Massachusetts Taxpayers Foundation

News Release

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Municipal Finances Recovering Slowly but Cities and Towns Face Long-Term Squeeze

Municipal finances showed modest improvement in fiscal 2014 but are well shy of the pace of prior economic recoveries, according to the Massachusetts Taxpayer Foundation's 44th annual Municipal Finance Data report released today.

Total municipal revenues and expenditures grew by 4.1 percent to $24.3 billion statewide in fiscal 2014, a slight improvement over the 3.7 percent growth in fiscal 2013 but less than the average annual growth of 4.7 percent during the Proposition 2 ½ era.

Municipalities are confronting the reality that all three major sources of revenue—property taxes, local aid, and local receipts—are experiencing only modest growth, which is not likely to change for the foreseeable future.

- Property taxes, the largest source of revenue for municipalities, grew by four percent, the strongest annual growth since fiscal 2010. However, this compares to 5.3 percent average annual growth since Proposition 2 ½ was fully implemented in 1985.

- Cherry sheet aid, which excludes school construction, totaled $4.8 billion, an increase of 3.2 percent or $150 million from fiscal 2013; Chapter 70 funding accounted for $121 million or 80 percent of this increase.

- Unrestricted state aid rose for the first time after three years of level funding, up 2.4 percent or $21 million to $920 million, but still below the $935 million in fiscal 2008 before the economic crash.

- In fiscal 2014, local receipts such as motor vehicle excise taxes, hotel and meals taxes, building permits, and charges for services, grew by $100 million or 2.4 percent. Only in two other years since 2000 has the growth in local receipts been weaker (a 1.1 percent increase in fiscal 2012 and a 2.9 percent decrease in fiscal 2010).

- The local option hotel and meals taxes introduced in fiscal 2010 continue to be an important revenue source for municipalities. These taxes combined for $264 million, up $19 million or eight percent from fiscal 2013. That amount includes $4.2 million in revenues from 21 communities that adopted one or both of the taxes for the first time in fiscal 2014. A total of 178 municipalities have adopted the local hotel tax and 182 have a local meals tax.

- Revenues from all other sources—mainly the use of free cash—showed the largest proportional gain this year, growing by $190 million or nearly 20 percent to $1.1 billion. However, free cash can vary widely from year to year so municipalities cannot rely on it as a long-term solution to tightening budgets.

Beyond slower revenue growth, the costs for retiree benefits are consuming an ever growing share of limited budgets. The state's 351 cities and towns have more than $44 billion in total unfunded liabilities for pensions and retiree health care. Municipalities are already under pressure to fund pension obligations, and for all but a handful of communities funding retiree health care obligations would crush municipal budgets and taxpayers.

In fiscal 2014, cities and towns increased their pension contributions by seven percent, from $1.26 billion to $1.34 billion, nearly double the rate of revenue growth. Despite this increase, unfunded pension liabilities have continued to grow, reaching $14.2 billion by the beginning of fiscal 2014.[1] With two-thirds of local systems planning to increase their annual payments by at least four percent per year, pension costs will add to the budget squeeze for years to come.

While municipalities have been funding pensions for nearly three decades, they have set aside virtually nothing for the $30 billion in retiree health care liabilities. Unable to fund these enormous liabilities in advance, most municipalities pay only their share of health care premiums for that year's retirees while pushing retiree health care obligations for current employees into the future and adding to existing liabilities.

As annual spending on pensions and retiree health care grows, the fiscal squeeze already pressuring municipalities tightens further. Even if municipalities ignore their long-term obligations and do not pay down their retiree health care liabilities, they cannot escape the fact that those costs are rising and eroding the resources available for important services like education and public safety.

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The 44th edition of Municipal Financial Data is supported by a grant from First Southwest Company. In addition to the analysis of overall trends in local finances, the report provides a series of statistical tables that detail basic financial information for each of the state's 351 cities and towns. The report also includes comparisons of average residential tax bills; percent of low income students; and per capita expenditures, income, and equalized values.

The Massachusetts Taxpayers Foundation is a nationally recognized, independent, nonprofit research organization whose purpose is to promote the most effective use of tax dollars, improve the operations of state and local governments, and foster positive economic policies. Over the past two decades the Foundation has won 16 national awards for its work on health care access and costs, transportation reform, business costs, capital spending, state finances, MBTA restructuring, state government reform, and municipal health reform.

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[1] While a portion of the increase in unfunded liabilities is because municipalities have lowered investment return assumptions or reduced the time period for paying down the liability, most local pension systems still assume they will achieve annual returns of at least eight percent and will require 15 or more years to fund these liabilities.