

Moving Up in a Downturn: Management Challenges and Strategies for Municipalities

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Executive Summary

Faced with decreasing revenue contributions from the state of New Jersey, and hard caps on tax revenue sources, local municipal officials are weighing options for cutting services while addressing the myriad of mandated services dictated by the federal and state governments. In conversations, precipitated by CELG focus groups, mayors and business managers of medium size cities in New Jersey have explored their options in keeping their towns moving. This paper lays out the concerns, limitations and impacts of the possible strategies that are available. The issues that local officials were grappling with boil down to the quintessential question of what is the appropriate role of government in society? And, although the range of impacts of this downturn on municipal governments ranges from very inconvenient to dire, the opinions of the officials are more uniform: state government must reconsider some of the constraints imposed on local governments.

Introduction

The global recession hit the private sector first. The impact on municipalities lagged as their fiscal health depends upon the trajectory of the private sector economy. Now as the downturn enters its third year, the municipal landscape is totally engulfed in fiscal trauma. As expected, New Jersey municipalities are facing unprecedented financial pressures and local leaders struggle under the added weight of reduced funding from the state, tax levy caps, and pass through costs from mandates. And, just as predictably, the 566 municipalities in the state vary in their ability to handle the downturn. But the magnitude of this downturn impacts practically every local government, and it has caused questioning of the core values of government: What is the role of government in society? What goods and services are within the realm of government responsibility and what ones are not?

This research grew out of the authors' reaction to the real distress that we discovered among individual mayors and business managers around New Jersey. These local officials were trying to patch holes in budgets with measures that would resonate with them personally and professionally. At the individual level, co-workers and friends were laid-off, or put on furlough; at the organizational level hard decisions had to be made about programs, which in turn had negative impacts of neighbors and citizens. This was not your standard economic downturn; this was an event of a higher magnitude.

Using focus groups targeting Business Administrators and Mayors of medium size municipalities in New Jersey, we have attempted to describe the municipalities' situations, the constraints under which they are operating, and the actions they have taken to cope with the new economic realities. Ultimately, we found that city administrators in New Jersey are having a difficult discussion about the role of government in society; one of the most basic questions that lays at the foundation of any government. The mayors and business managers are grappling with a "reset" of the fundamental societal role of their towns and cities. If only there was a button they could push.

This article will first describe the situation in New Jersey. Next it will outline the methods used to gather the data. Then we will relate the constraints imposed on municipal leaders and the options they pursued initially to stem the budget shortfalls. Finally we will discuss the bigger picture solutions that seem to be evolving out of this continuing crisis.

The State of the State

For New Jersey municipalities, fiscal year 2011 is likely to present the worst financial environment since the Great Depression. The national economy has yet to show signs of sustained recovery and the lag in employment and tax collections are unlikely to improve the fiscal health in municipalities before 2012. The economic recession also continues to constrain employment growth and private sector financial stability.

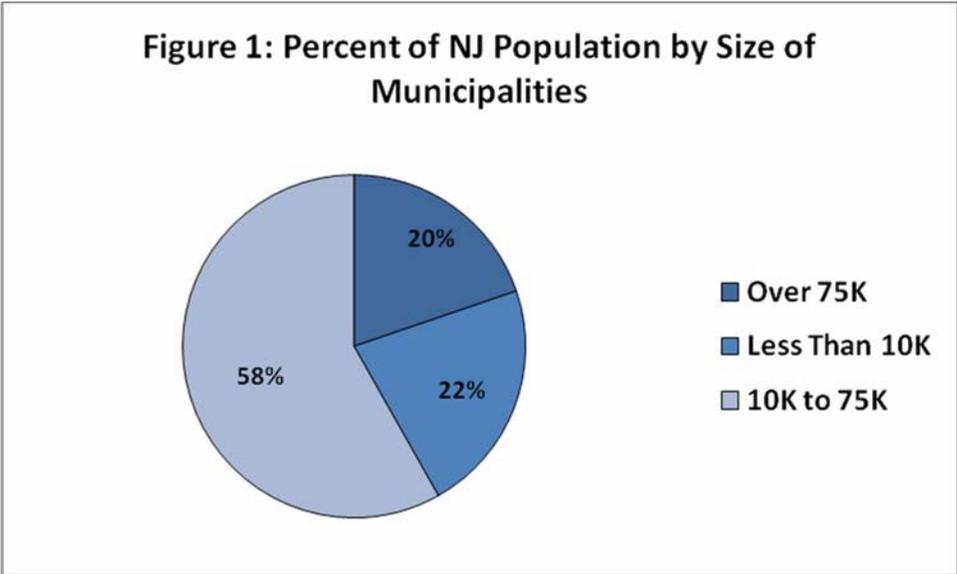
The public sector, which typically lags the private sector in feeling the impacts of recession, is struggling with reduced tax revenues, and no recovery in sight (Hoene, 2009). Public opposition to tax hikes, already at an all time high, is increasing in intensity. Concomitantly, the state of New Jersey, a source collector of some municipal financing, continues to face difficult decisions as structural debt and underfunded obligations combine with constrained tax revenues to pressure budget reductions. The resulting state spending cuts in municipal aid and school aid create additional revenue pressure at the municipal level.

Adding to the financial situation, municipalities are facing new and stringent property tax levy caps and spending limits. Municipalities are also dealing with contractual obligations and expenses that exceed the legislatively imposed tax levy caps. In a 2010 research brief on American Cities, The National League of Cities reported that three in four (75%) of locally elected officials surveyed reported, “overall economic and fiscal conditions have worsened over the past year,” and, “...one in two (52%) city officials report that service levels will continue to decrease next year if city tax rates and fees are not increased (McFarland, 2010).

New Jersey municipal leaders participating in focus groups reported economic distress brought on by a combination of economic conditions and the lack of new revenue sources. Not only are tax revenues and state aid decreased in this fiscal year, New Jersey municipalities must also face the imposition of a new 2 percent property tax levy cap on remaining property tax revenue sources. A perfect storm of tax revenue decreases combined with cuts is created. Moreover, municipalities must deal with contractual obligations and expenses that exceed the legislatively imposed tax levy cap, while coping with the reduced revenues.

Methodology

Between April 2009 and May 2010, the Center for Executive Leadership in Government (CELG) at Rutgers University conducted 12 focus group discussions with business managers and mayors of New Jersey municipalities. Individuals who participated in the sessions work in municipalities with populations greater than 10,000 and less than 75,000 as of 2009. This size town was selected because 58% of New Jersey citizens live in municipalities in our targeted pool (Figure 1). Municipalities over 75,000 (20% of population) and under 10,000 (22% of the population) were excluded due to their unique funding circumstances and service delivery characteristics.



Source: New Jersey League of Municipalities (Municipalities, 2009)

Mayors and municipal business managers were invited to provide feedback on the fiscal year 2010 budget process. Participants in the focus groups were encouraged to share short and long-term solutions to the economic pressure. Mayors and business managers participating in the research were asked to describe how they were dealing with the fiscal crisis, and to describe the management strategies they employed.

New Jersey municipalities are different in some ways from the national municipal landscape. New Jersey is more suburban and urban than rural. It is characterized by home rule, for the most part it has weak county governments, and property tax is the primary revenue for local governments. NJ also abuts New York City on the north and Philadelphia on the south which adds to the suburban character of the state.

Focus Groups were organized in North, Central and South Jersey to accommodate participating municipalities. The sample, drawn from the NJ State League of Municipalities 2009 Directory, included representation from 44 municipalities representing 14 counties. Although all group sessions were recorded, anonymity was promised to all participants. The sessions were homogeneous, business managers and mayors attended separate sessions.

Municipalities participating in the focus groups experienced state reductions in municipal aid averaging 22% in this fiscal year. School aid cuts to the same municipalities averaged 4-5% for the same period.

Findings

Municipal officials were asked to discuss the management strategies and the impact of those strategies on the financial health of the jurisdiction. The strategies that emerged from the conversations reflect both traditional and new approaches. Most local officials noted that traditional cost cutting strategies were used first and resulted in significant expense savings. However, given the length and impact of the recession, and the new property tax caps, most participants felt it was imperative that new strategies be pursued.

Once they were able to share their analysis of the current situation, both the mayors and the business managers offered strategic thoughts about how to address the long term problems. There is a question: what is the role of government and what services should be delivered. Although there was no reset button uncovered, the strategic options emerging from the conversations result in new ideas for dealing with the future. The traditional and new strategies listed in the table below summarize the ideas and feedback from participants on potential issues and impacts of cost reductions.

Traditional Cost Reductions			
Strategy		Issues	Impact
1. Line item cuts, across the board cuts, and outsourcing		<ul style="list-style-type: none"> ➤ In the third year of budget cuts during recession there are few options for meaningful budget savings 	<ul style="list-style-type: none"> • Service quality reduced and difficult to prioritize service cuts (senior citizens vs. afterschool program)
2. Personnel Cuts	○ Furloughs	<ul style="list-style-type: none"> ➤ Limited applicability 	<ul style="list-style-type: none"> • Short term savings
	○ Layoffs	<ul style="list-style-type: none"> ➤ Civil Service rules and contracts constrain savings 	<ul style="list-style-type: none"> • Expanded job descriptions for remaining employees
	○ Retirement	<ul style="list-style-type: none"> ➤ Constrained replacement, retards succession planning 	<ul style="list-style-type: none"> • Increase pension costs • Loss of institutional history • Loss of expertise
	○ Attrition	<ul style="list-style-type: none"> ➤ Civil Service and contracts limit flexibility to organize remaining employees 	<ul style="list-style-type: none"> • Loss of service delivery • Mismatch of skills to work
3. Delay Capital Projects		<ul style="list-style-type: none"> ➤ Maintenance is deferred, cost of capital increasing with short revenue shortfalls 	<ul style="list-style-type: none"> • Long term competitiveness threatened (roads, water/sewer) • Infrastructure decay
New Approaches to Cost Reduction			
Strategy		Issues	Impact
1. Consolidation and sharing service delivery		<ul style="list-style-type: none"> ➤ Municipal shared services constrained by some contracts ➤ County level ability to deliver varies 	<ul style="list-style-type: none"> • County level service variability increases
2. Legislative Toolkit		<ul style="list-style-type: none"> ➤ Municipal spending reductions from legislation take time to have effect 	<ul style="list-style-type: none"> • Civil service reforms, arbitration & elimination of unfunded mandates will reduce costs over time, but not immediately
3. New revenue sources	○ Economic Development	<ul style="list-style-type: none"> ➤ Constraints on private capital markets and economic recession ➤ Long term strategy requires available land and markets 	<ul style="list-style-type: none"> • Commercial properties provide alternative revenue • Redevelopment or non-urban development
	○ Fees for services and entertainment taxes (restaurants, services)	<ul style="list-style-type: none"> ➤ Differentiates service delivery by citizen ability to pay/income level ➤ Revenues allow services to continue, but may limit service access by income ➤ No revenue raising authority beyond property taxes 	<ul style="list-style-type: none"> • Heightened distrust (dissatisfaction) with government • Fees at schools and towns will support some services • Perceived as nuisance taxes

Traditional Cost Cutting: Budget Cuts Will Not be Enough

In the third year of recession, mayors and business managers reported that they have employed traditional cost cutting strategies to the point of diminishing returns. The local officials described using line item reductions, across the board cuts to programs and service contract revisions in the first and second years of the recession to deal with lower revenues. The focus group participants all reported having been through cost cutting periods in prior recessions. Having had the experience of cost cutting before, managers reported working hard to reach 2009 budgets, and struggling further to close the 2010 budget cycle. Looking to the 2011 calendar and fiscal year budgets, local officials reported deep concern that there was very little, if any, budget trimming left to be done in a third year of reductions.

In fact, mayors and business managers alike spoke of the impacts of the prior two years' cuts on service delivery. Each municipality has a set of core services related to safety and education, but the additional services delivered vary. The process to prioritize services varies. Therefore the severity of impact of the cuts varies widely, with one mayor lamenting the need to restrict leaf pick up while another mayor described line item budget cuts that would restrict after school programs.

Local officials appreciated the opportunity to exchange ideas during the sessions. New ideas and new methods for cutting costs were discussed and ranged from cuts to specific budget line items to approaches for decreasing broad cost drivers. Many mayors described cost cutting actions resulting from reviews of existing contracts – rebidding or renegotiating fees for service. The ideas ranged from methods to reduce legal services costs, to strategies for optimizing uniformed officer's schedules and strategies for reducing insurance costs.

"...we think every community is trying to reduce full time to part time (employees) and outsource where it makes sense..." (focus group participant)

Personnel Cuts

Given the limitations towns now face in further cutting budgets, every municipality also described using both tested and new strategies for cutting personnel costs; often the single largest cost in budget. We heard from local leaders that while budgets were pared deeply in fiscal 2010, no expense item would be sacrosanct in fiscal 2011. A business manager emphasized the need for extraordinary measures,

"...we think every community is trying to reduce full time to part time (employees) and outsource where it makes sense. Our fixed costs will exceed our property tax revenues by the end of the next fiscal year. We will redefine what it means to be a city."

The news about municipal cost cutting across the country has focused extensively on personnel actions to reduce operating expenses. New Jersey officials confirmed that

beginning in Fiscal 2009, personnel cuts topped the list of actions taken to reduce costs. But by Fiscal 2011, mayors and business managers caution the impacts of furloughs, lay-offs and attrition actions will become unsustainable and counterproductive. In particular, the loss of institutional knowledge and experience has begun to impact the delivery of services as they hold the line on hiring - even as more staff retires and leaves public service. As described by a business manager,

“..we have taken steps to try as best we can to keep our workforce informed of our budget situation...union negotiations have provided some breathing room... we think every community is trying to reduce full time to part time (employees) and outsource where it makes sense to reduce costs.”

Management strategies described in the focus groups centered on cutting the biggest line item costs in the budgets, and often dealt with personnel.

- Furloughs, a popular short term tool for reducing costs, have not produced sustainable benefits. Business managers described furloughs as an interim fix that did not eliminate costs. In addition, furloughs delay the need for addressing the question of what services should be cut. And furloughs are a burden on employees, reducing work days and incomes without contributing to a reduction in workload.
- Lay-offs were also used by about half of the participating municipalities. Business managers were not enthusiastic about using lay-offs, describing the impact as negative on morale, and producing little if any short term cost impacts. Many reported labor contracts restrictions in using lay-offs as a strategy.
- Retirements were reported to be increasing in many municipalities. Public service employees fearful of pension fund changes are reported to be retiring at accelerated rates, and some workers eligible for retirement are volunteering to leave in order to help avoid lay-offs. Regardless of the reason for increased rates of retirement, the impact on municipalities has been felt in pension obligations, which are accelerating faster than planned.
- Attrition management was described by every local official as a tool used to reduce headcount. By not back-filling positions after retirements and employee departures, municipalities are able to reduce headcount without layoffs, although some integral positions remain vacant.

Each of the traditional personnel strategy initiatives affects the workforce capacity of New Jersey municipalities. Experienced and seasoned managers left the public sector workforce during a period when succession planning and skill development were being treated as unaffordable luxuries. Expanding job descriptions for remaining employees was cited as a resultant impact. Local officials described the need for all employees to pick up the slack created by fewer workers, placing additional stress on those that remain.

Some opportunities were also cited from the personnel actions as municipalities rethink how work processes are completed. One Mayor explained that he asked every city

employee to pick up tree branches if they saw them lying in the road, "...rather than wait for a phone call from a resident about a fallen branch and then have to dispatch a Public Works truck, any city vehicle out can reduce the time and cost of keeping the roads clear." However, the limitations of expanding job descriptions were also evident as municipal officials deal with civil service job definitions, and the lack of transferable skills between new and more seasoned employees.

Delaying capital expenditures was also noted as a step taken by most municipalities. Although infrastructure maintenance was described as important, the short term benefit of delaying capital outlay outweighed the long term benefits of investment. Participants alluded to the increased future cost of deferred maintenance on infrastructure like roads. But with few exceptions, most municipalities are deferring capital outlays. Only one mayor described an alternative, he is not deferring capital, citing the need to remain competitive in the quest for jobs and in order to remain attractive to employers and potential residents.

New Approaches to Cost Reduction

While New Jersey has a long history of discussions regarding consolidation of towns, very little progress is reported. What mayors and business managers reported was the extensive use of shared services between municipalities and in some counties. The shared service strategy is reported to have varied success, and to be dependent on the costs structures of the jurisdictions considering the merger of services. With the rapid deterioration of financial stability, increased opportunities to share best practices and new ideas would be useful.

Shared services were frequently cited as a strategy that had been employed to reduce costs. Each local official described some strategy for sharing services among and between contiguous jurisdictions. Municipalities share a myriad of services from trash collection, to centralized dispatch, to animal control. Some counties have begun to provide shared services to reduce overall cost structures for municipalities.

Another option emphasized by municipal officials was the need for multi-jurisdictional collaboration on legislation to reduce short term and long term costs. Improved collaboration between local and state officials would help to minimize the unintended consequences of rules that increase short term costs, or reduce service delivery options. With mandatory spending caps and limited revenue sources, municipal officials are feeling trapped in a quagmire. Thoughtful conversation regarding what tools are needed will place those closest to solving problems – the local officials – as a resource for those at the state who control the mechanisms and behaviors of local government.

A Need for Tools

The long running debate in New Jersey on home rule masks some of potential solutions to the fiscal constraints. For example, legislative controls limit revenues and taxes at all

levels of government, causing deep distress for municipalities who are often vilified as the cause of high property taxes. As one mayor stressed,

“We need solutions to the issues actually driving costs, whether they are inside or outside any arbitrary cap. We need to know that the State will deliver on promises of support. The state has the only authority to create real reforms in order to achieve sustainable property tax relief.”

Given decreased revenues and a 2% cap on property taxes, expense reduction is not enough. The property tax cap law exempts cost increases for health care, pensions, debt service, states of emergency and increased school enrollment. Since

“...What is critical, if you take nothing else from this conversation, is the lack of conversation. This year, before the state made cuts in aid, we were below the cap. After the state aid cuts, we are OVER the cap...” (Focus group participant)

municipalities were already operating under a 4% property tax law passed in 2007, most officials know what costs drive budgets beyond the exemptions from experience. Local officials are very concerned that citizen expectations for lower property taxes will not be met as authorized exemptions drive costs above the 2% limit, even while service quality deteriorates.

New Jersey is not unique in having municipal officials and state officials at odds with each other with regard to methods for dealing with the fiscal crisis. But, problem solving

mechanisms are limited by the polarized views and public finger pointing. As the focus group participants emphasized, the debate on what to do next is primarily a function of local versus state views of what problem needs fixing. Resoundingly, municipal leaders – elected and appointed – highlighted their frustration with the lack of communication between the state and municipalities. Specifically, public officials from the municipalities tended to regard the state as the despot that was good at directing but incapable of active listening.

Local officials suggested the state re-establish economic incentives for good service delivery and budget management. Today, municipalities in solid fiscal shape are punished by receiving reduced state aid while those economically disadvantaged cities are bailed out. Providing incentives to local officials for good management would encourage good decision-making. In fact, it was painful to hear some of the business managers remarking how they were punished for being efficient. Municipalities operating below the cap are most restricted in increasing revenues during the downturn. Similarly, municipalities and school districts with reserves and contingencies lost all control over “rainy day” funds. The idea of incentives - and the parallel negative of existing disincentives – was stated loud and clear. Rather than reducing aid to well managed cities, the state could consider not punishing those cities that control costs and are able to manage a surplus or stay below average costs increases.

Controls imposed by tax caps are not well understood. As one local official explained,

“...tax caps are not really 4% or 2%...with a budget of \$27 million last year, only \$13 million came from tax revenue, so the cap is 4% on \$13 million not 4% on \$27 million. My police contract alone would eat up the majority of that increase (before the 2% cap was signed into law).”

What local officials emphasized was the need for reforms to curb tax bill increases – and caps alone will not get the job done.

Unfunded mandates need revenue sources or reform

Mandates, particularly those deemed “unfunded mandates” were cited by local as a source of extreme financial pressure. Examples include the Stormwater Management Rule, binding interest arbitration, Civil Service Rules and COAH (Council on Affordable Housing) regulations. Each of the example programs present municipalities with spending requirements, but no revenue sources to fund

“Local governments are at a crisis point with State Mandates...” (Focus group participant)

the required actions. Mayors in the focus groups described having a perverse relationship with Trenton. While completely dependent on the legislature for the power to act and govern, mayors agreed that state government does not trust local government. As one business manager commented, “Some of the rules that have been created, for example pension rules and binding arbitration regulations, will obviate any improvements in public sector services as they are counterintuitive to good government.” The state has been reticent to consider any rules which grant local governments more freedom and flexibility from state rules which require towns to do certain things or prevent them from doing others.

Mayors pointed to the rules such as Stormwater Management – as an example of mandates that transfer the burden and cost of water planning actions to local municipalities from the state – without a cap on spending or budgets to cover the costs. Summarized by one mayor,

“Local governments are at a crisis point with State mandates. There will not be any relief for property tax payers with the current decisions by interest arbitrators to provide salary increases to uniform police and firefighters, new regulatory responsibilities for municipalities and COAH requirements. We need clean water, but we do not have unlimited resources to plan and implement new regulatory reform. The requirements have a cost, and it will be offset by new revenue or the elimination of other services.”

New Revenue Sources

Creating new sources of revenue for municipalities was suggested by a number of municipalities. Some mayors described using the economic development programs

like the Urban Enterprise Zones (UEZ) to attract new commercial ratable properties to their jurisdictions. Other mayors suggested the state consider allowing local entertainment and dining taxes to allow municipalities benefits from downtown revitalization projects that created local centers. Enabling legislation does not exist to allow new revenue generation options for local governments. New sources can potentially decrease the residential property tax burden.

New Strategies Required

Without exception, the local leaders told us they envisioned a totally different landscape for the future. Some described it as a “total reset” of expectations about what government should provide. Citizens’ service expectations may be disconnected relative to the resources available. Good management is not likely to be sufficient to meet citizen expectations. Once the debate goes beyond the need for tools to manage the cap, local officials acknowledge a need to set priorities: health, safety and education probably make the list. But the debate regarding the role

and obligation of government is happening in municipalities today. In some communities, senior services are critical to residents, while in others, parks and summer youth programs may have more relative importance. How will local officials deal with tradeoffs between trash removal and special need transportation services? Local services need to be transitioned over a period of time, longer than a year.

There is a consistent concern that the public and the government are in denial about the magnitude of the problems facing municipalities. As one business manager suggested, “This is like boiling a frog. If you put a frog in a pot of water and slowly turn the heat on, the frog sits in the hot water before realizing that it has started to boil and he can no longer get out. After you sit in the water and it starts getting warmer, you don’t realize you are going to die.” The budgets may close this year, but there is a structural gap emerging that is not being dealt with that can overrun the municipalities. There is a need to hit the reset button and prepare for the future.

The Essential Question

What is the role of government? What will local governments look like when we get through this present economic decline? And what about the state’s interaction with the municipalities? Will, will we really make a change or will we limp through and end up with a smaller version of what we have now?

*“This is like boiling a frog.
After the frog sits in the water
and it starts getting warmer,
He doesn’t realize the heat will
kill him until it’s too late to get
out of the pot...” (Focus group
participant)*

The question, prominent at every level of government, is being posed first to local municipalities. Balanced budget requirements, tax revenue shortfalls and state aid cuts have combined to create a perfect storm for the current and coming fiscal year. There is simply no time to whittle away at expenses – the question of what services to provide is facing most local officials right now.

The public sector budgets for the current fiscal year and foreseeable future could not be more austere. Conversations with the local officials over the past year underscore the need to understand the constraints and opportunities municipalities face – what should the services be? How much will they cost, and how will the decisions be made? What trade-offs will governments face? Actual service delivery is a uniquely local function for governments. The mayors and business managers attending these sessions described the need to question every choice in service delivery.

The focus group results underscore both the depth of the problems facing municipalities, and the need for redefining the role of municipalities and the services government provides. Although home rule exists in New Jersey, the state imposes obligations on the municipalities driving costs to the local jurisdiction. In order to eliminate costs from local governing bodies, the rules the state imposes need revision. The redefinition of what local services are and how they should be provided and paid for presents a unique – if undesirable – opportunity for resetting strategy and mission. *Moving up in a downturn* is an expression first introduced in the private sector to describe the regeneration opportunities presented during industry downturns (Rigby, 2001). The experience of New Jersey municipalities, documented through candid discussion with public sector officials during the focus groups, indicates the need and opportunity for re-examining and re-defining the role of municipalities while beginning a conversation about new approaches to local service delivery. Operating under the premise that municipalities are often the source of solutions that too often go unnoticed, it is possible to look to the experience of local officials for new ideas. Successful reinvention of the role of municipalities in a constrained financial environment will require collaboration between the state and local governments.

Conclusion

New Jersey municipalities are between the proverbial rock and a hard place. Local officials are dependent upon property taxes for revenue. They have no alternative authority to raise revenues beyond the tax levy cap. At the same time, the municipal contractual and statutory expenses are growing faster than the revenue. The state holds the authority to impose service delivery standards and regulations on the municipalities, and has done so while capping the absolute funding available to meet those service delivery requirements. As a result, municipalities are being forced to decide – what will be the structure and function of local government in New Jersey.

The mayors and business managers attending these focus groups spoke with great frustration and concern about the lack of communication with the state. The observations reported are stated more mildly than they were delivered, in part to help bridge the conversation to those who might be able to act on the input.

Frustrated local officials articulated the fact that they have very limited options. Given the costs of government are raising and the ability and desire of citizens to pay is declining, what is the answer? One alternative is a town run by a group of part timers without benefits. Another alternative is dramatic service reductions. Are the costs savings adequate to warrant these dramatic alternatives? With citizens expectations set very high regarding property tax caps and the need for reducing property taxes, the need for communication is extremely high.

The mayors and business managers feel they are carrying the burden of answering the core question of what is the role of government in society. The State is not often seen as a partner; rather, in many cases the state is seen as an adversary. The State could greatly improve the situation by removing some of the constraints on municipal action, particularly with respect to mandates and rule requirements. The magnitude of this economic downturn prompts a more thoughtful analysis of what the role of government is in society.

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