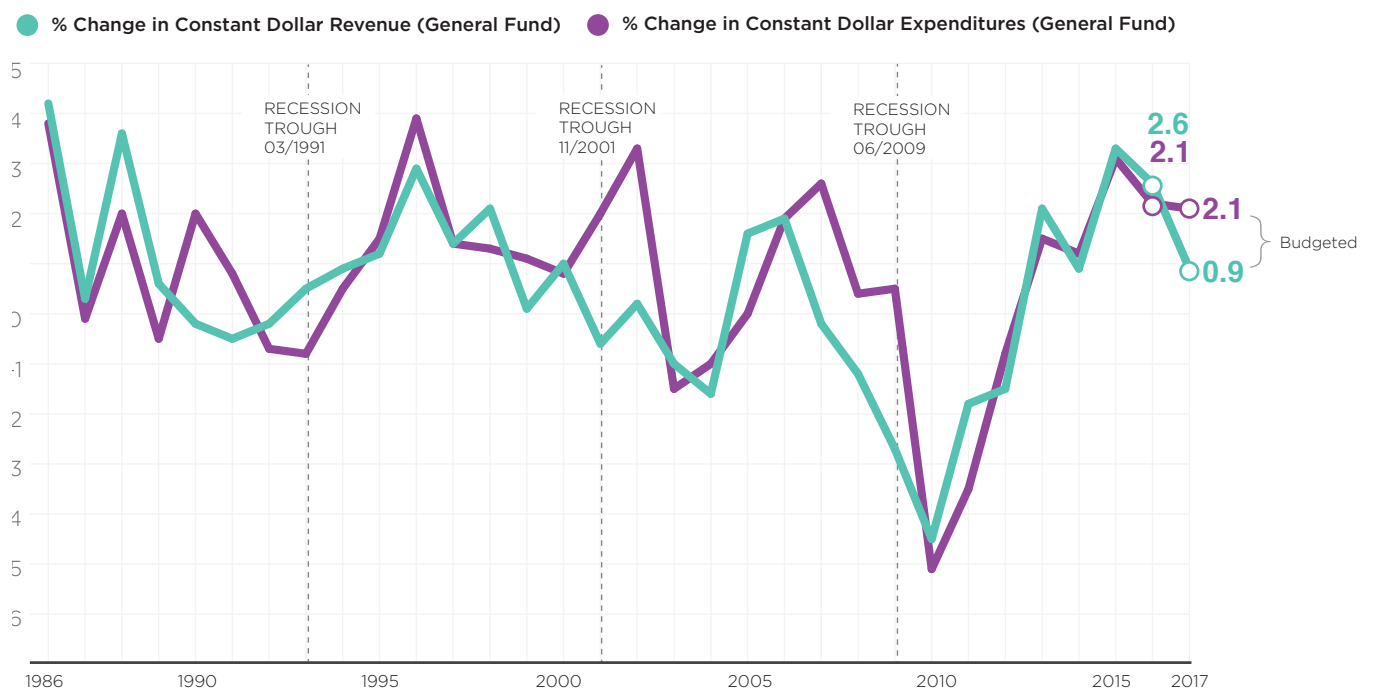
Revenue and spending trends also point to a slowdown in fiscal growth. Each year, we ask city finance officers to provide information about the portion of their city's budget referred to as the General Fund. General Fund revenues are derived from property, sales, utility and other taxes, user fees and shared revenues. They provide funding to cities' general operations and constitute on average more than 55% of total city spending, most of which is discretionary.

Post-recession trends indicate that revenue growth is starting to slow.

In constant dollars, General Fund revenues grew by 2.61% in 2016 over 2015 (see **Figure 4**).³ Post-recession trends indicate that revenue growth is starting to slow following the highest post-recession growth of 3.26% in 2015. The more significant drop in revenue growth in 2014 was largely due to higher inflation at that time (2.3%), followed by significantly lower inflation in 2015 (0.5%) and 2016 (0.9%).

Cities have budgeted for a 0.9% increase in 2017 revenues. This minimal growth projection is the result of slowing revenue growth overall, a return to higher levels of inflation in 2017 (2.1%) and the typical conservative approach that finance officers take for revenue estimates. For these reasons, actual 2017 revenues will likely be somewhat greater than

Figure 4 Year-to-Year Change in General Fund Revenue and Expenditures



estimates. For the same reasons, once the fiscal year ends, actual expenditures will likely be less than budgeted expenditures. Expenditure growth for 2017 is budgeted at 2.1%.

Additionally, over the past two years when cities closed their books on the fiscal year, a trend of stronger revenue over expenditure growth emerged. This may indicate that cities are shoring up ending balances to help stabilize their fiscal position.



RICHMOND, VIRGINIA

Tax Revenues

HOUSTON, TEXAS

Changes in General Fund revenues typically reflect the changing economic and fiscal environments within which cities operate. However, differences in the composition and collection of property, sales and income taxes affect how each revenue stream responds to economic conditions.⁴ While nearly all cities have access to a local property tax, more than half are also authorized to collect local sales taxes, and some cities (fewer than 10% nationally) are authorized to collect local income or wage taxes.

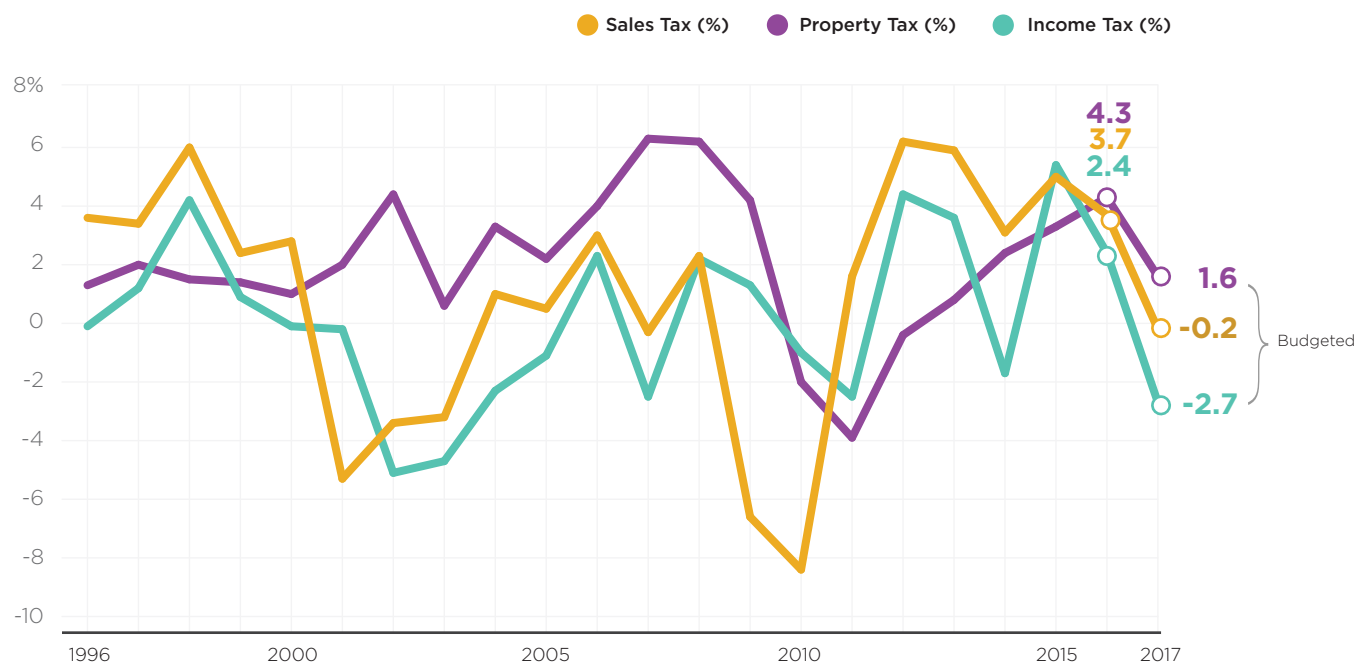
This year, we find robust growth in property tax revenues and a significant weakening of sales and income tax revenue growth.

Property Taxes. Local property tax revenues are driven by the value of residential and

commercial property, with property tax bills determined by local governments' assessment of property values. Property tax revenues are considered more inelastic, or less responsive, to economic changes than other tax sources. It typically takes longer for economic shifts to affect housing values and property tax collections. Also, assessment practices are such that property tax revenues typically reflect the value of a property anywhere from 18 months to several years prior to collection. **(For more on the lag which takes place between economic changes and city revenues, see page 20.)**

Although 2016 witnessed strong property tax revenue growth at 4.3%, this source of revenue is anticipated to slow to 1.6% in 2017 (see Figure 5).

Figure 5 Year-to-Year Change in General Tax Receipts



General Fund revenues still have not fully recovered from the recession.

According to Harvard's Joint Center for Housing Studies, "housing markets continued to strengthen in recent years, with new and existing home sales, prices and construction levels all on the rise. Still, single-family construction, traditionally the largest source of residential investment, remains well below historical levels. As a result, low inventories of homes for sale are driving prices above pre-recession peaks in many cities."⁵ These findings bode well for property tax revenues but introduce both immediate and longer-term concerns regarding housing affordability.

Sales Taxes. While property tax revenues are considered a lagged indicator, sales taxes are more elastic. Consumer sales respond more quickly to economic shifts so that when consumer confidence is high, people spend more on goods and services. Historically, city governments with sales tax authority then reap the benefits through increases in sales tax collections.

With the strengthening of the economy and improved employment and housing landscape, consumer confidence has been on the rise in recent years.⁶ In 2016, sales tax revenues grew by 3.7%. Indeed, Moody's upgraded its outlook for the retail sector from stable to positive last year.⁷

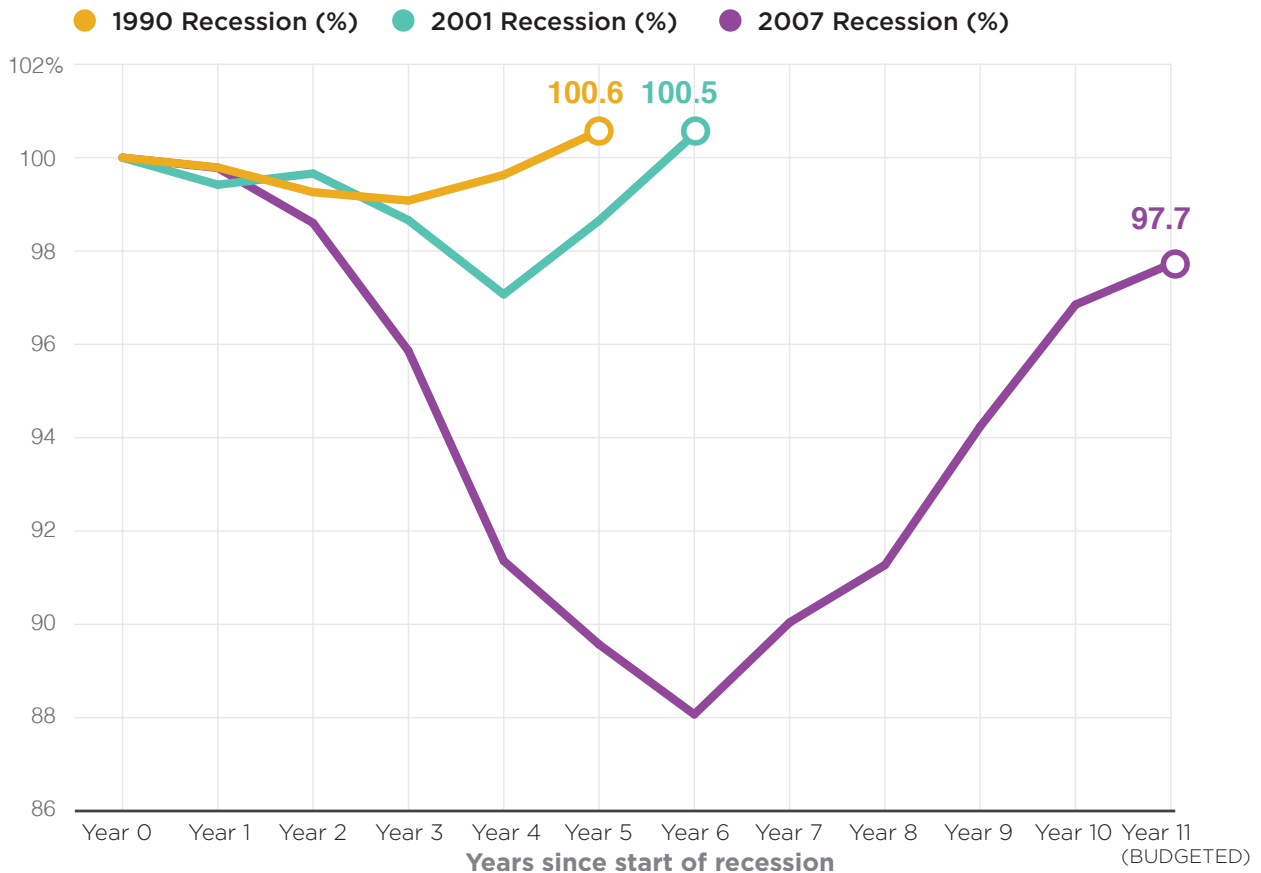
Importantly, however, the growth that has occurred in the retail sector has been driven largely by online sales, with poorer performance shown by brick-and-mortar stores.⁸ Since local governments do not reap as much revenues from online sales, they cannot capture this growth. This lack of interstate e-commerce taxing authority is making its presence felt in city budgets across the country. For 2017, city finance officers predict a slight decline or leveling off (by -0.2%) of sales tax receipts.

Income Taxes. Like sales taxes, income taxes are a more elastic source of revenue as they respond more quickly to local economic circumstances. At the city level, income tax revenues are driven primarily by income and wages, rather than by capital gains (with the exception of New York City).

Cities realized a 2.4% increase in income tax receipts in 2016 but anticipate a significant decline of -2.7% in 2017.

Income tax revenue is a fiscal indicator to watch as it captures local labor market nuances that may be missed by broad national economic trends. For example, despite gains in national employment, there is still a significant number of individuals—approximately 3.6 million—who are currently out of work and looking to reenter the labor market.⁹ Even for those who are working, nominal wage growth since the recovery officially began in mid-2009 has been low and flat.¹⁰ Gradual employment gains and slow wage growth, widening income inequality and a lack of expansion of middle-income jobs continue to contribute to the decline and volatility of income tax revenues.

Figure 6 General Fund Revenue Recovery During Recent Recessions



In a broader context, this slowdown, stagnation or decline of all three primary sources of city revenues comes when General Fund revenues still have not fully recovered from the recession. Revenues stand at less than 98% of what they were in 2006 (see **Figure 6**).¹¹ Given other indicators of fiscal challenge in the municipal sector, it is possible that revenues may not return to prerecession levels during this economic cycle.

Fiscal Policy Actions

MINNEAPOLIS, MINNESOTA

Despite these challenges, cities must anticipate changes, actively adjust revenues and expenditures throughout the year and balance their budgets on an annual basis. To better understand local fiscal policy responses, we asked city finance officers about specific revenue and spending actions taken in 2017.

As has been the case for much of the past two decades, the most common action taken to boost city revenues, regardless of broader economic trends, has been to increase fees charged for services. Two in five (42%) city finance officers report that their cities raised fee *levels* (see **Figure 7**). Approximately one in four cities increased the *number* of fees that are applied to city services (26%).

Twenty-seven percent of cities increased their local property tax rates in 2017. Since the mid-1990s, irrespective of economic conditions, the percentage of city finance officers reporting increases in property taxes in any given year has been reported at about this same level, reflecting state- and voter-imposed restrictions on local property tax authority as well as the political challenges of raising property tax rates. Increases in sales, income or other types of tax rates are even less common, and this has continued to be the case in 2017.

When asked about expenditure actions taken in 2017, most cities report increased spending on employee wages (86%), public safety expenditures (75%) and infrastructure (74%) (see **Figure 8**).

Figure 7 City Revenue Actions

	Decrease (%)	Increase (%)
Fee Levels	2	42
Property Tax Rate	7	27
# of Fees	1	26
Level of Impact Fees	3	23
Other Tax Rate	2	9
Sales Tax Rate	1	8
Tax Base	2	6
# of Other Taxes	2	5
Income Tax Rate	1	2

Figure 8 City Spending Actions

	Decrease (%)	Increase (%)
Employee Wages	1	86
Public Safety	2	75
Infrastructure	4	74
Capital Projects	6	61
Size - Municipal Workforce	8	46
Pension Plans	3	41
Other City Services	7	38
Human Services	3	35
Health Plans	6	35
Inter-Local Agreements	1	22
Contracting Services	4	20
Education	4	17

Beyond 2017



BOISE, IDAHO

This year, the municipal sector may experience its second post-recession year-over-year contraction in revenues if our expectations about budgeted revenues and expenditures for FY17 are generally accurate. This slowdown is fueled primarily by declining, or at best, stagnating sales and income tax collections, but it is also buoyed by growth in property tax revenues. Costs that can no longer be delayed, such as those for infrastructure and for employees and retirees, as well as cuts from federal and state partners, will continue to contribute to the fiscal uncertainty facing cities.

Moving forward, although national economic indicators are on the uptick, fiscal challenges in the local and state government sectors will materialize in downward pressure on gross domestic product (GDP). State and local government spending comprise about 20% of GDP. According to the most recent Bureau of Economic Analysis estimates, positive contributions to GDP made by personal consumption, nonresidential fixed investments, exports and federal government spending have begun to be offset by negative contributions from state and local government spending.

Additionally, drastic economic and technological changes occurring in the most recent recovery period, as well over the past 30 years, point to the imperative to reexamine the field's conventional thinking about the ability of city finances to buffer against economic downturns and to capture revenue growth during periods of economic expansion. This is probably most obvious in the restructuring of the retail industry and the legal challenges for cities of capturing retail sales tax on all online transactions. While consumer spending on online goods

Local governments will make the hard choices needed to serve their communities.

and services has increased, cities have limited capacity to collect online sales taxes.

Also, widespread and increasing state constraints on local property taxes are encouraging cities to search for other revenues. A recent study of cities across the country found that the most common fiscal policy action taken when a city approaches the ceiling of property taxes is to increase sales taxes.¹² Within their limited taxing authority, however, cities are stuck between a rock (property tax caps) and a hard place (limited online sales tax authority), often resulting in the increase of fees for services.

At the end of the day, local governments will balance their budgets and make the hard choices needed to serve their communities. These forced choices, however, have consequences and threaten the competitiveness and quality of life of our nation's drivers of economic and social vitality: its cities.

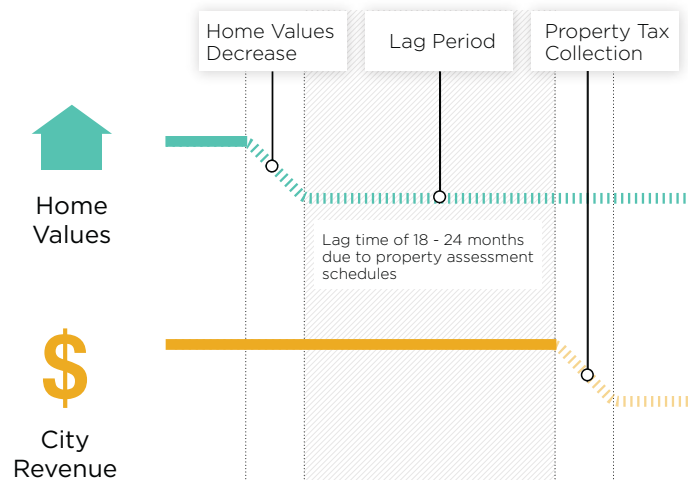
The Lag Between Economic & City Fiscal Conditions

We often refer to the lag between changes in the economic cycle and the impact on city fiscal conditions.

What does this mean? The lag refers to the amount of time between the point when economic conditions change and the point when those conditions have an impact on reported city revenue collections. In fact, cities likely feel the impacts of changing economic conditions quite early. However, because reporting of city fiscal conditions occurs in most cases on an annual basis, whether through annual budget reporting or NLC’s annual survey, those impacts tend to not become evident until some point after they have started to occur.


How long is the lag? The lag is typically anywhere from 18 months to several years, and it is related in large part to the timing of property tax collections. Property tax bills represent the value of the property in some previous year, when the value of the property was last assessed. A downturn in real estate prices may not be noticed for one to several years after the downturn begins because property tax assessment cycles vary across jurisdictions; some reassessments occur annually while others occur every few years. Consequently, property tax collections, as reflected in property tax assessments, lag behind economic changes (both positive and negative) by some period of time. Sales and income tax collections also exhibit lags owing

Lag Between Economic and City Fiscal Conditions



to collection and administration issues, but such lags are typically no more than a few months.

Figure 4 shows year-to-year changes in city General Fund revenues and expenditures, and it includes markers for the official U.S. recessions from 1991, 2001 and 2007, with low points, or “troughs,” occurring in March 1991, November 2001 and June 2009, according to the National Bureau of Economic Research. Comparing the dates of the recessions to the low points in city revenues and expenditures as reported in NLC’s annual survey (typically conducted between April and June of every year), the low point for city revenues and expenditures after the 1991 recession occurred in 1993, approximately two years after the trough of the U.S. economic recession (March 1991 to March 1993). After the 2001 recession, that low point occurred in 2003, approximately 18 months after the trough



of the U.S. economic recession (November 2001 to April 2003). Our reporting on this lag depends upon when the annual NLC survey is conducted, meaning that there is some degree of error in the length of the lag; for instance, had the survey been conducted in November of 1992 rather than in April of 1993, we might have seen the effects of changing economic conditions earlier. Nevertheless, the evidence suggests that the effects of changing economic conditions tend to take 18-24 months to be reflected in city budgets.

About the Survey

The City Fiscal Conditions Survey is a national email survey of finance officers in U.S. cities conducted annually from May to July. Surveys were emailed to city finance officers for a sample of 1,018 cities with populations greater than 10,000, asking for their assessments of fiscal status, actions taken and factors affecting their fiscal conditions. The survey also requested budget and finance data from all cities with the exception of the 100 largest cities by population; such data from those cities were collected directly from online city budget documents. In total, the 2016 data are drawn from 261 cities for a response rate of 26%. The data allow for generalizations about the fiscal condition of cities.

The number and scope of governmental functions influence both revenues and expenditures. For example, many northeastern cities are responsible not only for general government functions but also for public education. Some cities are required by their states to assume more social welfare responsibilities than other cities. Some assume traditional county functions.

Cities also vary according to their revenue-generating authority. Some states—notably Kentucky, Michigan, Ohio and Pennsylvania—allow their cities to tax earnings and income. Other cities—notably those in Colorado, Louisiana, New Mexico and Oklahoma—depend heavily on sales tax revenues. Moreover, state laws may require cities to account for funds in a manner that varies from state to state. Therefore, much of the statistical data presented here must also be understood within the context of cross-

Categories	Survey Responses	%
TOTAL	261	100
Population		
>300,000	54	21
100,000-299,999	72	28
50,000-99,999	79	30
10,000-49,999	56	21

state variation in tax authority, functional responsibility and state laws. City taxing authority, functional responsibility and accounting systems vary across the states.

When we report on fiscal data such as General Fund revenues and expenditures, we are referring to all responding cities' aggregated fiscal data included in the survey. As a consequence, the data are influenced by the relatively larger cities that have larger budgets and that deliver services to a preponderance of the nation's cities' residents.

When we report on nonfiscal data (such as finance officers' assessment of their ability to meet fiscal needs, fiscal actions taken or factors affecting their budgets), we are referring to percentages of responses to a particular question on a one-response-per-city basis. Thus, the contribution of each city's response to these questions is weighted equally.

Endnotes

1 When asking for fiscal data, we ask city finance officers to provide information about the fiscal year for which they have most recently closed the books (and therefore have verified the final numbers), which we generally refer to as FY 2016; we refer to the prior year as FY 2015 and to the current fiscal year for budgeted (estimated) amounts as FY 2017.

2 The factors include infrastructure needs/costs, public safety needs/costs, human service needs/costs, wages, pension costs, health benefit costs, prices and service costs, federal aid, state aid, federal mandates, state mandates, city population, city tax base, the health of the local economy, and gas and oil prices.

3 “Constant dollars” refers to inflation-adjusted dollars. “Current dollars” refers to non-inflation-adjusted dollars. Constant dollars are a more accurate source of comparison over time because the dollars are adjusted to account for differences in the costs of state and local government. To calculate constant dollars, we adjust current dollars using the U.S. Bureau of Economic Analysis National Income and Product Account estimate for inflation in the state and local government sector.

4 National League of Cities. (2015). Cities and State Fiscal Structure. Retrieved from www.nlc.org/resource/cities-and-state-fiscal-structure-2015

5 Joint Center for Housing Studies of Harvard University. (2017). The State of the Nation’s Housing 2017. Retrieved from www.jchs.harvard.edu/research/state_nations_housing

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6 Mitchell, J. & Zumbrun, J. (2017, Aug. 15). Consumer Spending Gives Some Retailers a Lift, But Risks Abound. The Wall Street Journal. Retrieved from <https://www.wsj.com/articles/happy-consumers-ramp-up-spending-but-risks-abound-1502817081>

7 Moody’s Investor Service. (2016, Jun. 30). Moody’s: Outlook for US retail industry changed to stable from positive. Retrieved from https://www.moody.com/research/Moodys-Outlook-for-US-retail-industry-changed-to-stable-from--PR_351500

8 Tu, J. I. (2017, Aug. 10). Nordstrom has strong online growth, while brick-and-mortar sales lag. The Seattle Times. Retrieved from <http://www.seattletimes.com/business/retail/nordstrom-has-strong-online-growth-while-brick-and-mortar-sales-lag/>

9 U.S. Census Bureau. (2016). American Community Survey [Data file]. Retrieved from <https://www.census.gov/programs-surveys/acs/>

10 Economic Policy Institute. (2017, Aug. 4). Nominal Wage Tracker. Retrieved from <http://www.epi.org/nominal-wage-tracker/#chart1>

11 This estimate is calculated from the compounded year-over-year decline/growth in constant dollar General Fund revenues for each recession, with the year prior to the start of each recession (1989, 2000, 2006) as the base year (i.e., Year 0 in figure 5).

12 Wang, S. (2015). The effect of state-imposed tax and expenditure limits on municipal revenue structure: A legal approach (Doctoral dissertation).

DATA TABLES

FIGURE 4: Year-to-Year Change in General Fund Revenue and Expenditures

Change in Constant Dollar Revenue (General Fund), Percent

1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
4.18%	0.34%	4%	0.55%	-0.21%	-0.53%	-0.18%	0.55%	0.93%	1.25%	2.85%	1.43%	2.14%	0.11%	0.97%	-0.58%
2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
0.25%	-1.01%	-1.59%	1.58%	1.85%	-0.22%	-1.18%	-2.75%	-4.50%	-1.79%	-1.53%	2.08%	0.86%	3.26%	2.61%	0.9%

Change in Constant Dollar Expenditures (General Fund), Percent

1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
3.77%	-0.11%	1.97%	-0.46%	2.04%	0.78%	-0.73%	-0.77%	0.54%	1.52%	3.86%	1.37%	1.31%	1.09%	0.76%	1.96%
2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
3.33%	-1.49%	-1.03%	0.04%	1.88%	2.64%	0.37%	0.50%	-5.10%	-3.49%	-0.84%	1.46%	1.17%	3.10%	2.18%	2.1%

FIGURE 5: Year-to-Year Change in General Tax Receipts

Sales Tax, Percent

1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
3.6%	3.4%	6.0%	2.4%	2.8%	-5.3%	-3.4%	-3.2%	1.0%	0.5%	3.0%	-0.3%	2.3%	-6.6%	-8.4%
2011	2012	2013	2014	2015	2016	2017								
1.6%	6.2%	5.9%	3.1%	5.0%	3.7%	-0.2%								

Income Tax, Percent

1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
-0.1%	1.2%	4.2%	0.9%	-0.1%	-0.2%	-5.1%	-4.7%	-2.3%	-1.1%	2.3%	-2.5%	2.2%	1.3%	-1.0%
2011	2012	2013	2014	2015	2016	2017								
-2.5%	4.4%	3.6%	-1.7%	5.4%	2.4%	-2.7%								

Property Tax, Percent

1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
1.3%	2.0%	1.5%	1.4%	1.0%	2.0%	4.4%	0.6%	3.3%	2.2%	4.0%	6.3%	6.2%	4.2%	-2.0%
2011	2012	2013	2014	2015	2016	2017								
-3.9%	-0.4%	0.8%	2.4%	3.3%	4.3%	1.6%								

FIGURE 6: General Fund Revenue Recovery During Recent Recessions

1990 Recession

Year 0	Year 1	Year 2	Year 3	Year 4	Year 5								
1	99.79%	99.26%	99.08%	99.63%	100.57%								

2001 Recession

Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6							
1	99.42%	99.66%	98.66%	97.07%	98.65%	100.50%							

2007 Recession

Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11		
1	99.78%	98.60%	95.86%	91.36%	89.57%	88.07%	90.04%	91.27%	94.24%	96.85%	97.72%		



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