



Ongoing Financial Troubles of Michigan's Local Governments

**Cities in Crisis: Financing Local
Government in 2011**

May 23, 2011

Eric Luper

Director of Local Affairs

eluper@crcmich.org





Citizens Research Council of Michigan

- Founded in 1916
- Statewide
- Nonpartisan
- Private not-for-profit
- Promotes sound policy for state and local governments through factual research
- Relies on charitable contributions from Michigan foundations, businesses, organizations, and individuals





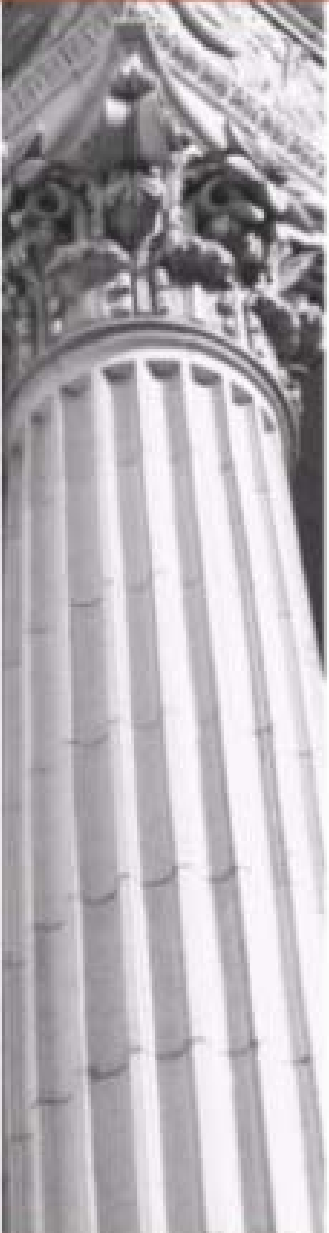
Recent Headlines

- Michigan communities struggle with budget cuts
- Tecumseh looks at reducing some city services
- East Lansing cuts \$1.9 million from city budget
- Grand Rapids city manager says budget cuts may force layoffs, City Hall closure for two weeks
- Cuts may eliminate 41 Grand Traverse County jobs
- Negaunee council looking for more cuts to budget



Still Early-Mid Stages of Local Government Recession

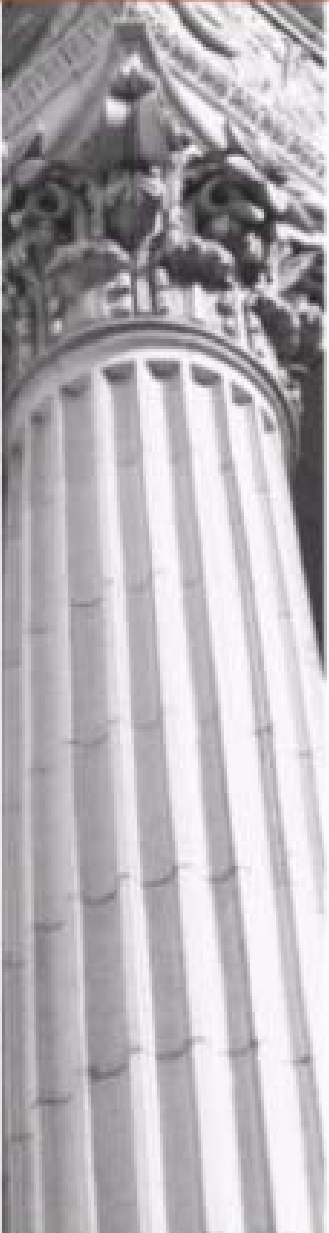
- Property tax bases continue to decline for several years
- Property tax bases recover at snails pace when real estate markets recover
- Little prospect of state fully funding statutory state revenue sharing
- Local government will continue to shrink





Local Government Revenue Sources

- Property Taxes
- State Revenue Sharing
- Income Taxes
- Federal Funds





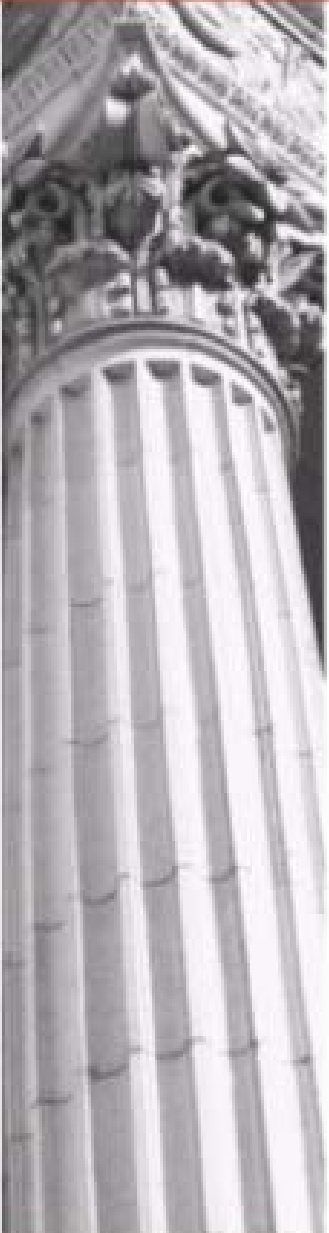
Property Tax Base Growth

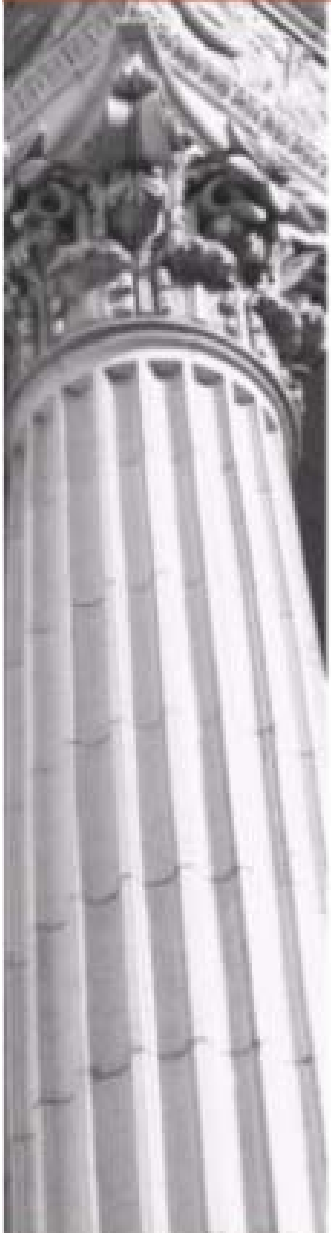
For Local Governments

- Average 7% annual growth in tax base
- Little year-to-year fluctuation

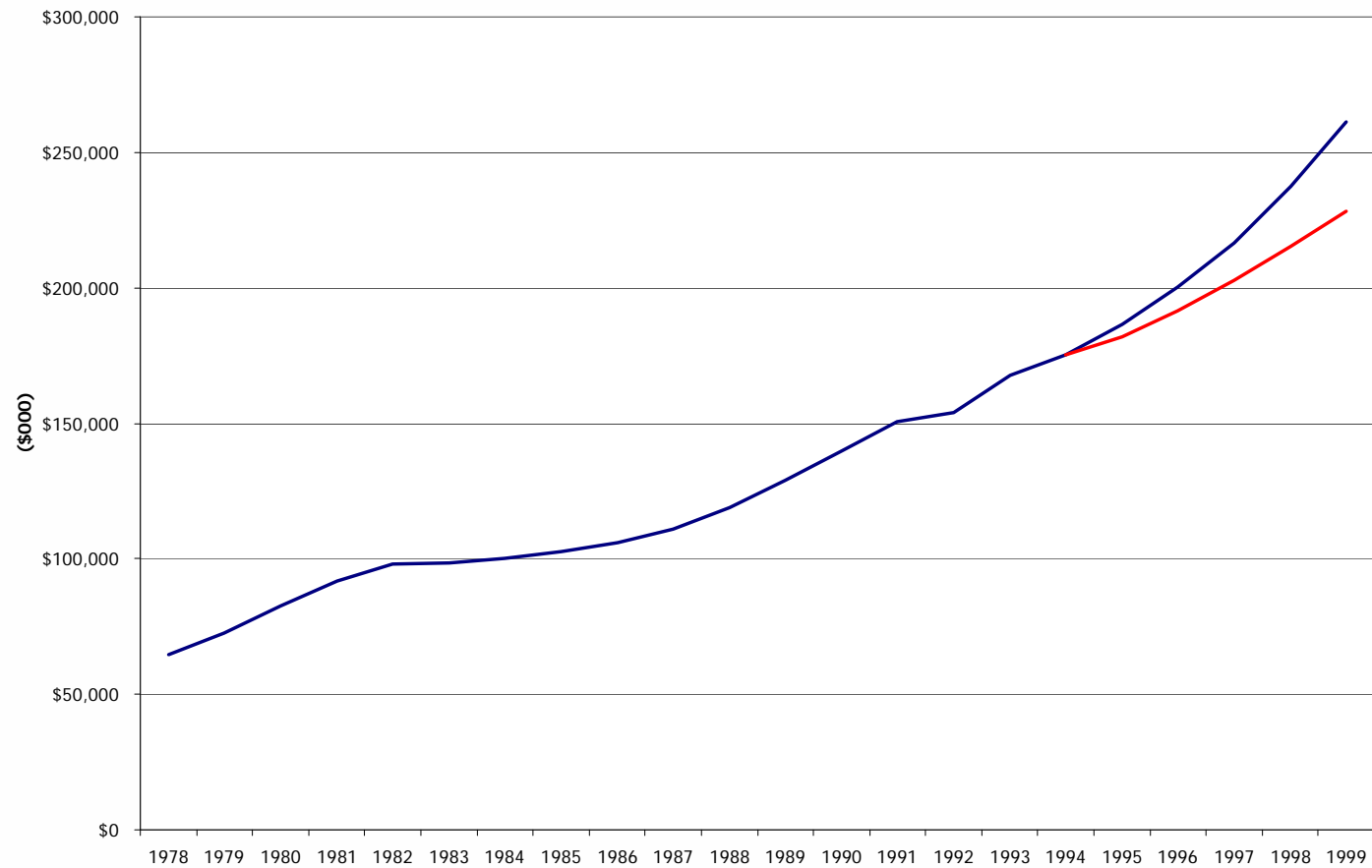
For Property Owners

- Increasing tax burden even when ability to pay decreasing
- Growth in tax base often outpaced inflation





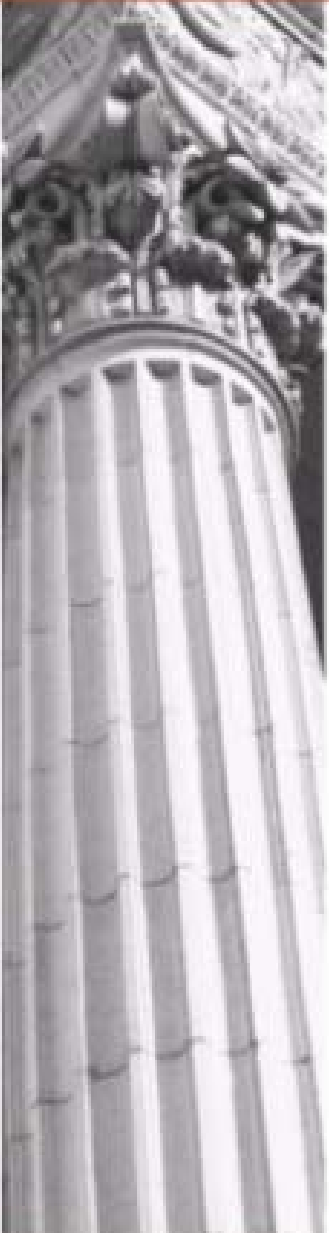
Steady, Consistent Growth of Property Tax Base





Taxpayer's Response to Steady Consistent Growth of Tax Base

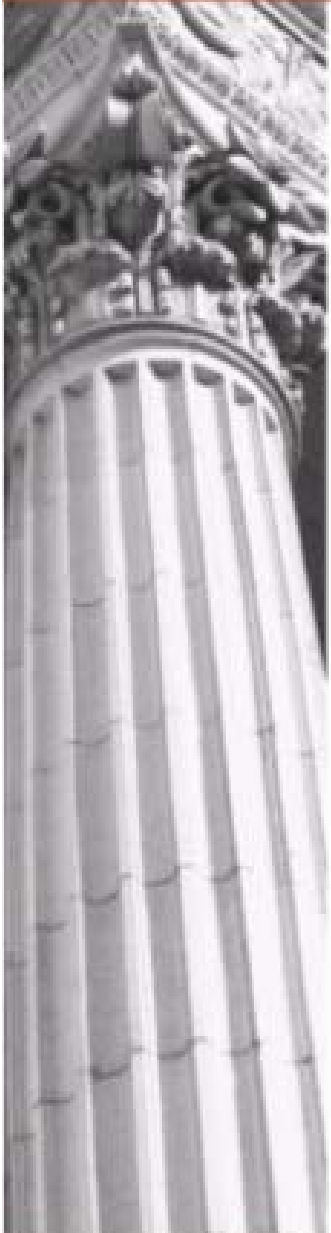
- Headlee Amendment
 - Unit-wide cap on growth of tax base
 - Rate of inflation
 - Tax rate "rolled back" so net yield = inflationary growth
 - Individual parcels could still grow faster than inflation
 - New development helped keep government revenues strong

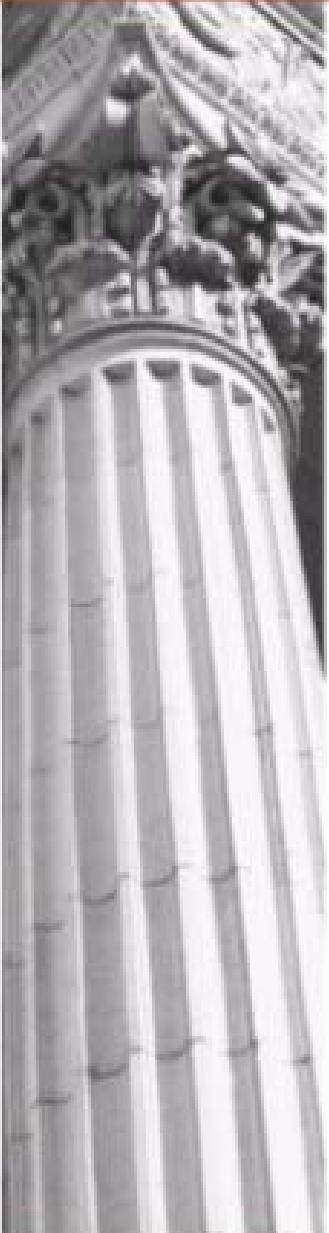




Taxpayer's Response to Steady Consistent Growth of Tax Base

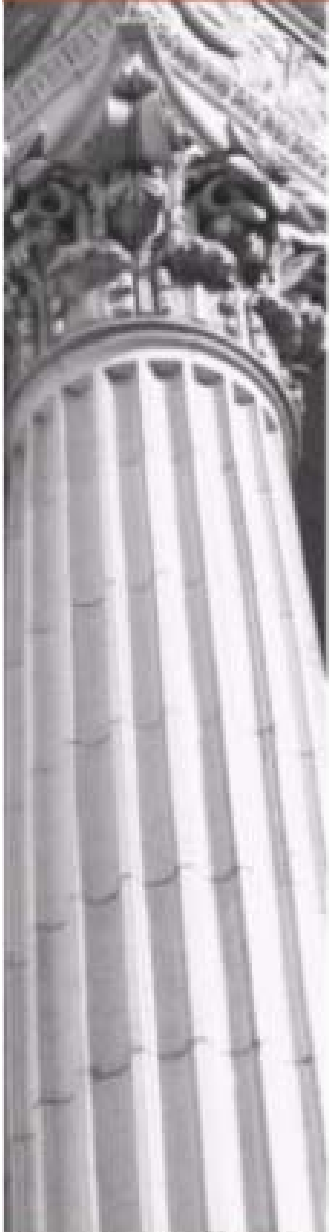
- Proposal A of 1994
 - Limit growth of individual parcels to rate of inflation
 - Return to SEV when ownership transfers
 - New development helped keep government revenues strong
 - Ownership transfers caused unit-wide growth to trigger Headlee tax rate rollbacks



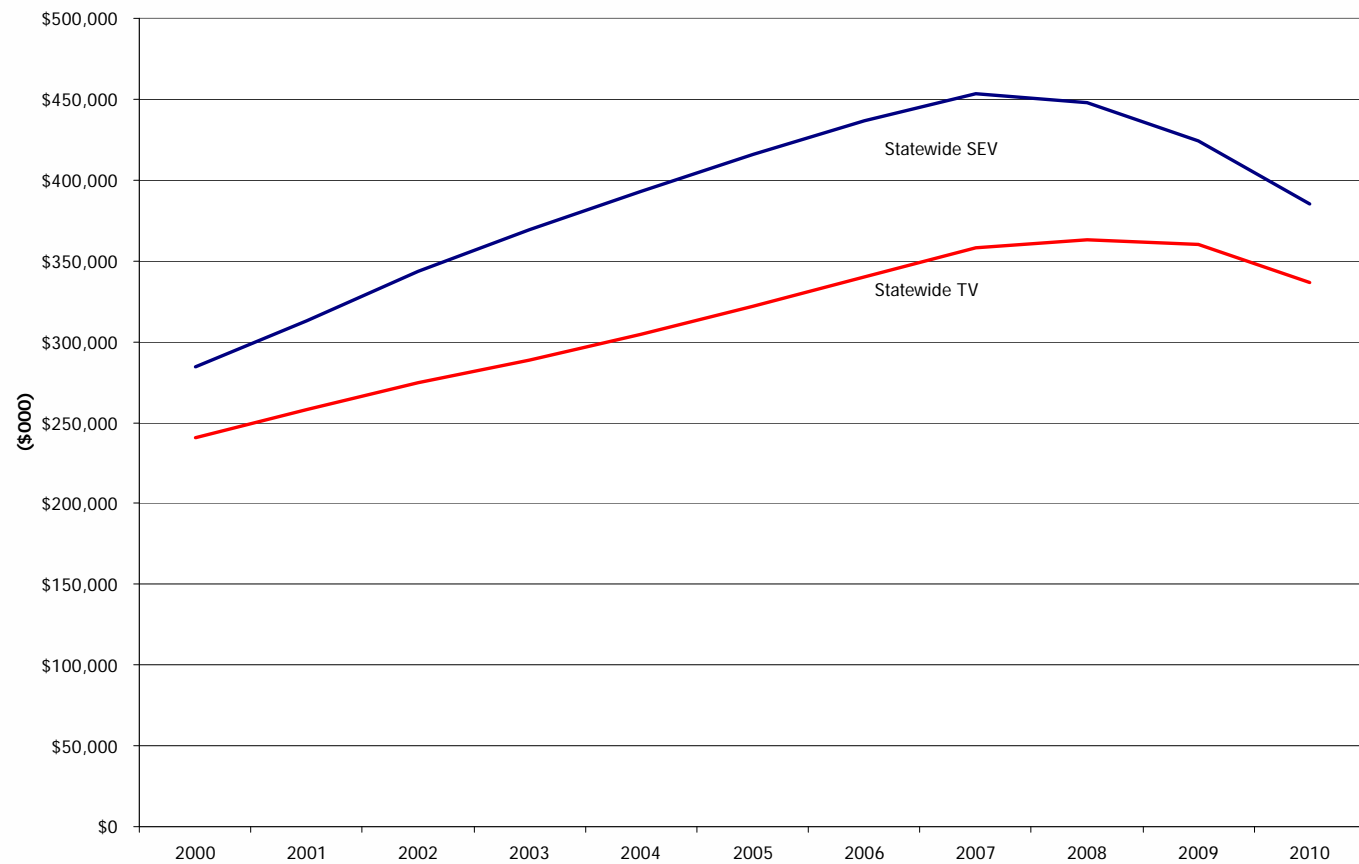


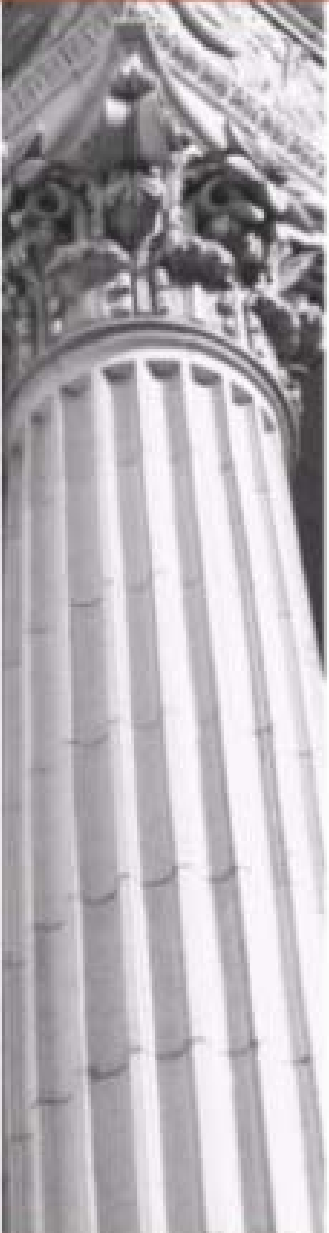
What Happened?

- Decline in manufacturing and automotive sector employment
- Housing bubble popped nationwide
- Real estate collapse became a major contributor to recession
- Foreclosures became a problem
 - Particularly in SE Michigan
- Demand for second homes declined
 - Particularly hurting northern Michigan



Reversal of Fortune in 2000s





When will Tax Base Recover?

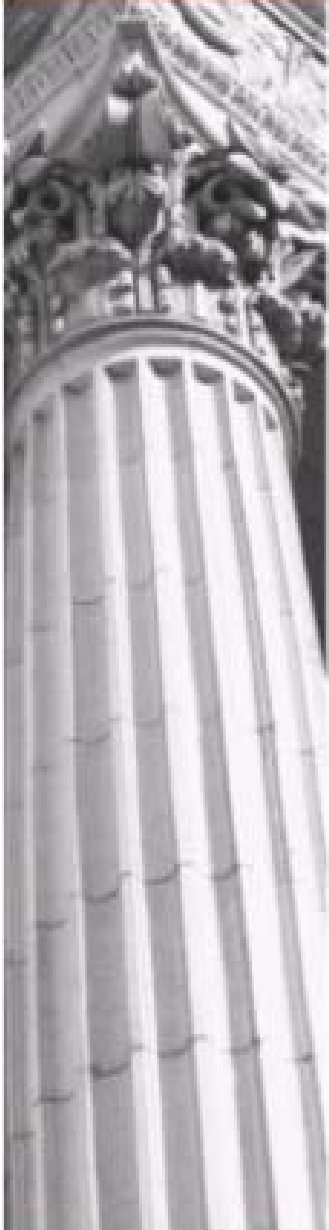
- Still a number of unknowns that will influence the answer to this question
- When will residential decline carry over to commercial and industrial properties?
 - Record number of appeals in MTT
- When will state become attractive place for new development?
 - End population exodus
 - Exhaust surplus of housing stock



Lag in Government Reflecting Economic Change

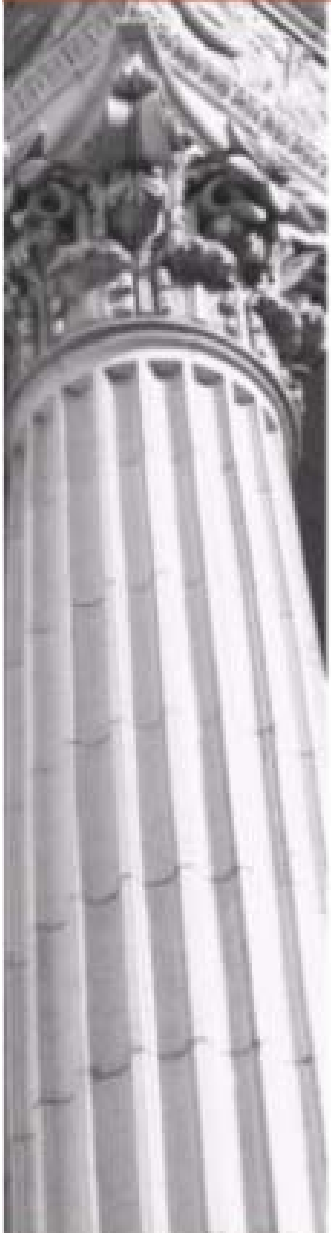
- Delayed impact of private sector recession on local government tax bases
 - 3-5 year lag on property tax bases
 - Usually on both sides of a recession, but it will be longer this time for Michigan because of "Taxable Value"
 - 2023-27 before tax bases return to 2007 levels
- Governments receive revenue in regular intervals
 - State – monthly for most taxes
 - Local – 2x/year for property taxes





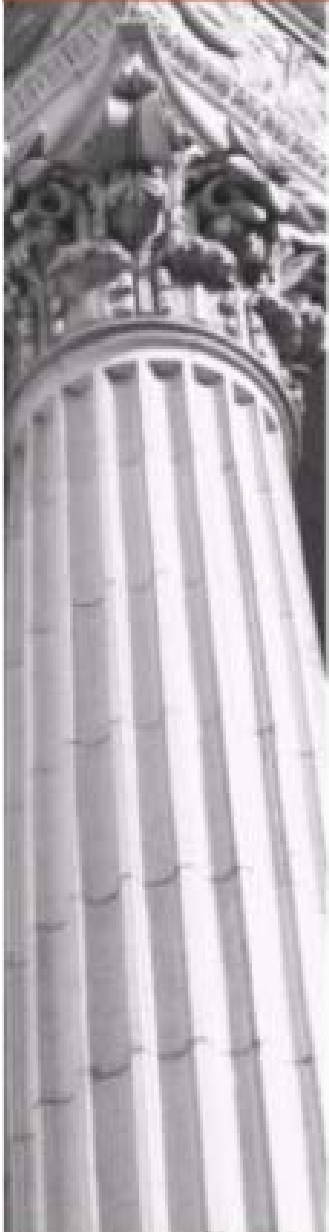
Repercussions

- A lot of people “trapped” in their current homes
 - Without benefit of appreciated value they don’t have money to put down for housing upgrades
- Tax capture for TIF funding greatly impacted
 - TIF, DDA, LDFA, Brownfield districts with little growth relative to base year
- Infrastructure installed for developments that didn’t occur
 - Good chance of bond defaults because of project decisions made during good times

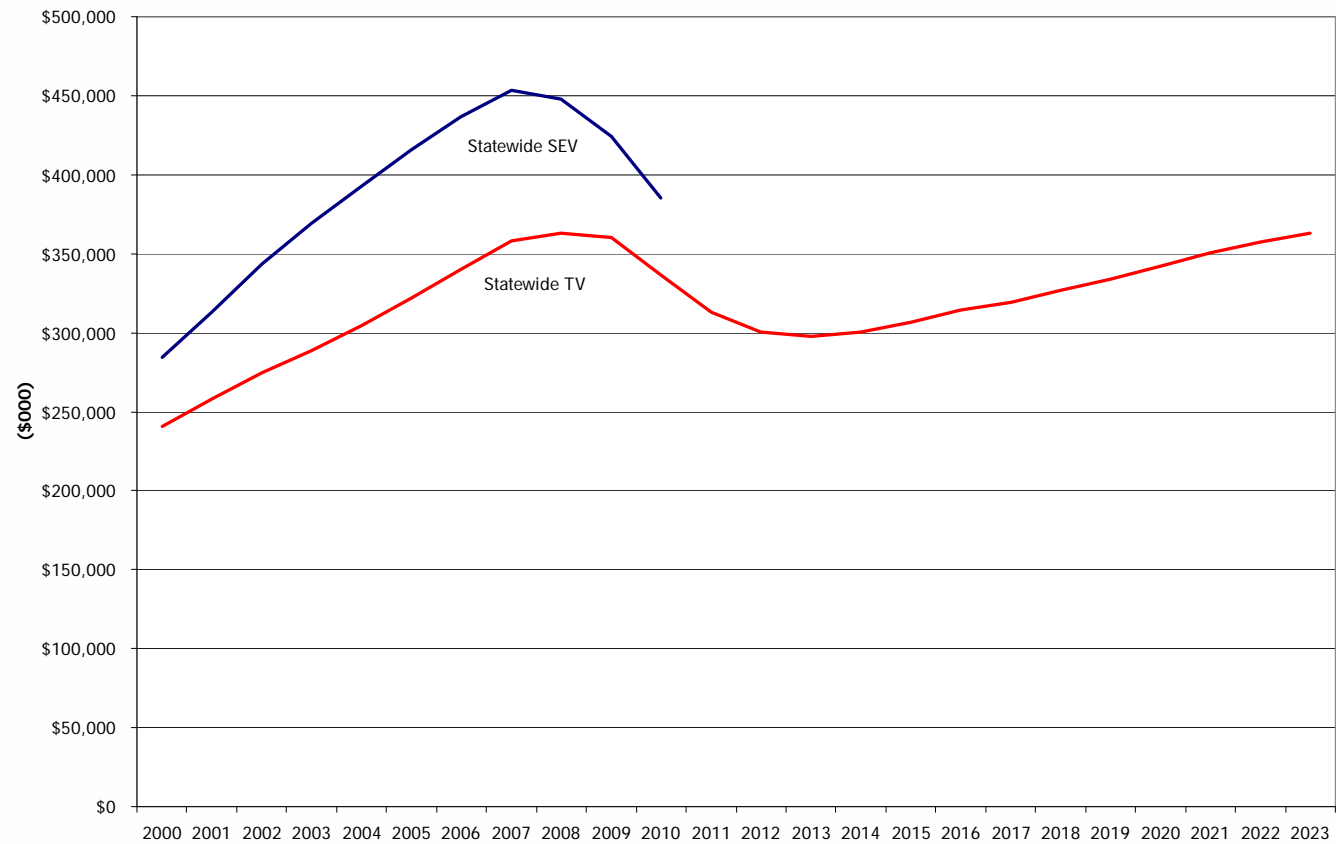


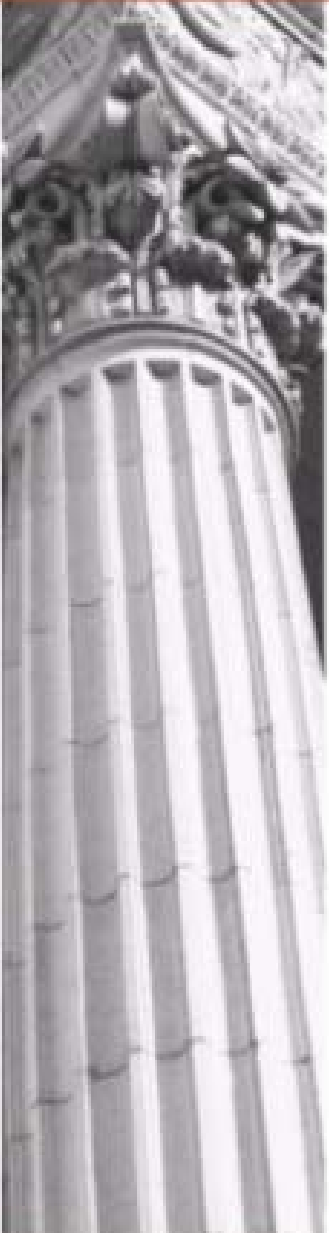
The Big Picture

- A few more years of declining tax base
- Statewide Taxable Value down about 20% by 2013
 - More in some regions, less in others
- Weak growth in real estate markets and property tax limitations collude to cause restrained growth in tax base
- Use of Taxable Value means decline will be only ~ ½ of that experienced in Great Depression

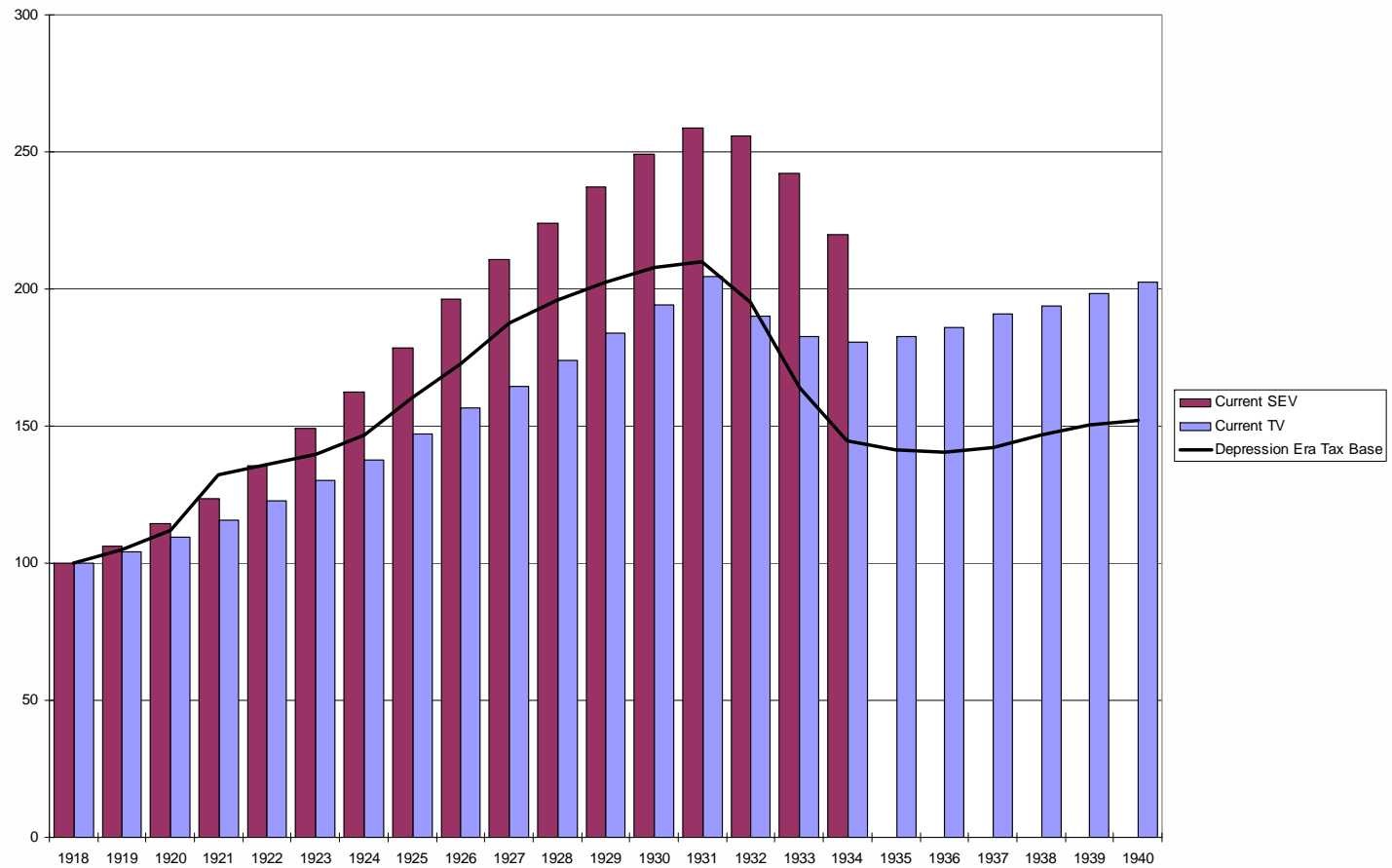


Prolonged Recovery





As bad as Great Depression!





State Revenue Sharing

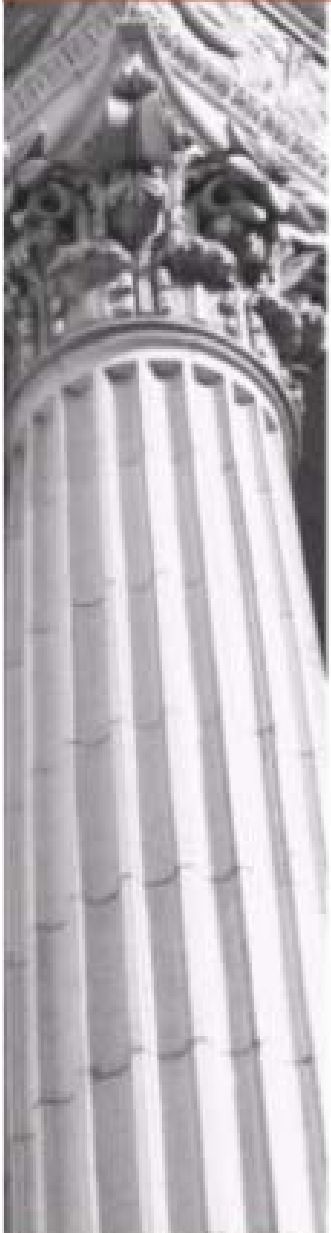
- Constitutional Program – Article IX, Section 10 of MI Constitution
 - 15% of 4% Sales Tax distributed on a per capita basis to townships, cities, and villages
 - All 1800+ CVTs receive this funding
- Statutory Revenue Sharing – Weighted formula used since 1971 (1998 in its current form)
 - Only about 700 cities and charter townships receive this funding





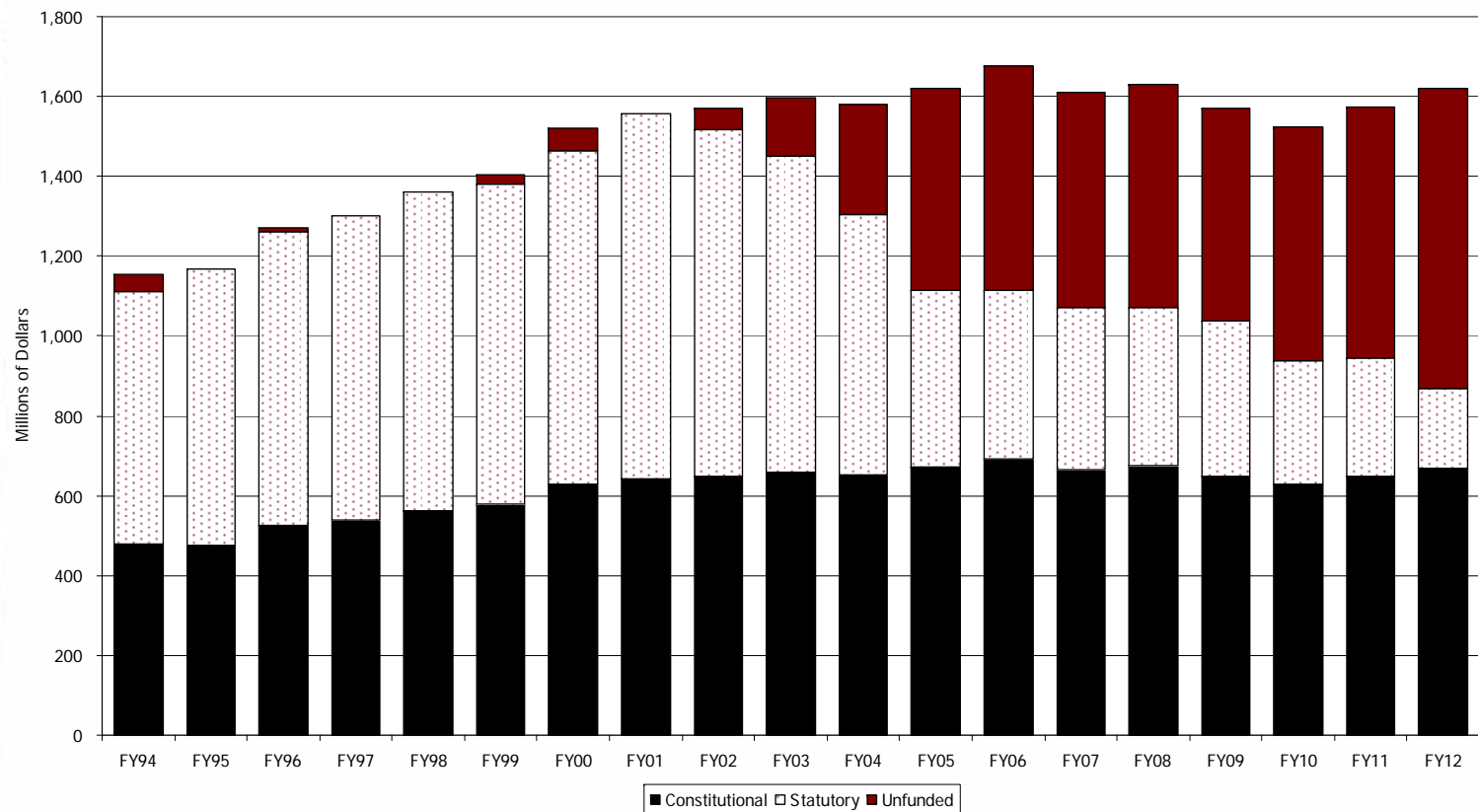
Diversions for Other State Purposes

- Diversions started in 2001
- Total of \$4 billion has used by state for other purposes
- Decline or hold constant while sales tax revenues growing caused constitutional revenue sharing to grow at expense of statutory revenue sharing
- Only about 700 cities and charter townships still receive funding





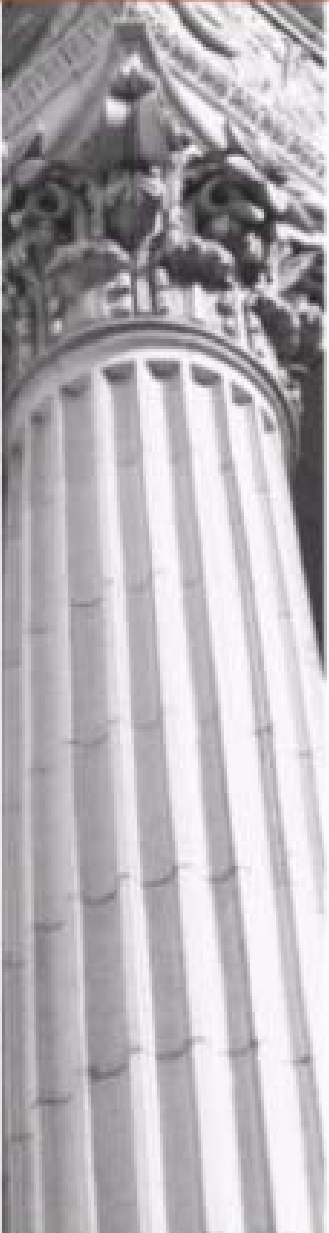
Actual & Foregone State Revenue Sharing





State Revenue Sharing

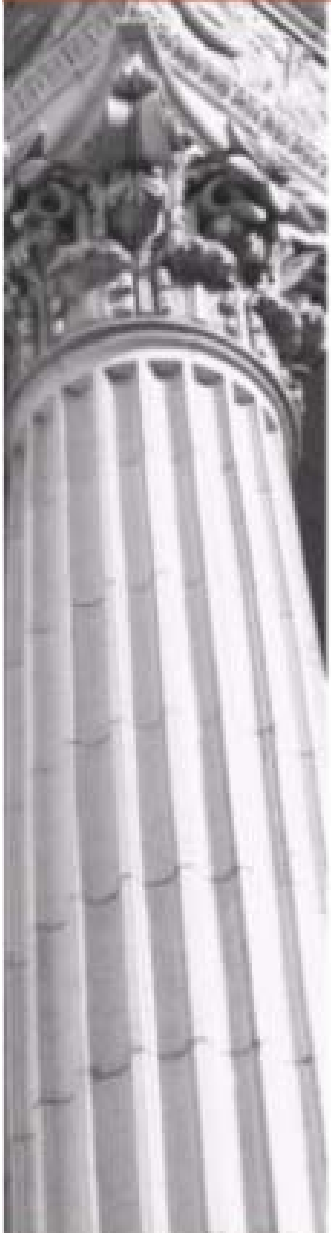
- Why Bother? Isn't this just a program for the state to send money to local governments when it has enough?
- Enhance Tax Equity – broader geographic area
- Minimize Market Disruptions – multiple taxing entities with varying tax rates lead people to alter market decisions to avoid taxation





Why State Revenue Sharing?

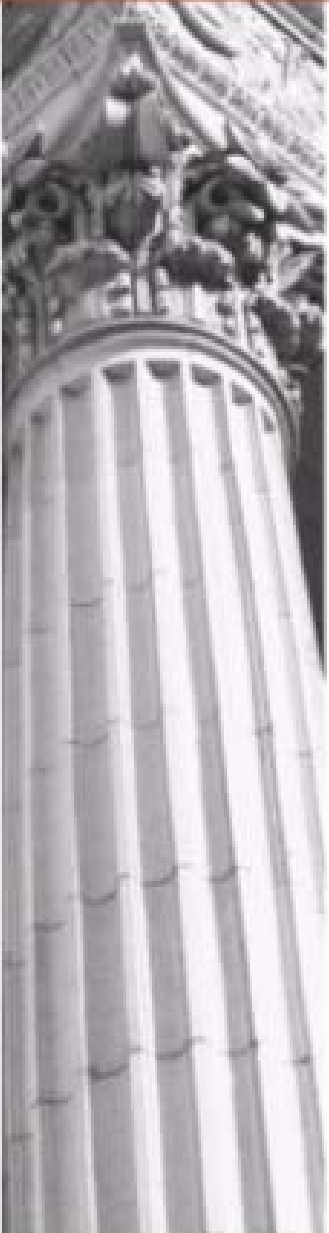
- Tax Base Diversity – diversify tax base beyond property tax
- Property Tax Relief – alternative revenue sources allow for lower property tax rates
- Enhance Taxpayer Efficiency – easier to interact with a single collecting agency
- Service Maintenance – State taxes preempted local taxes
- Minimum Level of Services – equalize the revenue raising capacity of local governments





Income Taxes

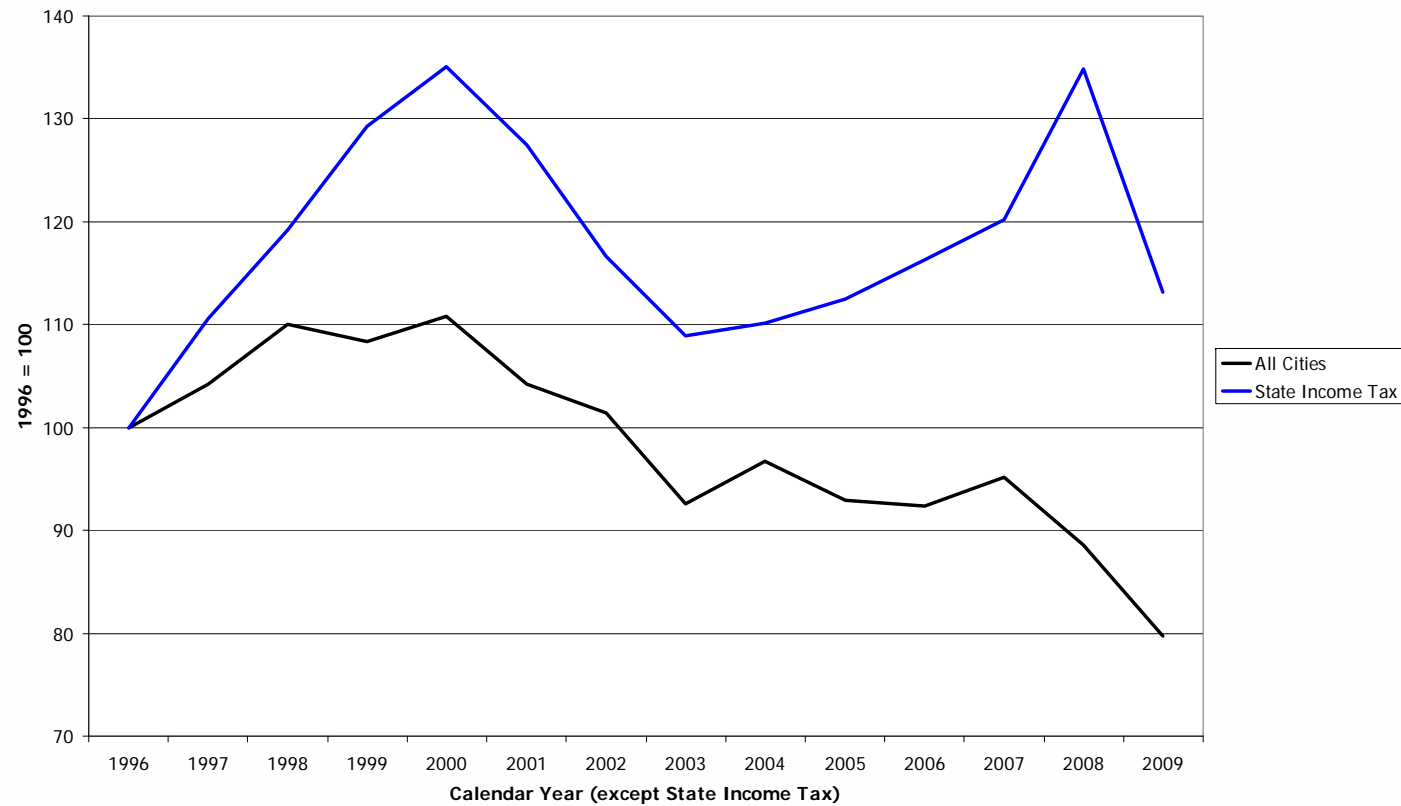
- Only available to Michigan cities
 - 22 cities actually levy
- Results have been mixed
 - Less productive than property taxes
 - Productive supplement to property taxes for smaller Michigan cities
 - Bigger cities have seen revenue growth at slower rates than state income tax





State vs City Income Tax Revenues, 1996 - 2009

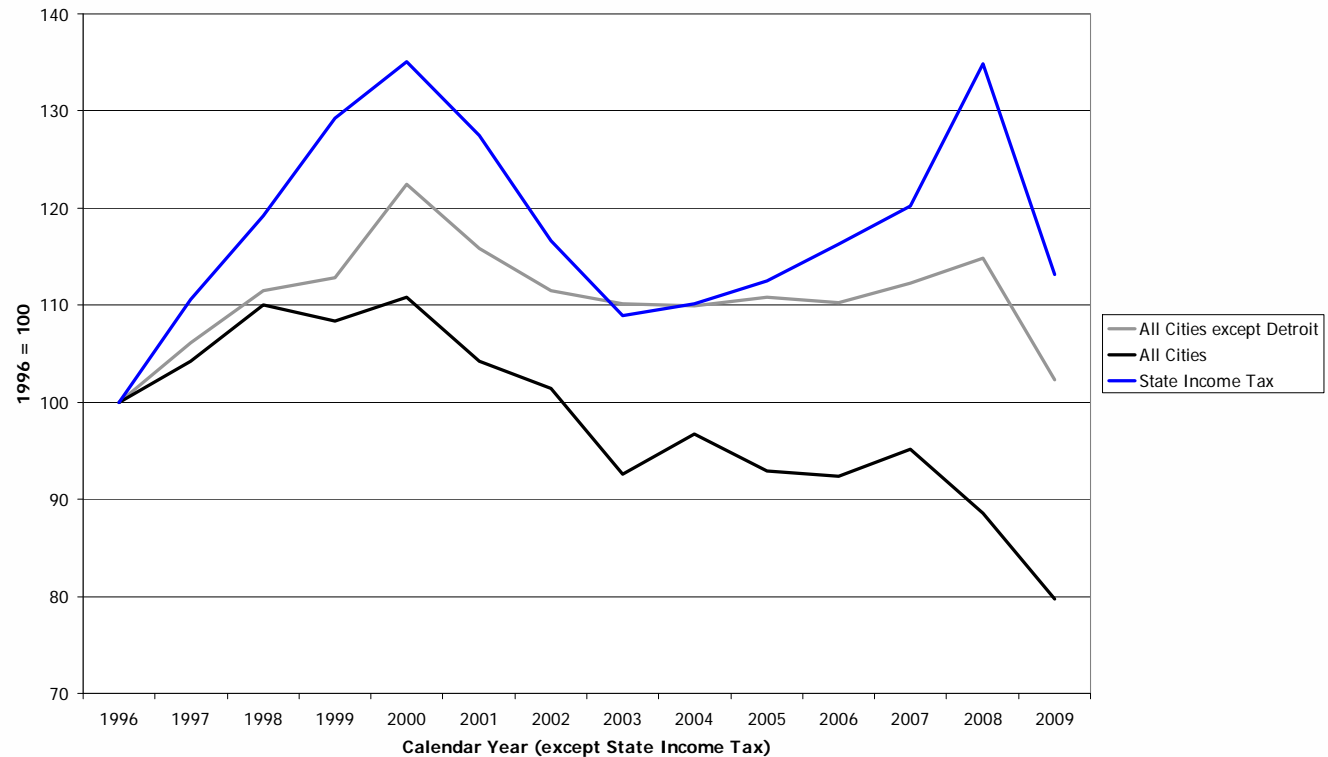
Revenue Trends for Michigan City Income Tax Revenues





State vs City Income Tax Revenues (without Detroit)

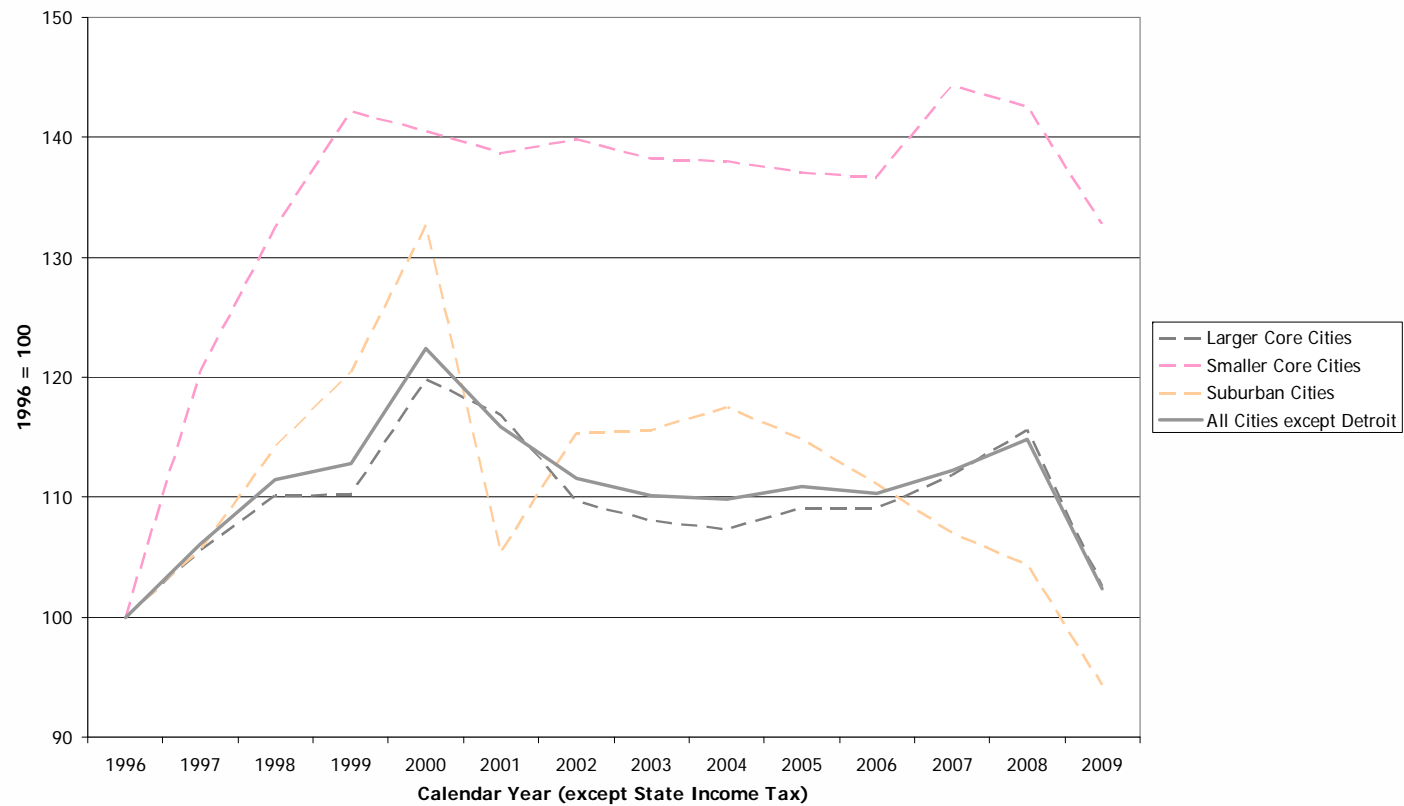
Revenue Trends for Michigan City Income Tax Revenues





Different Experiences for Different Size Cities

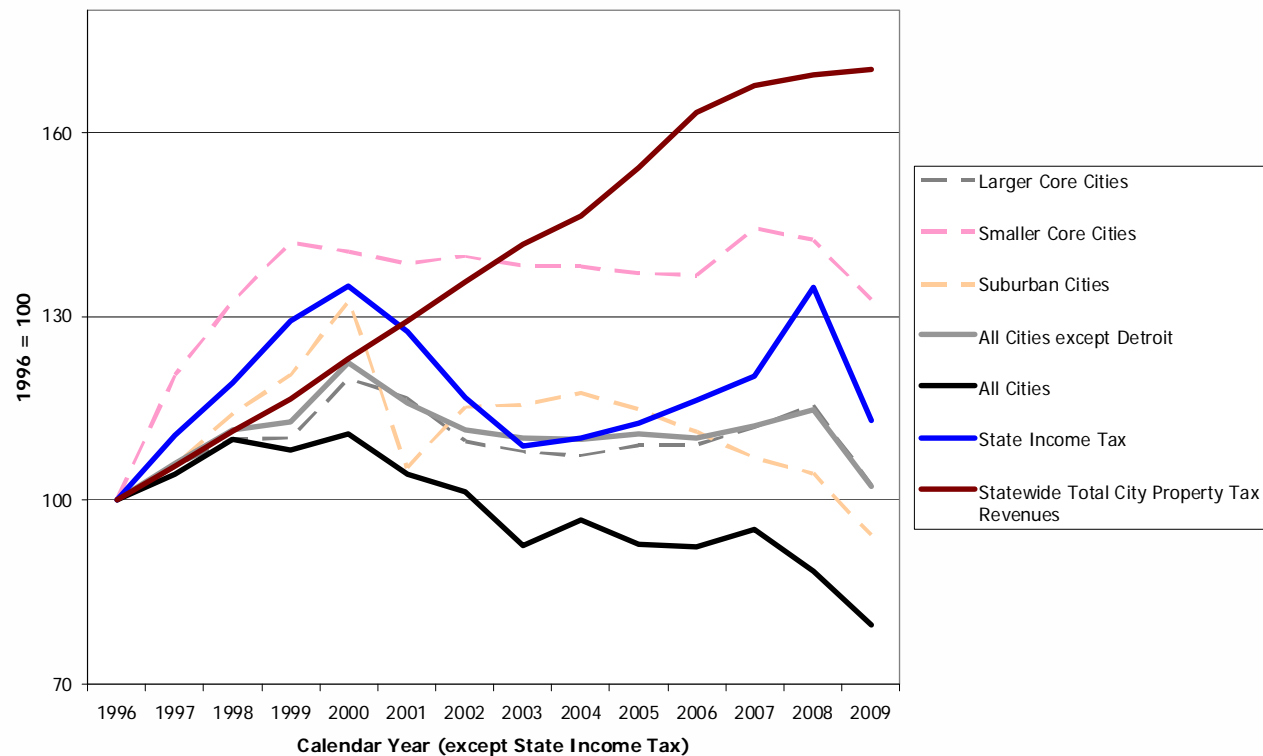
Revenue Trends for Michigan City Income Tax Revenues

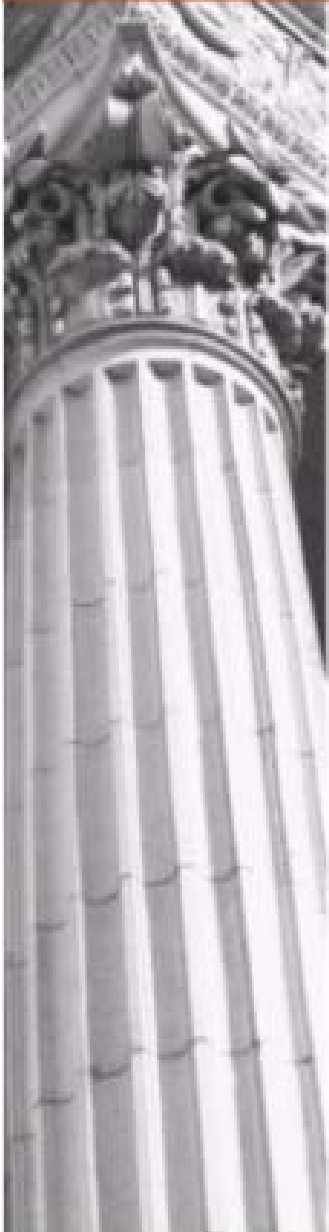




Still would have been better off with the property tax

Revenue Trends for Michigan City Income Tax Revenues





Federal Funds

- Unlike state government and school district, ARRA funds for local governments never supplemented operations
- Overall federal funding to cities down 50% over last 5 years
- CDBG funding in danger with Obama and Republicans wrangling over federal budget



How to Respond to Recession

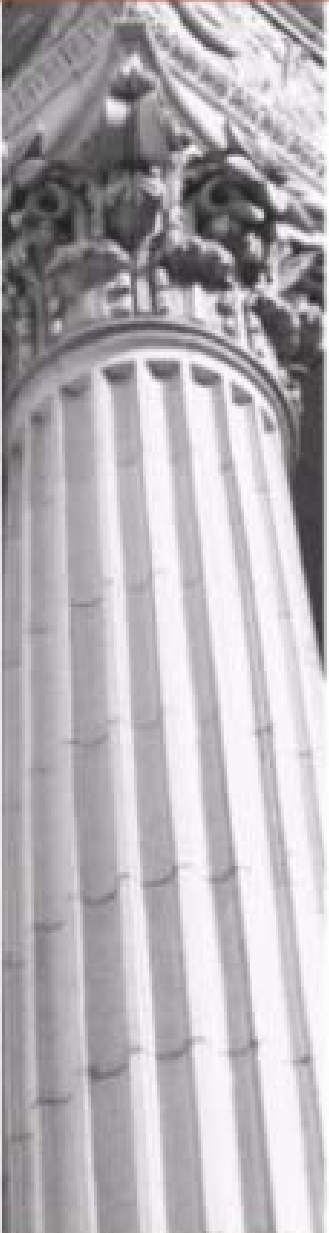
- **Business** – supply and demand
 - Production adjusted to meet changing demand
- **State Government** – program/department spending pressures driven by independent variables
 - e.g., population in poverty, number of incarcerations, university / school age children
- Some variance with economic cycles
- Some spending designed to be counter-cyclical
 - e.g., Medicaid, unemployment insurance, workforce training





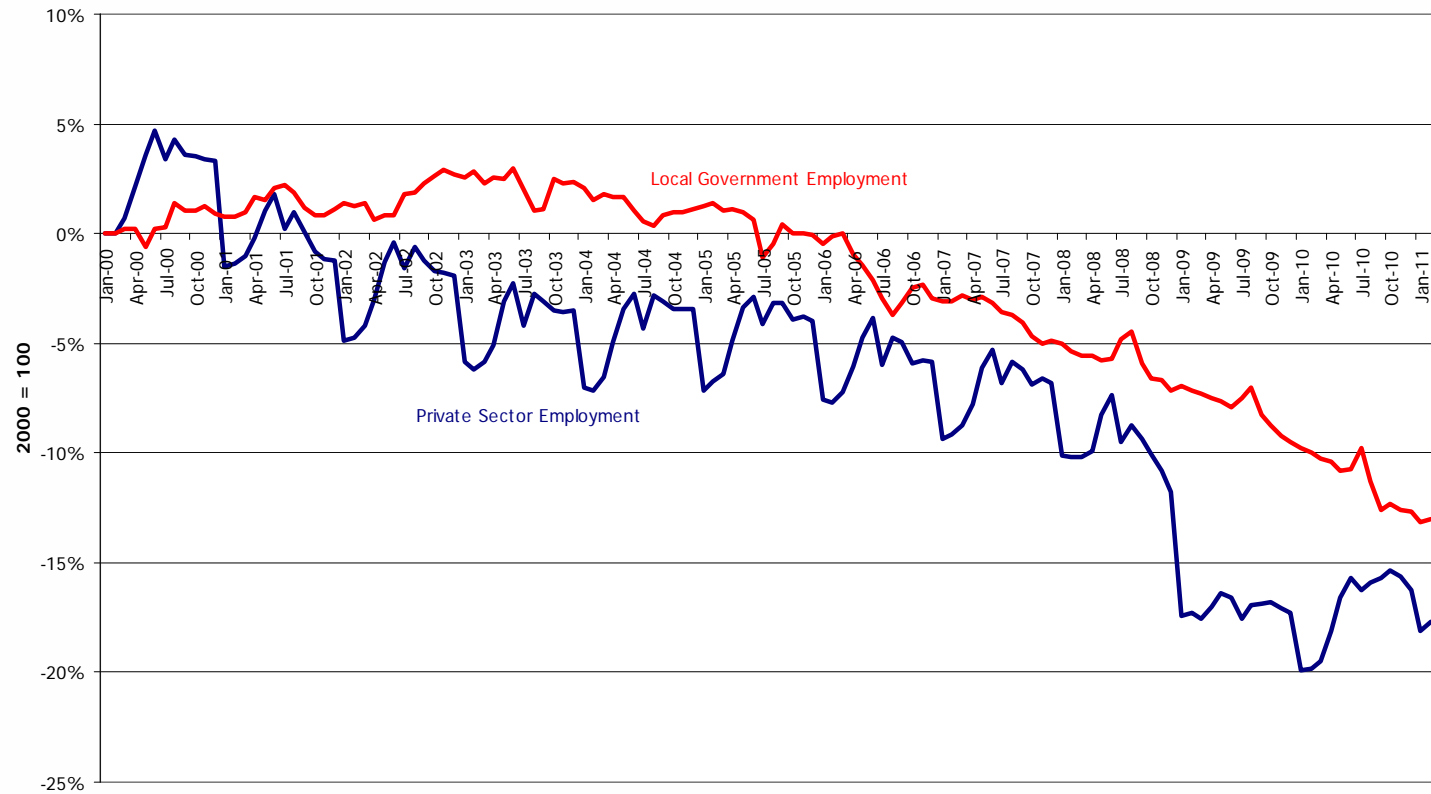
How do Local Governments Respond?

- Most determining variables experience little year-to-year fluctuation
 - Number of square miles – fire protection
 - Number of street miles – police patrol
 - Number of parcels – garbage collection, fire protection
 - Population – use of senior center, parks and recreation programs
- Little variation because of economic fluctuations
 - Exceptions – county health, tourist towns



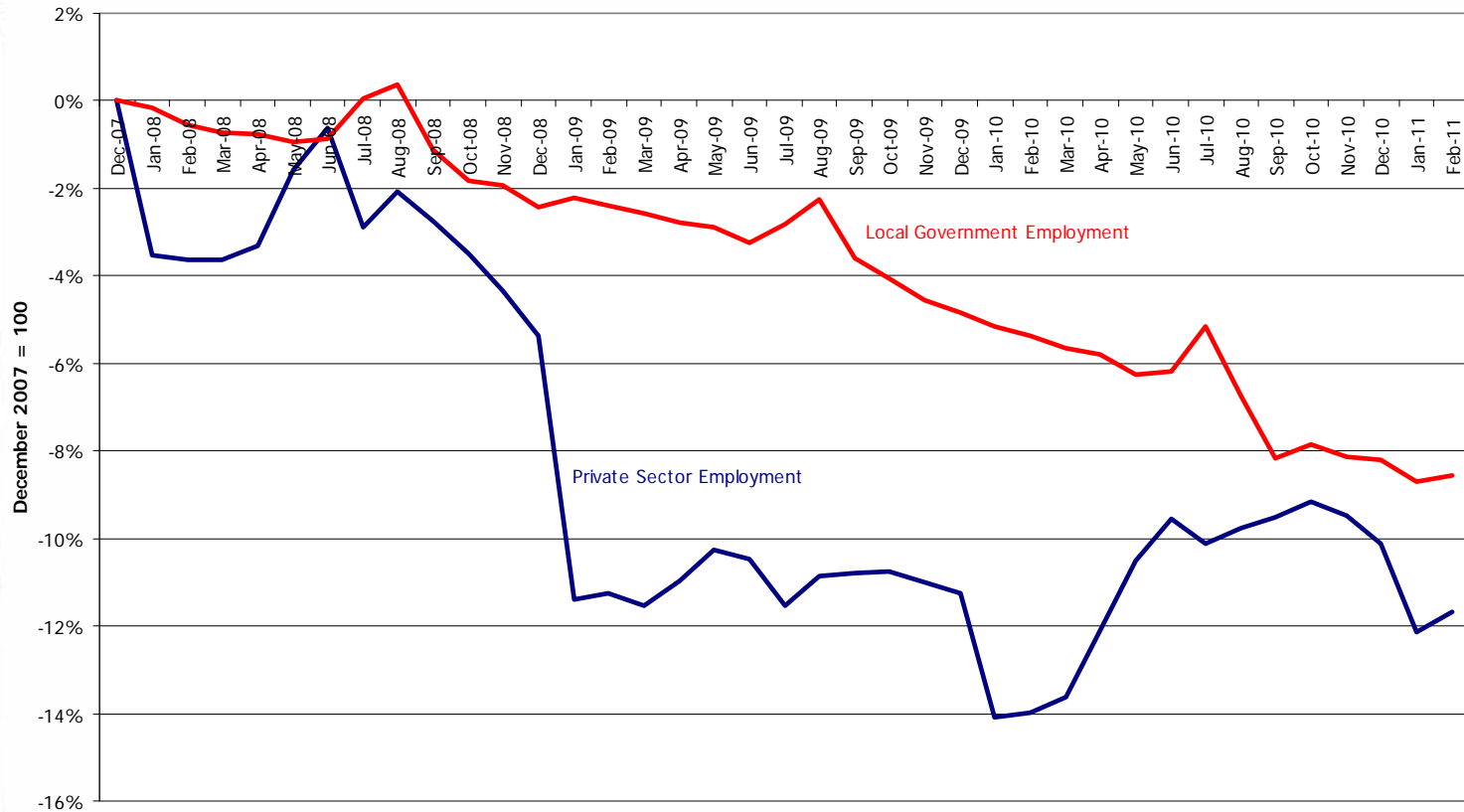


Local Government Response to Date – Downsize





Local Government Response to Date – Downsize (pt. 2)





Governor Snyder's Message to the Legislature

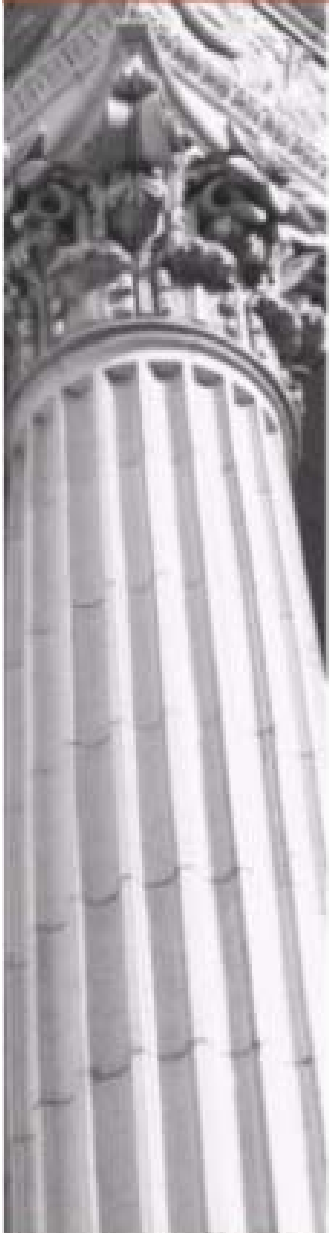
- Emphasis on quality of place in state-local interactions
 - Tie state departments/programs to services provided by local governments
- New hoops for CVTs to jump through to get state revenue sharing
 - Statutory revenue sharing only
 - Only for cities and charter townships still qualifying
 - After adjusting for new census numbers





Revenue Sharing Hoops

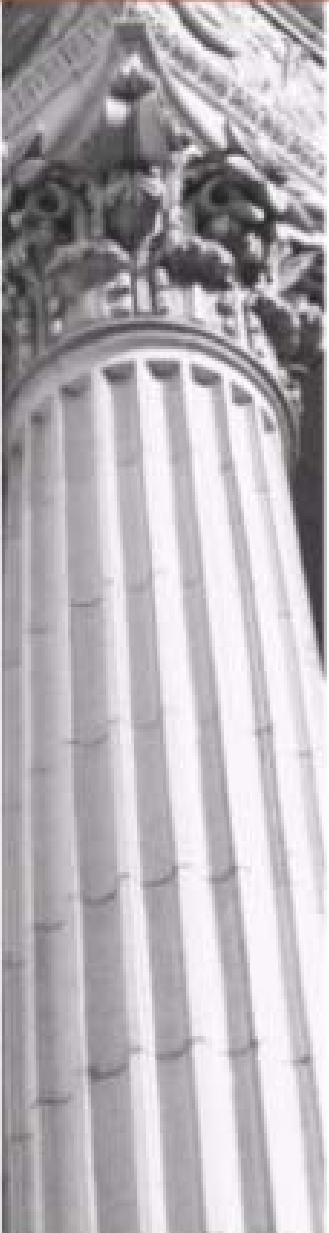
- **Accountability and Transparency**
 - www.michigan.gov/documents/snyder/LocalGovernmentDashboard_348149_7.pdf
- **Also look to:**
 - GASB – Service Effort and Accomplishment Reporting for Government
www.seagov.org/index.shtml
 - AGA – Performance and Accountability
www.agacgfm.org/performance/performancedefault.aspx
 - National Performance Management Advisory Commission
<http://pmcommission.org/>





Revenue Sharing Hoops

- Plans to Consolidate Services
 - Existing collaboration counts
 - "Good Faith Effort"
 - Otherwise undefined





Revenue Sharing Hoops

- Address Employee Compensation
 - All new hires in defined contribution or hybrid retirement plan
 - 1.5% multiplier for defined benefit plans (2% w/o social security benefits)
 - Controls to avoid pension spiking
 - All new hires on an 80/20 employer/employee health care premium split

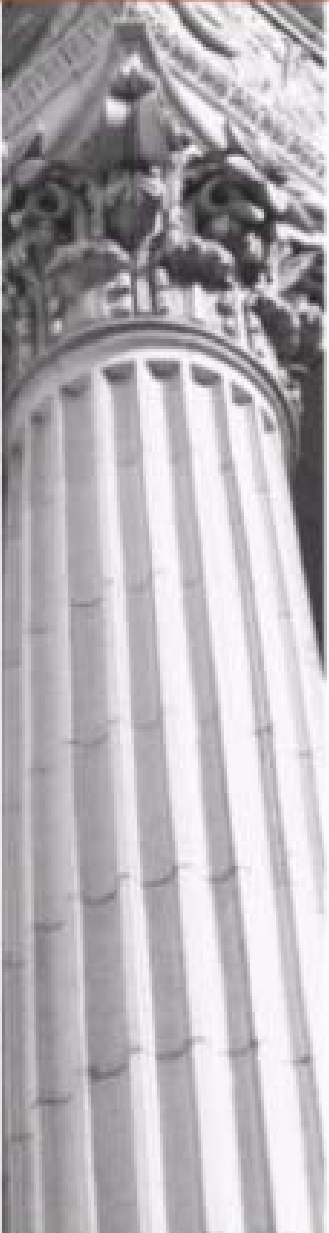
4/13/11 Gongwer News Service – SJR C and SB 7 to require public employees to contribute at least 20% of health care costs won approval from the Senate Reforms, Restructuring and Reinventing Committee on party-line votes. The measures would impact cities, townships, counties, villages, school districts, intermediate school districts, charter schools, public universities, community colleges, the state and any other public employee.





Governor Snyder's Message to the Legislature

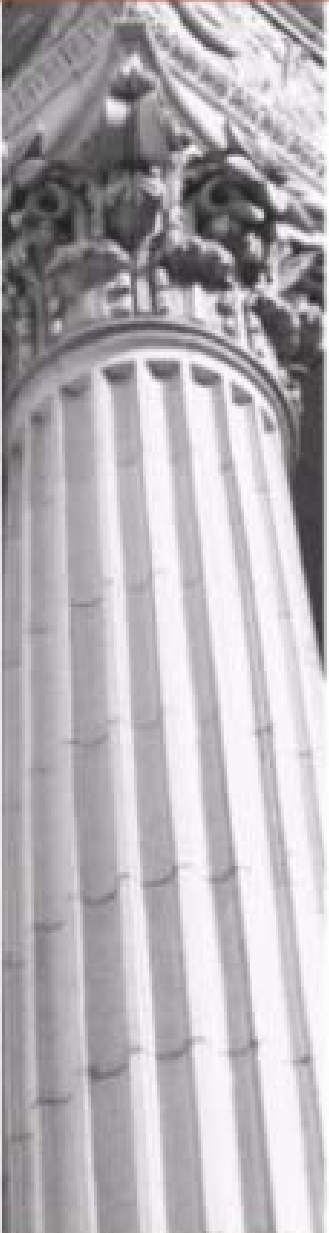
- Other parts of message
 - Enable consolidation of jurisdictions
 - Ensure collective bargaining at right time
 - Amend PERA
 - Reform PA 312 Binding Arbitration
 - Prohibit minimum staffing requirements
 - Local pension best practices
 - Unfunded Mandate reform





Take Aways

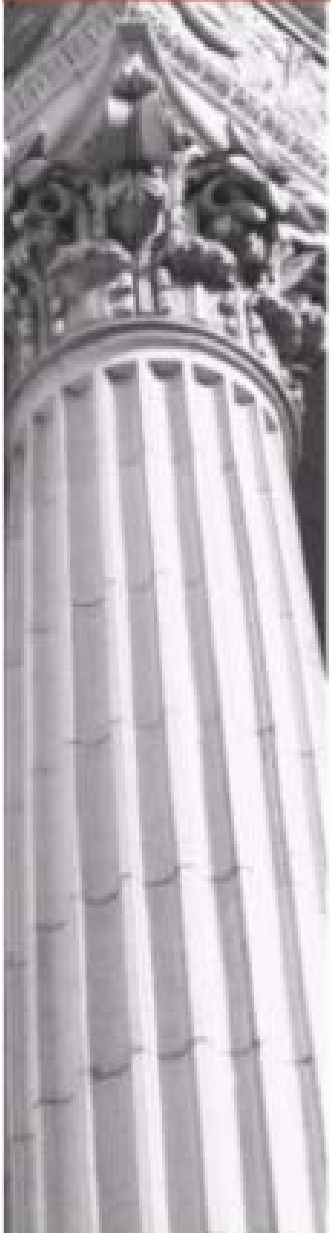
- Local Governments have severe revenue problems
 - Property Tax system in great need of reform
 - If state revenue sharing will not be funded, it should be replaced with regional taxes to be shared among local governments





Take Aways (pt. 2)

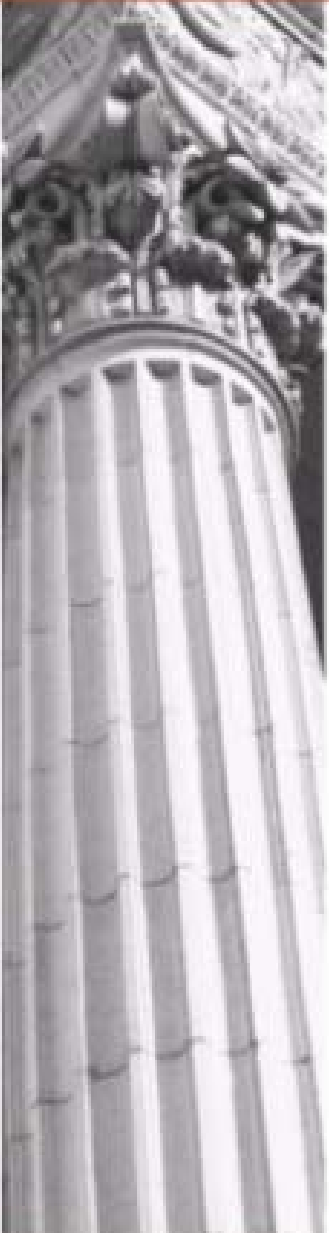
- Reforms proposed by Governor Snyder will be helpful, but will not help enough
 - Accountability is needed, but at this point we are reporting how fast ship is sinking
 - Consolidation of governments and service providers can achieve economies of scale, but result is only marginal savings
 - Reform of labor costs most helpful, but don't expect public employees to "do more with less" at same time they are being denigrated





Take Aways (pt. 3)

- Need Blue Ribbon task force to address level of government responsible for delivering specific services
- Need to reform governance of counties to empower and build confidence
- Need to reexamine regions to align with geography, travel patterns, etc.
- **Don't let a good crisis go to waste!**





Thank You for your attention

Questions?

www.crcmich.org

Eric Lupher

elupher@crcmich.org

734.542.8001

