The Fiscal Crisis and Cities in the West

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Western States & Cities

Across the nine western states that comprise the twelfth Federal Reserve District there are 1,701 cities and 253 counties. California has the most cities with 478, followed by Washington (281), Utah (242), Oregon (242), Idaho (200), Alaska (148), Arizona (90), Nevada (19), and Hawaii (1). This large number of cities has a diverse economic structure. First, I will briefly review the economic health and vitality of the states in the region by examining the gross domestic product. Next, I will look at employment and income trends in the west. Finally, I will examine the current housing situation. Following the brief overview of the region's economy I will explore the revenue structure of cities in the region.

General Economic Activity. The cities in the west represent a broad range of economic health and vitality. Economic activity has weakened recently. Nevertheless, the West continues to have one of the most economically productive areas, California (ranked 1st in domestic GDP) and two states with some of the lowest levels of economic output (Alaska and Idaho, ranked 45th and 42nd respectively). By another measure, looking as MSAs, the Western States include 8 of the 25 most economically active areas, as measured by GDP, including 2 in the top 10 (Los Angeles and San Francisco). In addition to being economically diverse, the Western states are diverse in their local government structures.

Employment and Unemployment. Employment in the nine-state region has decreased by over 92,000 jobs in just the last month, a decline of 0.3% from the previous month. Over the last year, these states have lost nearly 232,000 jobs. However, this has not been evenly spread across the states. The west-coast states have been particularly hard hit. California and Nevada have been hardest hit, loosing 101,000 and 70,000 jobs respectively. Utah and Hawaii, on the other hand, have not seen much job loss in the last year. Alaska is the outlier; the state has added 2,000 jobs, an increase of almost 1 percent in the last year. Unemployment, not surprisingly shows a similar pattern. Utah has the lowest unemployment rate in the region at 3.7 percent, ranking fourth nationally. California, Oregon, and Nevada have the highest rates in the region at 8.4, 8.1, and 8.0

percent, ranking 45th, 47th, and 48th nationally. The average unemployment rate in the region is 6.7 percent.

Housing Market. The erosion of activity in the housing market has significantly impacted Cities in the west. This includes new construction, sales of existing homes, and foreclosures. For example, residential permits for new construction are down on average of 40 percent across all of the western states. As a result of the downturn in the housing market, prices overall are down. Arizona, California, and Nevada have been the most affected by the downturn in the housing market. In the last reported quarter of 2008 (Q3), these three states saw declines in housing values of about 8 percent in the most recent quarter. When compared to the same quarter in the previous year, housing prices in California and Nevada are down 21 percent and Arizona prices are down 13 percent. The other Western states have also seen decline in housing prices, the average decline for the other Western states was nearly 2 percent.

Foreclosures are probably the most troubling aspect of the housing market for cities in the West. Four of the nine western states are in the top 10 for highest foreclosure rates (Nevada [1], Arizona [3], California [4], and Utah [9]). Additionally, several western cities are especially hard hit by foreclosures. Seven of the top ten foreclosure areas are in western cities. Las Vegas has the second highest foreclosure rate in the nation at 1 in every 61 homes, followed by five California cities (Merced [3], Modesto [4], Stockton [5], and Riverside-San Bernardino [6]), Bakersfield and the Vallejo-Fairfield area round out the top ten. Foreclosures are very troubling for cities because they lower overall property values, they often delay the payment of property taxes, and they represent an increasingly negative economic environment.

Revenue Structure

Each state has developed a different revenue structure to support the provision of municipal services. The mix of revenues will affect the ability of cities to weather an economic downturn. For example, sales tax revenues often respond to economic changes quickly than property tax revenues. Also, transfers from other governments are also extremely vulnerable to economic downturns. As the other governments are struggling to meet their financial obligations they are often willing to cut back on transfers to other governments. This section briefly reviews the revenue structures of western cities.

Intergovernmental Revenues. In all of the states, except Utah, cities receive a significant portion of their revenues from transfers from either the federal government or the state. The average for cities in the west is 19 percent in total intergovernmental revenues. The highest is for cities in Alaska at 34 percent of total revenues, closely followed by Nevada and Arizona (30 and 29 percent respectively). Utah cities receive the smallest IGR transfers at 8 percent of revenues, the next lowest is cities in Washington (10 percent). Because of the very different reliance on transfers, especially from the states, the reliance on other tax sources is also very different.

Property Taxes. Overall, property taxes are the most important revenue source for cities in the west. On average, western cities receive 19 percent of general revenues from property taxes. In four states, Alaska, Hawaii, Idaho, and Oregon cities generate more than 20 percent of their revenue from property taxes. Cities in Arizona are the least reliant on property taxes, only generating 7 percent of their revenues.

Sales Taxes. On average cities in the west generate 11 percent of their revenues from general sales taxes, and 6 percent from selective sales taxes. Notably, Oregon does not have a sales tax and Idaho and Hawaii report that cities receive no direct revenue from sales taxes. Cities in Arizona have the highest reliance on sales taxes (21 percent of total revenues), followed by Utah cities at 16 percent of revenues. Cities in Washington and Hawaii have the highest reliance on selective sales taxes, generating 8 percent of total revenues.

Other Revenues. Cities in the west on average receive 21 percent of their revenue from charges for services. Cities in Utah (23 percent), Nevada (25 percent), and Idaho (26 percent) have the highest reliance on charges for services. Finally, western cities also rely on other miscellaneous source for 13 percent of their revenues.

The Western Crisis. The general economic situation and the structure of city revenues have created a difficult situation for cities in the west. The earliest indication of a significant problem was highlighted by the city of Vallejo. In February 2008, Vallejo (population 115,552) announced that the city would likely run out of cash in early spring. The city formally filed for bankruptcy in May and in September a U.S. Bankruptcy judge declared the city insolvent and approved their bankruptcy petition. While the reasons for Vallejo’s insolvency are many fold, it is clear that the current financial crisis exacerbated the city’s precarious financial position. However, Vallejo’s financial difficulties are not unique, cities across the west are struggling with difficult financial consequences, many of which arise from the national financial situation.

Other Factors Affecting Municipal Revenues and Resources

The tightening of the debt market has had a significant impact for cities across the west. This has varied dramatically across the states. For example, in states with a high reliance on General Obligation debt (e.g. Hawaii, 80% of long-term debt and Nevada 67% of long-term debt) they are severely impacted by declines in property values since the property tax is most often the backbone of GO debt. However, other states have also been impacted significantly. Non-GO debt is typically viewed by the market as having a higher risk, and therefore requires higher interest payments. As the market has tightened cities have found that investors are extremely cautious about municipal debt, which has caused the interest rates to increase dramatically, especially for non-GO debt.

Western states whose local governments are most vulnerable to the economic downturn include California, Nevada, and Arizona. Cities in these states are particularly vulnerable because of the high rates of foreclosure, the rapid decline of property values, and a relatively strong reliance on intergovernmental revenues. Utah cities are probably the least vulnerable in the region given Utah's comparatively strong economic position. However, even that relatively good position leaves Utah cities vulnerable since that have a strong reliance on the volatile sales tax. In the end, this fiscal downturn will challenge cities across the Western United States as they struggle to provide services in a negative economic crisis that is driven by a wide range of factors.

12th Federal District

Share of Total Revenue

	Number of Cities	IGR -- State	IGR -- All Other	Property Taxes	General Sales Taxes	Selective Sales Taxes	Charges for Services
Alaska	148	30	4	22	6	2	16
Arizona	90	20	9	7	21	4	16
California	478	11	5	14	10	7	19
Hawaii	1	5	10	34	0	8	19
Idaho	200	11	6	27	0	2	26
Nevada	19	24	7	14	1	7	25
Oregon	242	7	6	23	0	6	20
Utah	242	4	3	13	16	5	23
Washington	281	7	3	13	11	9	20

Resources

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