Examining the Condition of Michigan and its Governments

Eric Lupher, President

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Society of Municipal Analysts

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Michigan's Path to a Prosperous Future: Challenges and Opportunities

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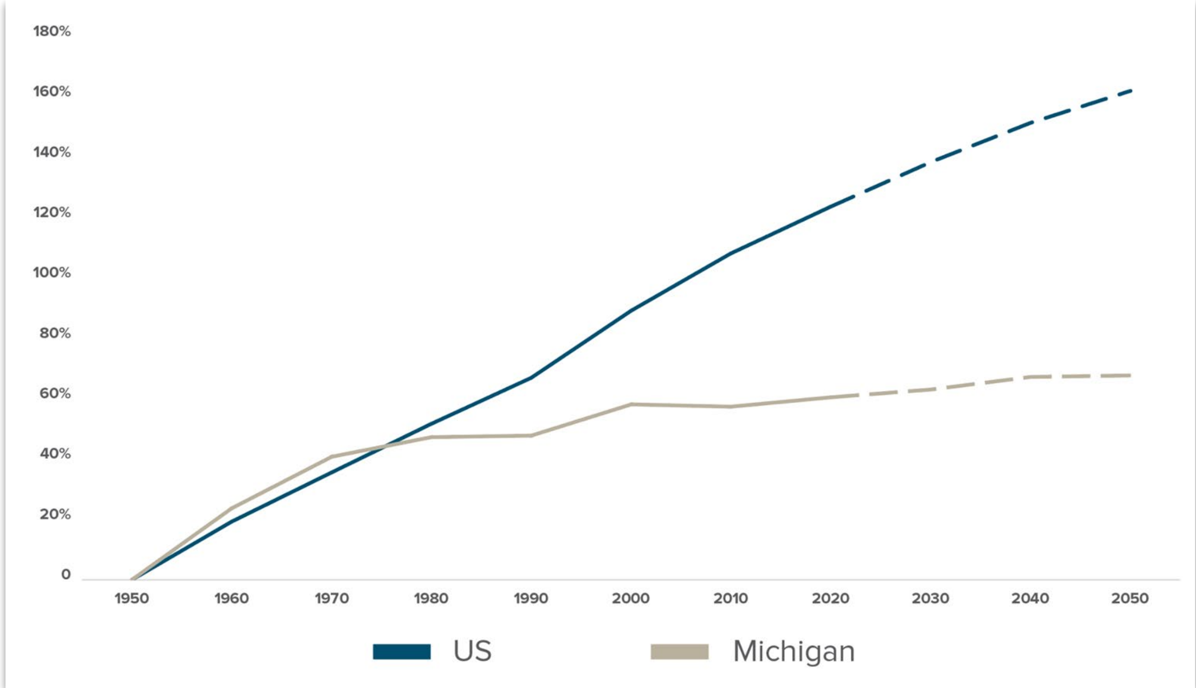
Michigan is Losing its Competitive Edge

- For decades, Michigan was a global powerhouse of innovation, leading the world with its technological developments and manufacturing outputs.
- But not any longer. In short, other states are surpassing Michigan on a number of measures – economy, education, and infrastructure to name a few. Our ability to stay competitive in comparison to other parts of the country is in jeopardy. We are now finding ourselves in the bottom third of national rankings, including 36th in K-12 educational outcomes, 34th in per capita personal income, 39th in health outcomes, 45th in electric service reliability, and 47th in road condition.
- Michigan's lack of population growth is at the root of many of these troubling trends.
- Michigan is suffering from brain drain, a shrinking workforce, declining health of its people, and a deteriorating infrastructure. All of this comes as racial and ethnic disparities across key indicators remain glaringly wide.

Michigan's Population is on a Path to Decline, Creating Challenges for our Workforce, Economic Growth and Fiscal Outlook

- Michigan's population growth has been slow since the 1970s and we are losing ground to the rest of the country.
- This gap will widen as Michigan's population is projected to grow at one-third the U.S. rate.
- On our current path, Michigan's population will start to decline in a generation.
- A declining population creates challenges for the state's workforce, customer base, and tax base.
- The state is also losing political influence, falling from 19 to 13 seats in the House of Representatives over the past 50 years.

Cumulative Population Growth from 1950, U.S. and Michigan

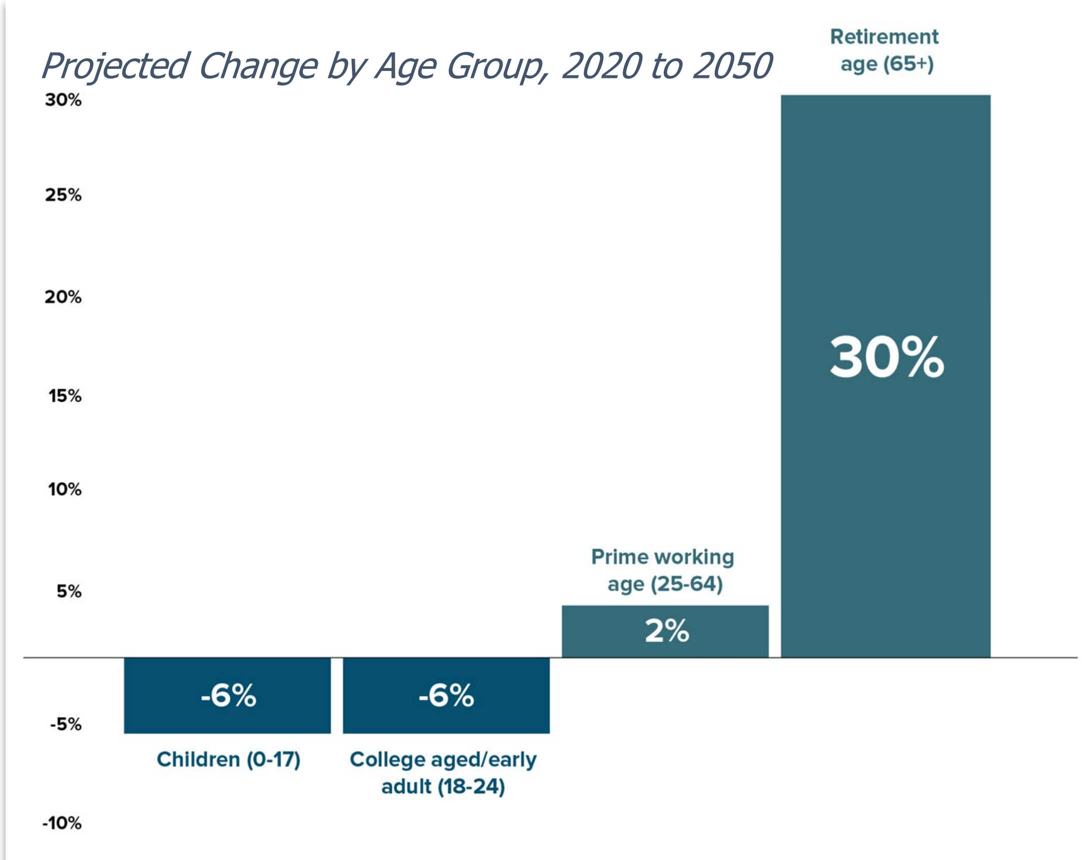


Sources of population data: U.S. Bureau of the Census (historical) and Jacob T. Burton, Gabriel M. Ehrlich, Donald R. Grimes, Kyle W. Henson, Daniil Manaenkov, and Michael R. McWilliams, University of Michigan, Research Seminar in Quantitative Economics, The Economic and Demographic Outlook for Michigan Through 2050, July 29, 2022 (projections)

Michiganders are Getting Older and Too Many Young People are Leaving the State, Impacting Our Future Workforce

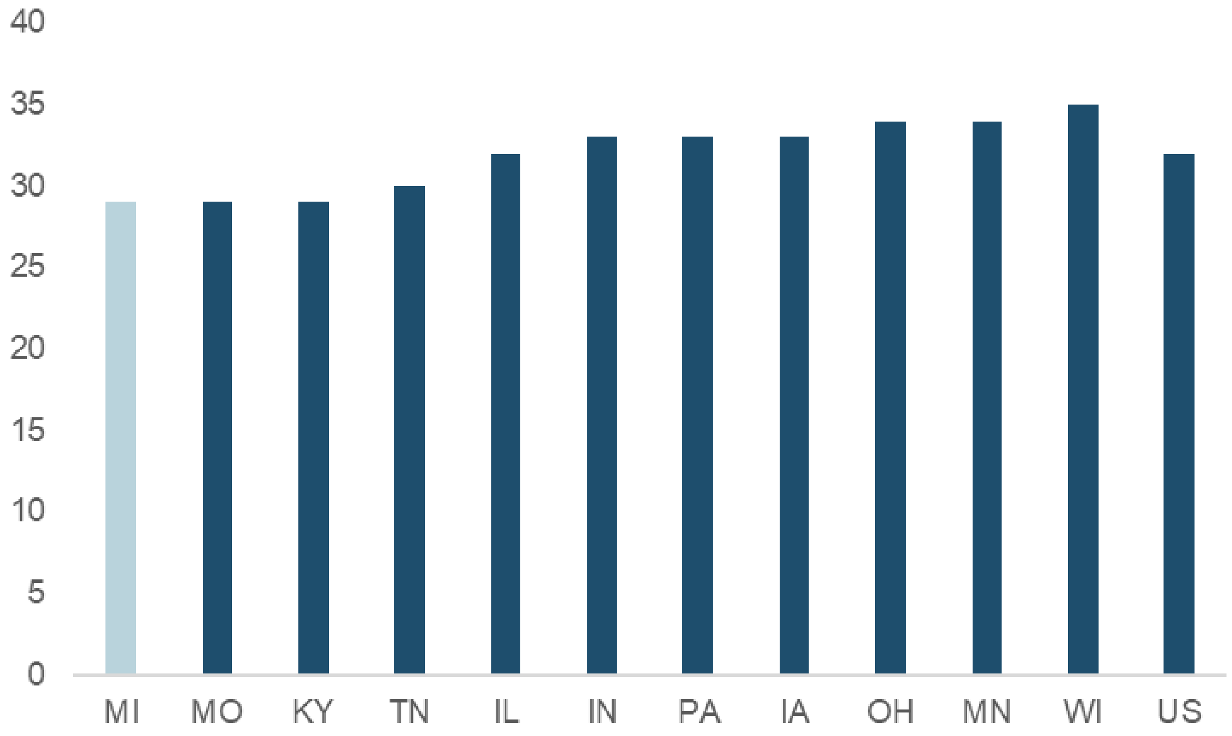
Michigan's younger populations are declining: from 2010 to 2035, the ratio of workers to retirees will fall from 4.5 to 2.5

- Too many of Michigan's young people are starting families, buying homes, and advancing professionally in other states, building those states' economies and populations.
- As more Michiganders retire and age out of the workforce, our ability to replace these workers, fill necessary jobs and attract companies to stay in or relocate to Michigan is in jeopardy.
- A rapidly growing older population is also increasing the need for resources to support health care and long-term services and supports.



Michigan's Educational Outcomes Lag the Nation

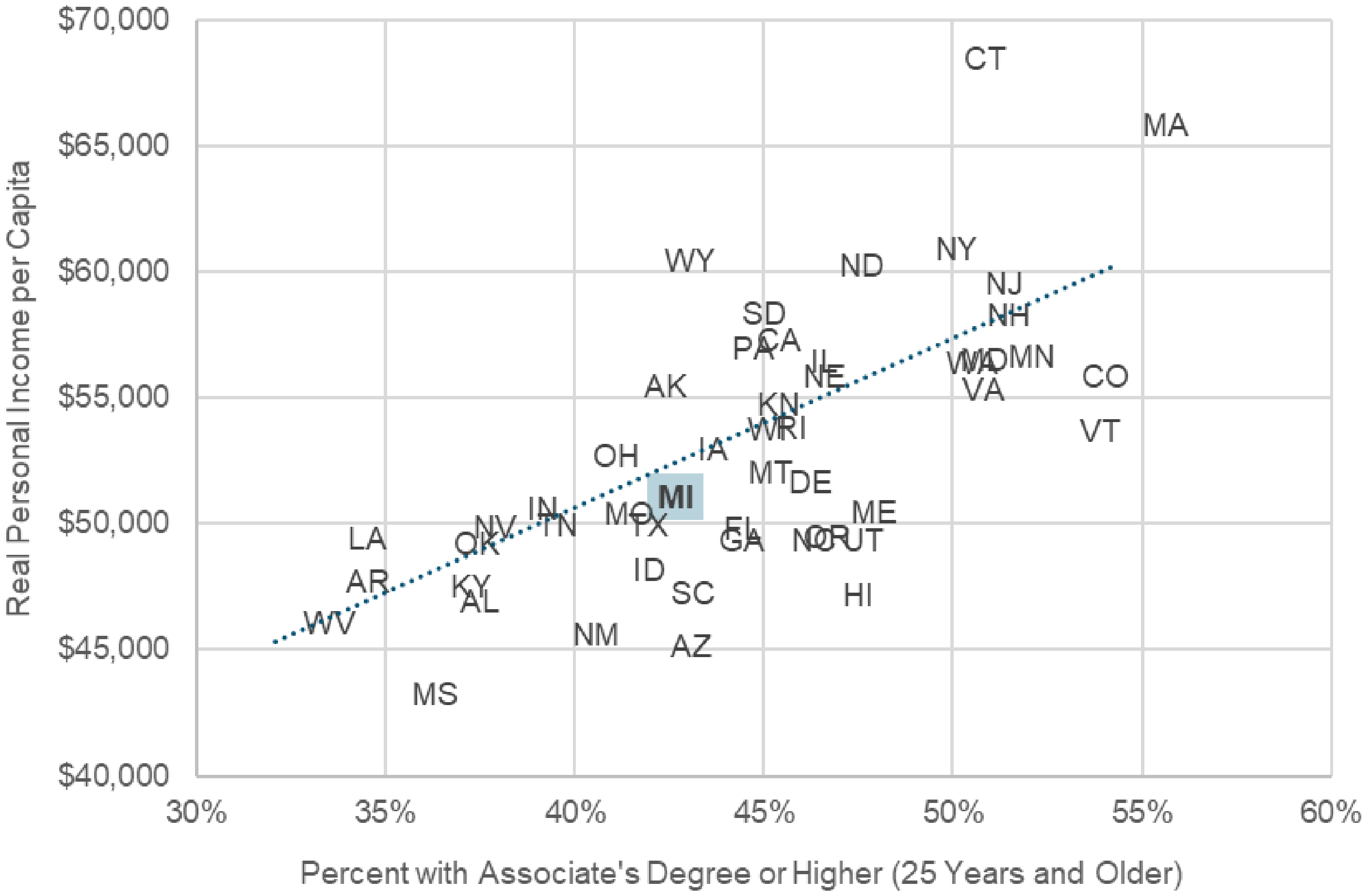
- Michigan's K-12 school system struggles to make our young people college- and career-ready. The state ranks 38th in math and reading proficiency.
- Michigan is in the bottom third of states for the percent of the population with college degrees. The cost of Michigan's higher education system is a barrier for many students who want to attend college, and many of those who do attend our colleges and universities are leaving the state.
- The state's education system is not generating home-grown talent to attract growth industries with high paying jobs.



Percent of K-12 Students Scoring at or Above Proficiency

A Struggling Education System is Widening Income Gaps

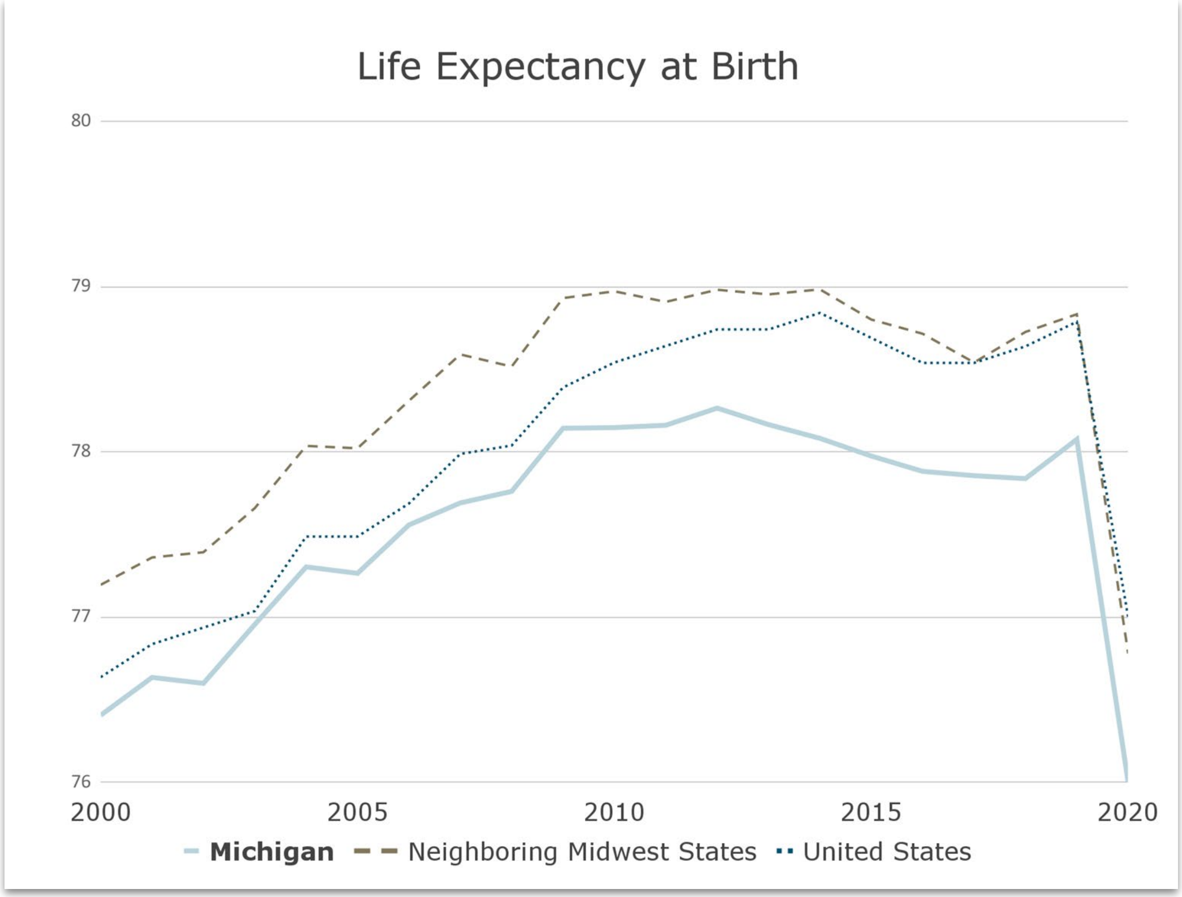
- States with high levels of populations with postsecondary degrees have higher incomes.
- Employment forecasts show that employment growth over the next decade will be faster in occupations that require a college degree for entry-level positions.
- Michigan is among states with low levels of college degrees and low income levels.



Michiganders Are Not Living As Long As Other Americans

Life expectancy has declined relative to national benchmarks over the past 20 years

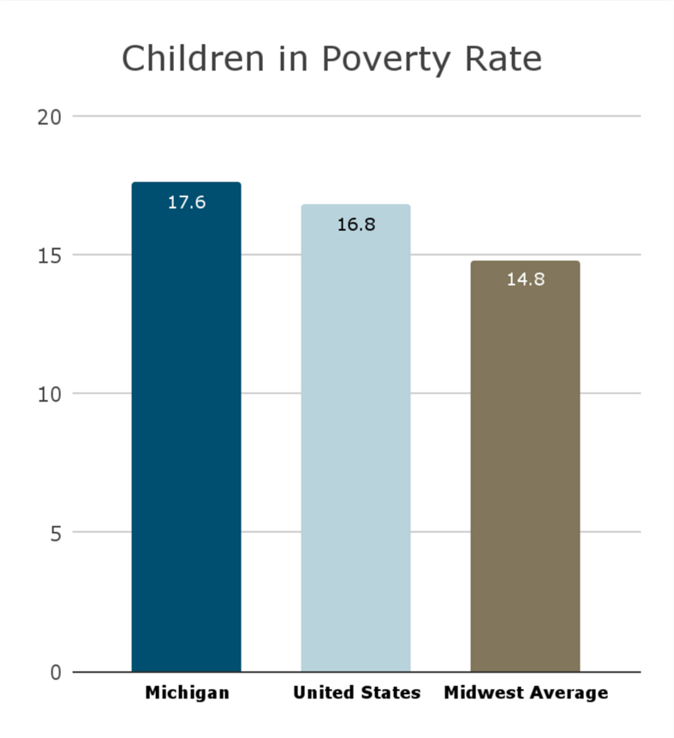
- In 2005, life expectancy at birth was nearly equal to the nation, but has diverged noticeably since then. Michigan's life expectancy in 2020 was lower than in 2000 at a full year less than the national average. Premature deaths (before age 75) in Michigan are also higher than the national average.
- Life expectancy across the country fell sharply in 2020 due to the COVID-19 pandemic, and early waves of the pandemic hit Michigan particularly hard, resulting in over 12,000 deaths.

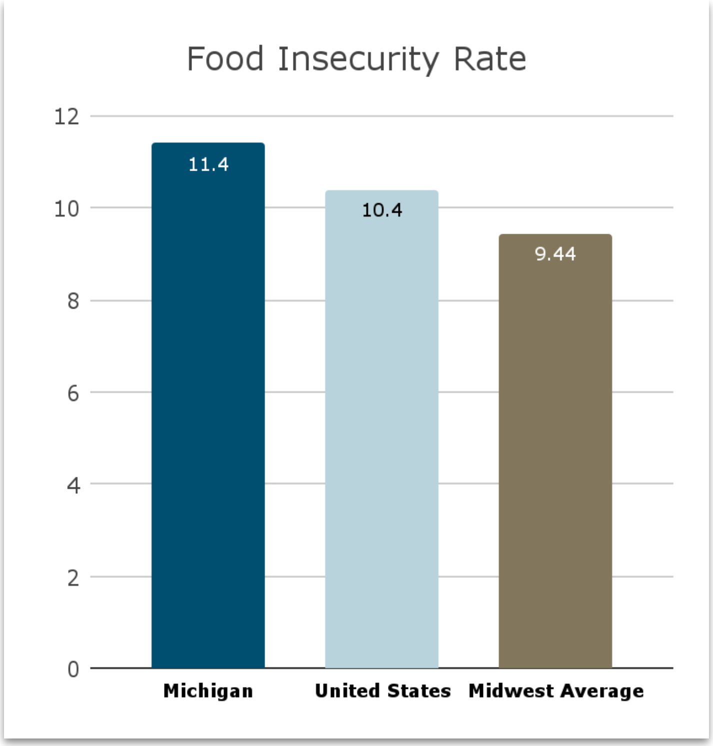


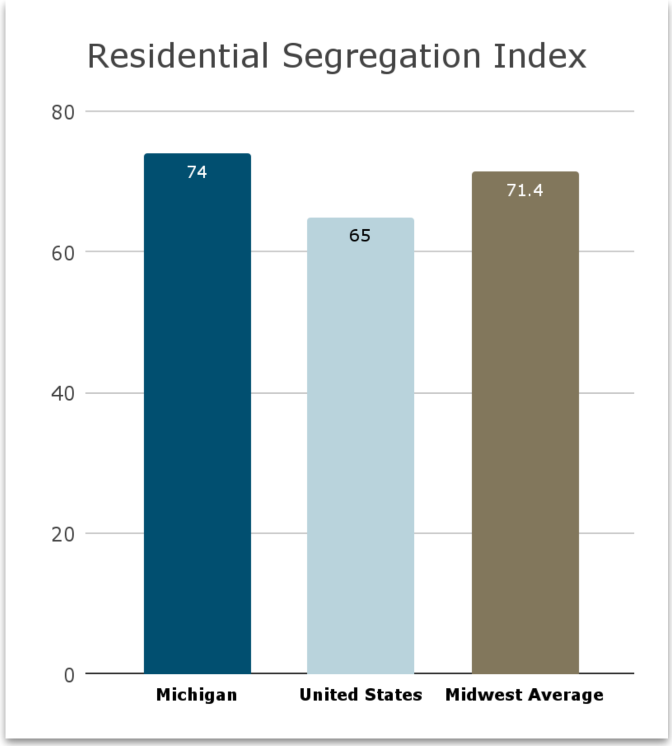
Social and Economic Factors are Determinants of Health

Michigan's poor social and economic indicators correlate with poor health outcomes

It's no coincidence that as Michigan ranks among the lowest states in health outcomes, it ranks 37th out of 50 states in social and economic factors, such as rate of children living in poverty, residents experiencing food insecurity and residential segregation.



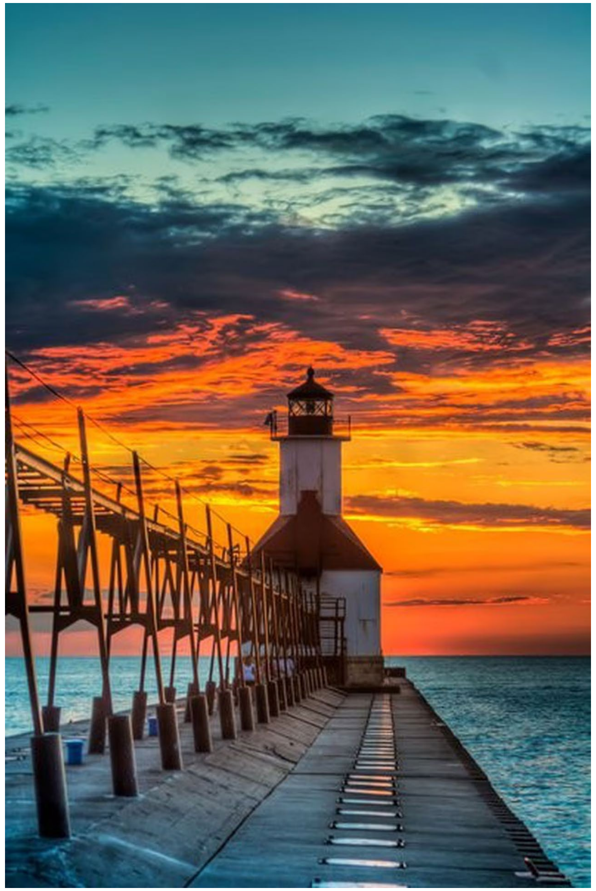




Michigan's Environment Could be Key to Future Growth

Michigan environment and natural amenities could be a core asset to attract new residents and investments

- Michigan has a wealth of natural resources
- Water resources, in particular, are unmatched by any other state
  - Great Lakes
  - Inland waters
  - Rivers
- Mature forests
- Unique dune ecosystems
- Leveraging these assets will require increased attention to environmental protection and related human health impacts
- As Southern regions get hotter and water levels rise, "Climigrants" may choose Michigan as a destination with plenty of water and tolerable temperatures.



Wide-Ranging Climate Impacts Require Wide-Ranging Responses

Successful climate adaptation will promote Michiganders' wellbeing and a sustainable state economy

Michigan's current climate policy emphasizes climate mitigation – reducing carbon emissions. These efforts will not measurably impact the climate change that the state experiences.

Climate adaptation must be built into state policies across the board.

- Infrastructure planning should include solutions such as routing power lines underground, ensuring stormwater systems can accommodate severe storms, and routinely inspecting and maintaining critical flood control facilities.
- Protecting Michigan's natural resources may include policies and programs that understand, track, and respond to harmful and invasive species and diseases, implementing land-use and forestry practices to reduce the likelihood of destructive wildfires, remediating sites with soil contamination, and managing shoreline areas.

Importantly, all policies must ensure that addressing one negative impact does not result in other negative impacts (maladaptation).

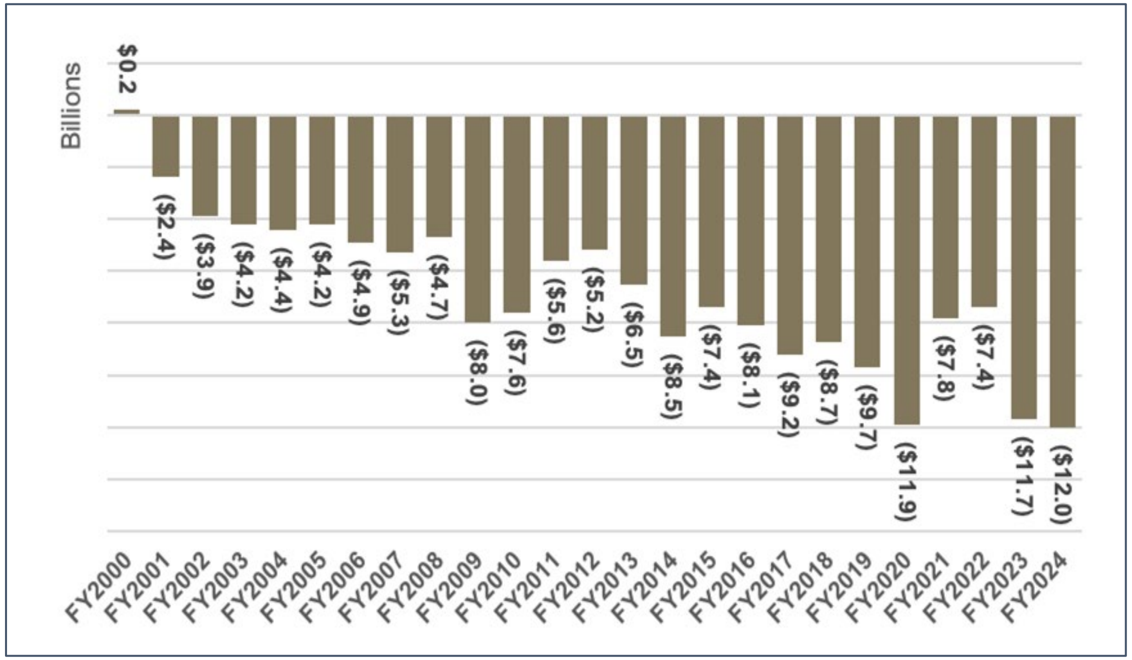
State Financial Condition

Michigan Taxing Increasingly Smaller Shares of Income

Slow revenue growth has brought state revenue $12 billion below the state's constitutional revenue limit.

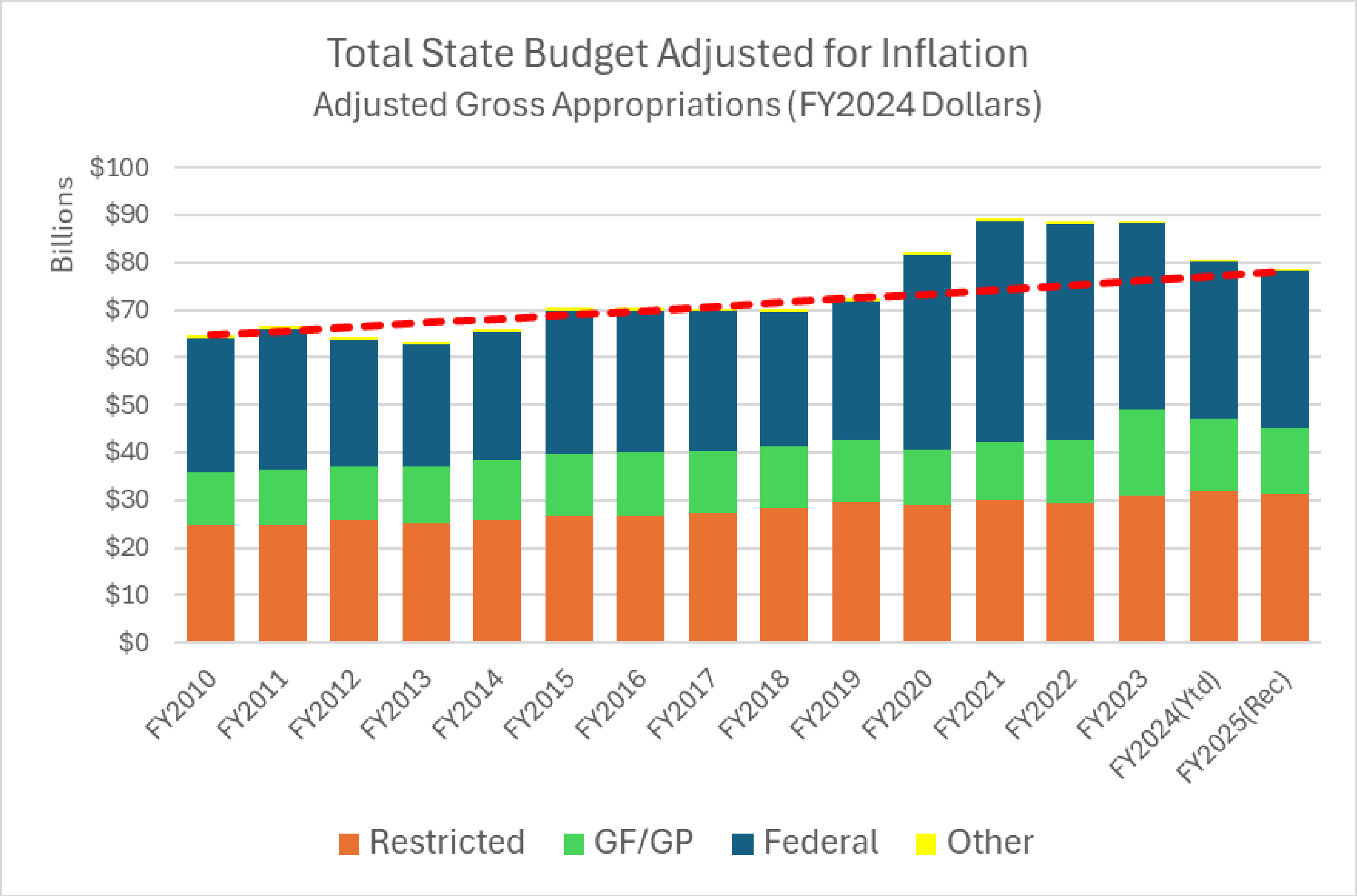
- 1978 Headlee Amendment included provision that state government should not tax more of residents' personal income than it did in 1978 – 9.49%
- Through 1980s, 90s, 00s, state not far below the revenue limit
- Since Great Recession, the delta has been widening
- Michigan's per capita personal income has been growing slower than the national average

State Revenue Relative to Constitutional Limit



Source: House Fiscal Agency, FY 2023-24 Appropriations Summary and Analysis, September 2023

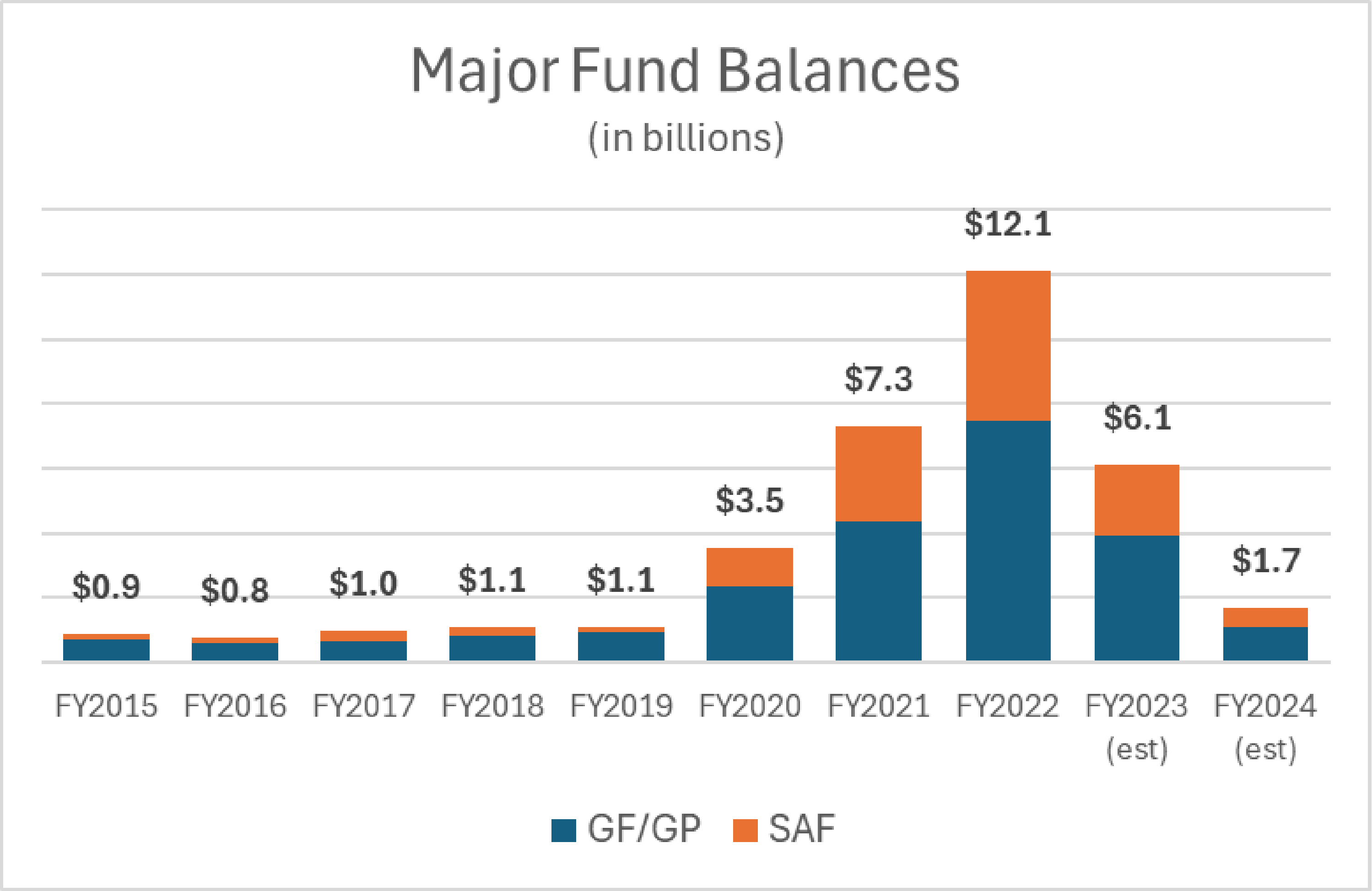
Perspective on Recent Budget Growth



- In actual dollars, FY2019 budget $58B; by FY2023 the budget grew to over $85B
- Growth was largely driven by huge influx of federal revenue as well as one-time spending out of state fund balances
- Proposed FY2025 budget returns to pre-COVID trend

Source: Research Council analysis of Senate Fiscal Agency and House Fiscal Agency data

State's "Money in the Bank" Has Fallen



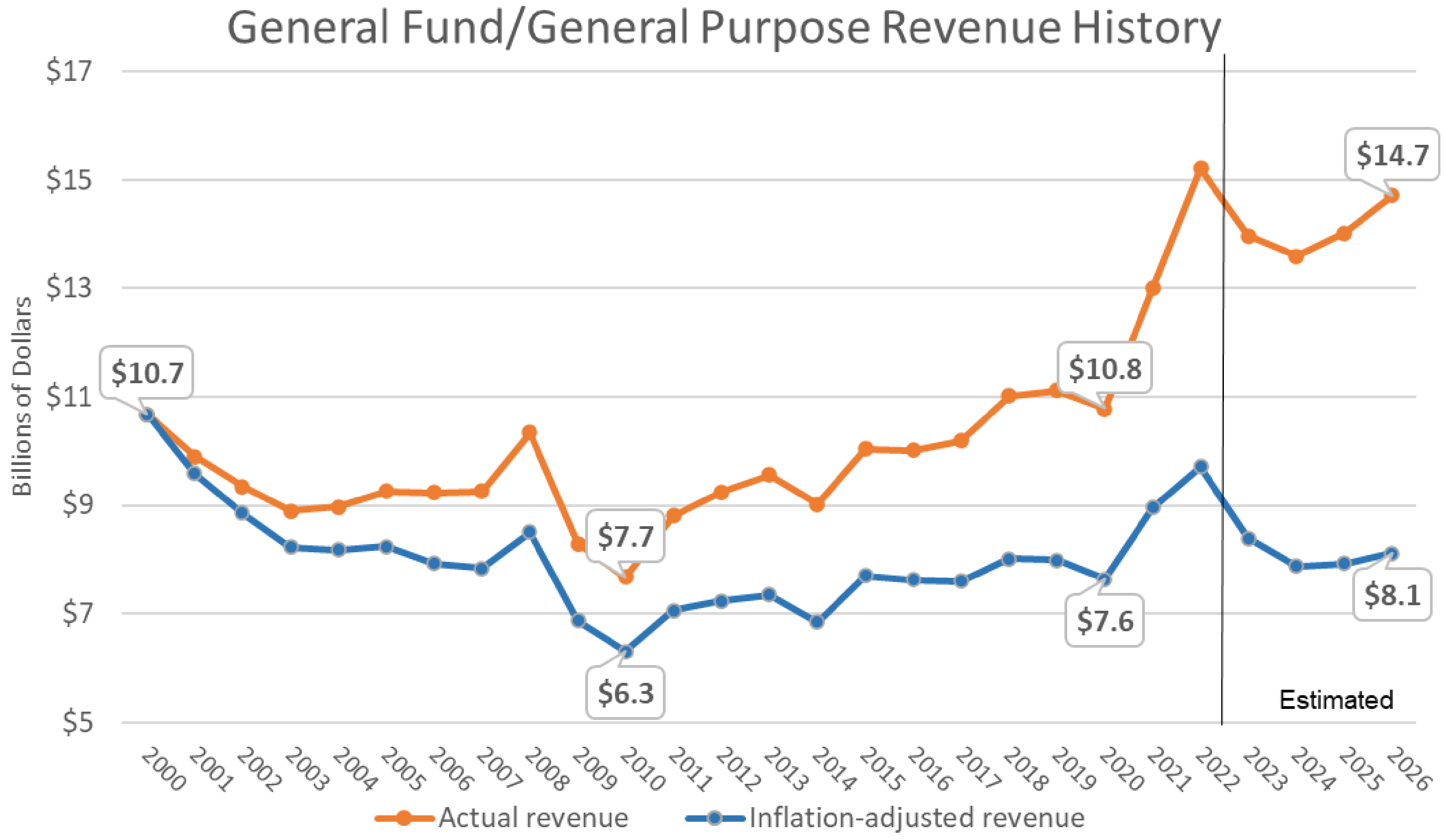
Both GF/GP and SAF projected year-end balances are down from the unprecedented levels realized over the previous four fiscal years.

FY2024 Year-End Balance Estimates:

- GF/GP: $1.1B
- SAF: $564M

Source: State of Michigan Comprehensive Annual Financial Reports and House Fiscal Agency projections..

Perspective: Inflation-Adjusted GF/GP Still Down



After climbing out of a two-decade hole, GF/GP revenue is expected to grow by close to $4B between FY2020 and FY2026

Still, adjusted for inflation, FY2026 revenue estimate is still down by 24% from FY2000

Source: Research Council calculations from Senate Fiscal Agency data. Inflation adjustment uses Detroit CPI-U data.

The Challenge of Funding Michigan's Local Governments

Michigan’s Overlapping Property Tax Limitations Create an Unsustainable Municipal Finance System

https://crcmich.org/publications/michigans-overlapping-property-tax-limitations

Local Governments Respond to Property Tax Base Limitations by Raising Tax Rates

https://crcmich.org/publications/raising-property-tax-rates

Property Taxes in Michigan

- Critical role of property taxes in U.S.
  - ➢ 72% of all local tax collections
  - ➢ 31% of all public revenue
- Heavy burden on the property tax to fund all forms of local government
- Only tax where amount due not easily determined by taxpayer
- General dissatisfaction has led to adoption of property tax limitations

Overview of Property Tax Limitations

States generally limit property taxes paid by one of three different ways:

1. A ***rate limit*** puts an upper boundary on the rate that a jurisdiction can levy.
2. An ***assessment limit*** provides a ceiling to the amount of annual assessment increases; that is, it limits how much a taxpayer's property value can increase year-to-year.
3. A ***levy limit*** restricts how much tax revenue a jurisdiction can take in year-over-year.

Property Tax Rate Limitations

- First attempt to limit property taxes
- 15, 18 and 50-mill limits adopted in 1932 and carried into 1963 Constitution
  - Only apply to certain local governments
  - Only apply to taxes supporting general operations
  - Lax enforcement

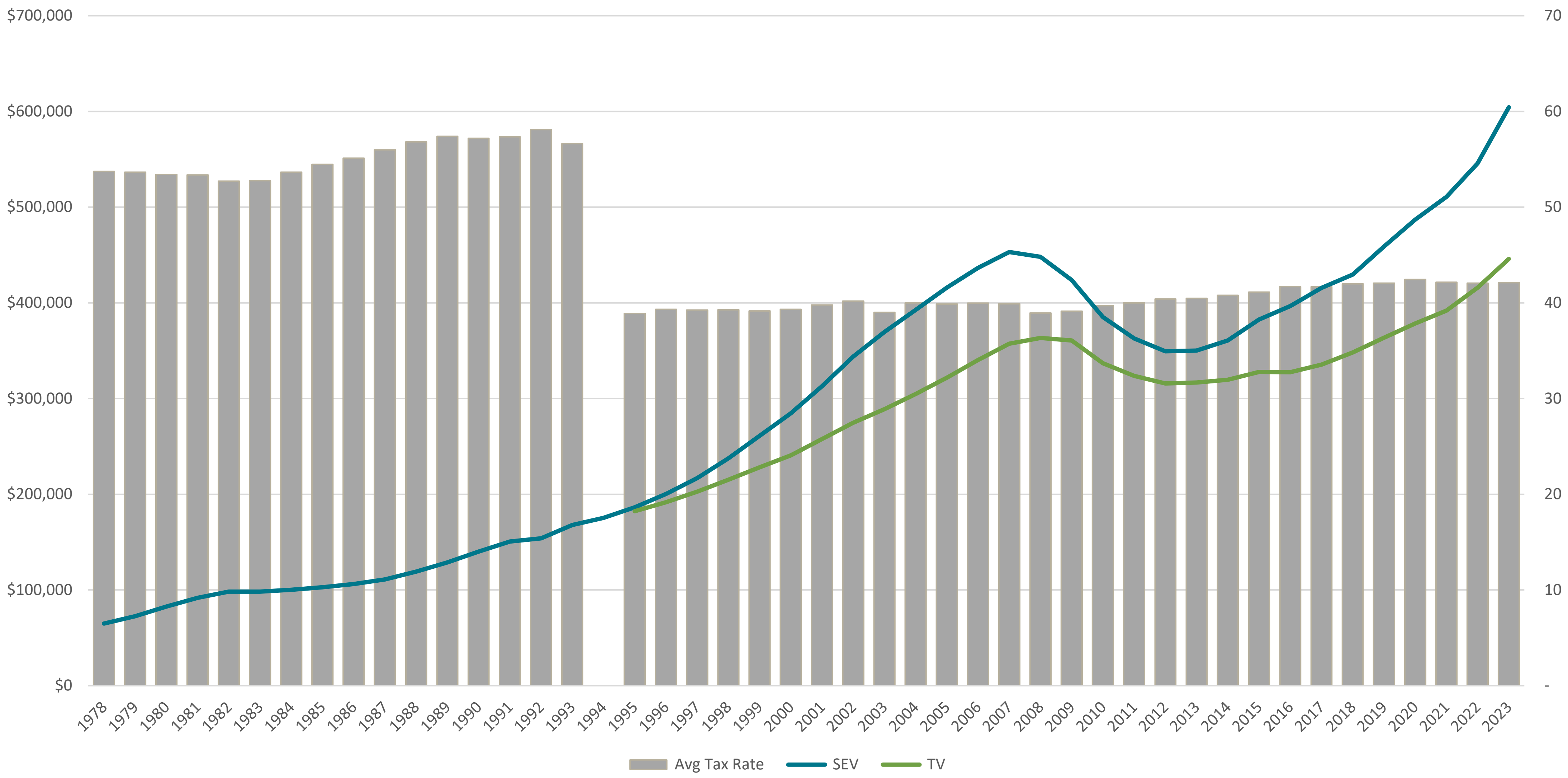
The Headlee Amendment – Levy Limit

- Adopted in 1978 to add 10 new sections to Michigan Constitution
- Article IX, Section 31, limits local property taxes in two ways:
    1. Requires voter approval to adopt new tax or increase rate of existing tax
    2. Limits total property tax revenue growth on jurisdiction-wide basis to the rate of inflation
- Created check on the growth of property tax collections overall
    - Headlee rollback: requires tax rate adjustment if tax base increases by rate greater than inflation
    - Headlee rollups allowed prior to 1993
    - Now Headlee override vote required for tax rate to be rolled up
- Failed to protect <u>individual</u> taxpayers from excessive yearly increases

Proposal A of 1994 – Assessment Limit

- Market-value based system of assessing property (SEV) replaced with modified acquisition value system (TV)
  - TV increases in property limited to lesser of rate of inflation or 5%
  - Excludes value of new construction
  - When property sold, tax base reverts to SEV and annual changes capped with new owner
- Layered a new tax limitation onto the general property tax
- Instituted differential taxation of business and homestead residential property
- Impetus included
  - Relief from high property taxes
  - Changing the school funding system so that it was less reliant on local property taxes and provided more equal per-pupil funding across the state

Statewide SEV, TV, and Average Tax Rates, 1978 to 2023



Example of Similar Properties in Oakland County with Very Different Tax Burden

Property "A"
Parcel capped since 1997
Fielding St., Ferndale
737 sq. ft., 1942 built
Sold 4/25/1996 for $28,000
TV $24,960 x mills (50.2377) =
Taxes of $1,254

Property "B"
Parcel uncapped for 2021
Northway St., Ferndale
744 sq. ft., 1942 built
Sold 3/13/2020 for $140,500
TV $71,290 x mills (50.2377) =
Taxes of $3,581

Interaction of Headlee Amendment and Proposal A

- Two property tax limitations work to control taxes in very different ways
  - Headlee Amendment limits <u>unit-wide growth of the amount of taxes collected on existing property</u> to the rate of inflation
  - Proposal A limits <u>growth in the taxable value of individual parcels of property</u> to the rate of inflation

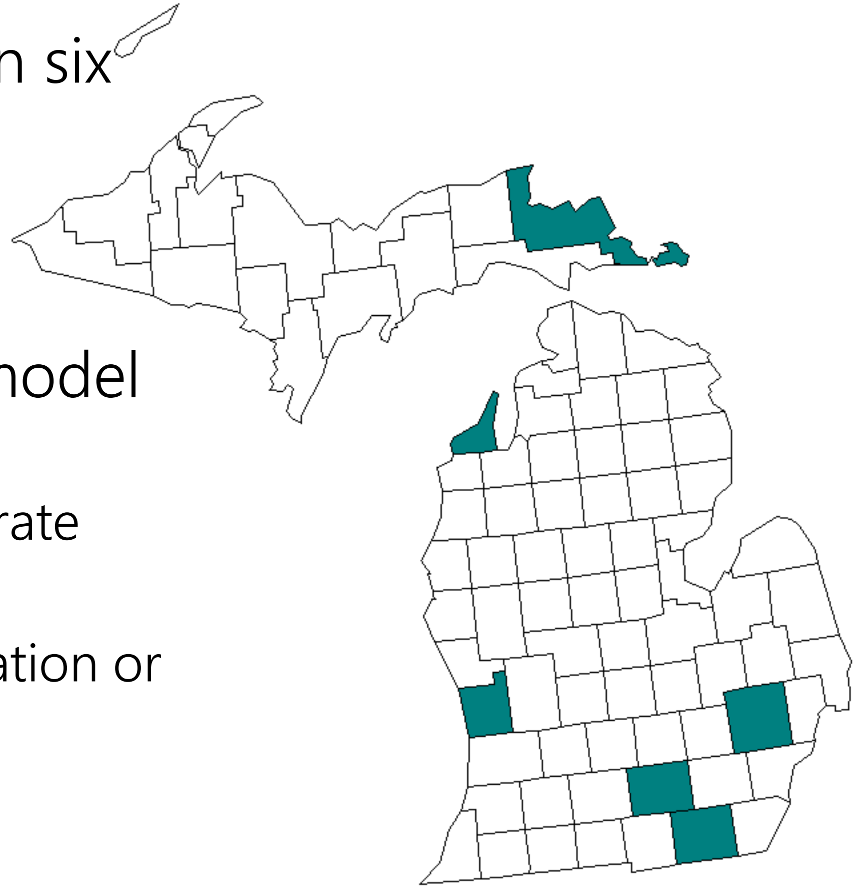
- Key question
  - Is the combination of the two tax limitations together more restrictive to property tax revenue growth compared to the limits imposed by each limitation individually?

Tax Limitation Analysis Model

Study of Tax Limitations Methodology

- Analyzes property tax data from local governments in six counties
  - ➢ Chippewa, Jackson, Leelanau, Lenawee, Oakland, and Ottawa

- Uses actual property tax data from 1994 to 2020 to model how the tax limitations interacted retrospectively
  - ➢ Holds constant policy preferences, such as changes to tax rate
  - ➢ Applies 1993 authorized tax rate to SEV and TV
  - ➢ Calculates Headlee tax rate adjustments based on appreciation or depreciation of existing property values + additions and subtractions



Model of Study

- Three different scenarios
  1. **No tax limitations scenario** shows a property tax scenario based on market value (SEV) and the 1993 millage rate with no limitations
  2. **Headlee Amendment scenario** shows how the Headlee Amendment limitations alone impact property taxes based on the 1993 millage rate and tax rate adjustments as calculated based on SEV
  3. **Headlee Amendment and Proposal A scenario** reflects current law (using the 1993 millage rate) with levy and assessment limits that restrain property tax growth with tax rate adjustments as calculated based on TV
- Goals:
  - Better understand interaction of the two tax limitations and their individual and combined effects on property tax bases and tax rates
  - Consider how the property tax limitations have affected both local governments that are dependent on the tax revenues and the property taxpayers that are footing the bill
- Hypothetical scenarios – do not reflect actual tax revenue collections

Categories of Local Governments

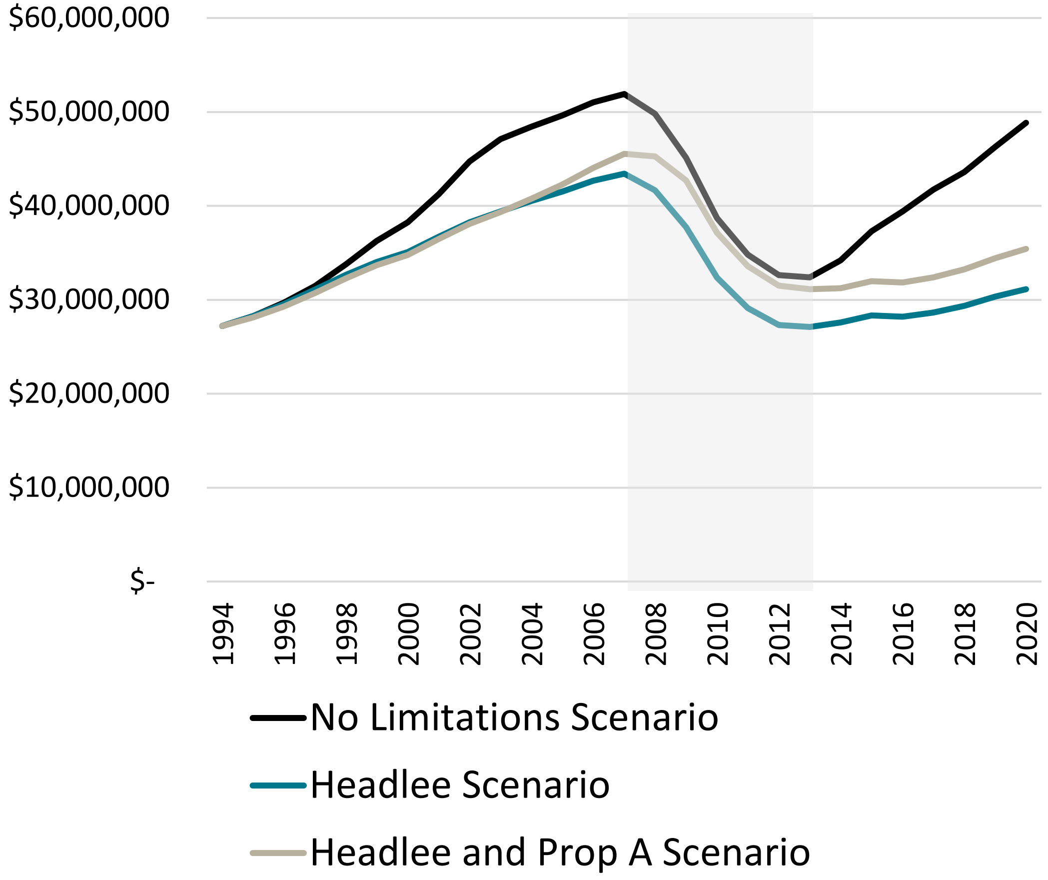
1. Six **counties** that vary drastically in urban/rural makeup, size and demographics
   - Counties more stable than cities/townships with less variability in property value changes over time
2. Eight **urban communities** ranging in size from less than 5,000 to over 60,000 residents
   - Categorized as growing or declining
3. Eight **suburban communities** ranging from large cities to small townships
   - Based on proximity to major city
4. Six **exurb communities** with an economic or commuting connection to central city
   - Low housing density and high rates of development and population growth
5. Thirteen **rural communities** including one small city and 12 townships

The Great Recession

- 2007 to 2009 recession with ties to financial crisis surrounding real estate markets
  - Major economic downturn that impacted most local governments' finances
  - Led to a precipitous decline in property values
  - Unusual during a recession

- Our analysis looks at how tax limitations affected tax revenues in three periods:
  1. From the adoption of Proposal A in 1994 until the onset of the Great Recession in 2007
  2. As a result of the Great Recession
  3. In the period since property values started rising after the Great Recession (around 2012)

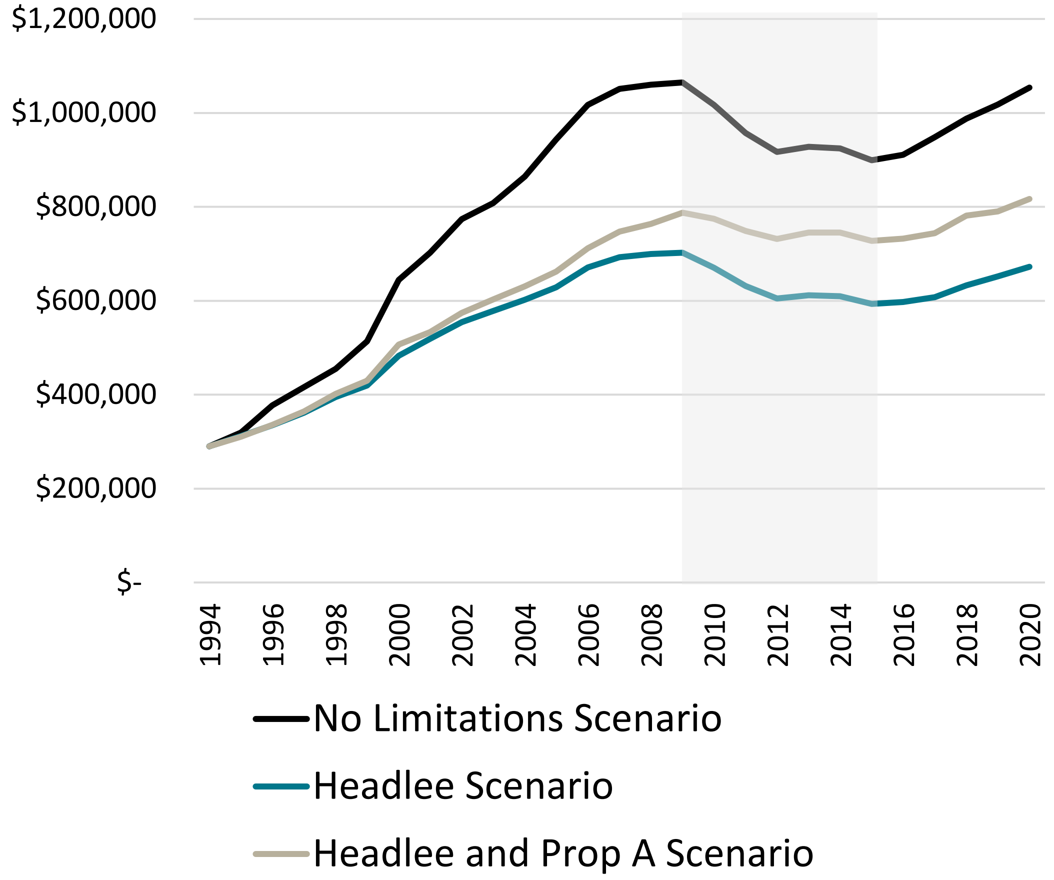
Property Tax Scenarios in Farmington Hills (Oakland County), 1994 to 2020



Source: Michigan Department of Treasury, SEV and TV data from reports L-4028 and L-4029 and Ad Valorem Tax Levy Reports

- Suburban community in SE Michigan
- Grew in population over time period
- Two tax limitation lines same until Great Recession
  - Revenues peaked in 2007/08 and reached lowest point in 2012
  - Revenue growth slower post-recession with limitations
- Revenues will not return to pre-recession levels for years with limitations

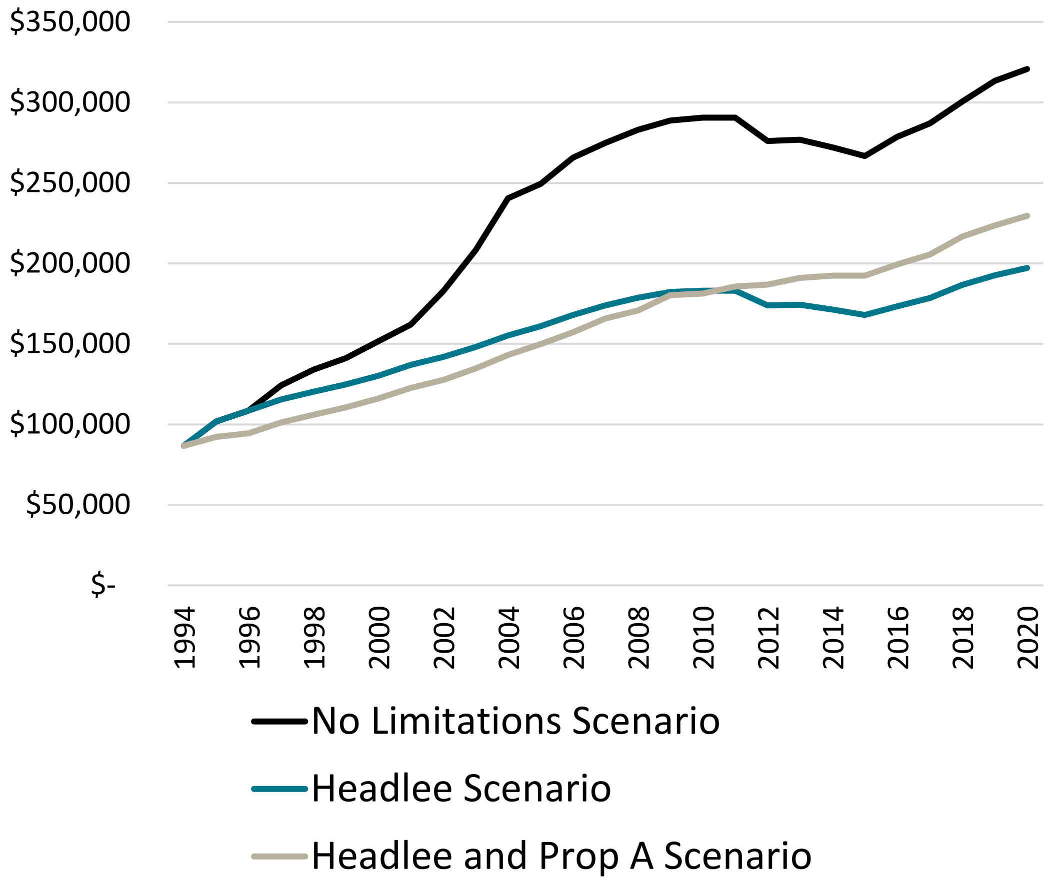
Property Tax Scenarios in Cambridge Township (Lenawee County), 1994 to 2020



Source: Michigan Department of Treasury, SEV and TV data from reports L-4028 and L-4029 and Ad Valorem Tax Levy Reports

- Exurb community
- All exurbs grew in population and have generally high median incomes
- Have enjoyed new development, which allows for tax revenue growth
- Revenues peaked in 2007/08 and reached low point in 2012
- Post-recession revenue growth slow, but faster than for suburbs

Property Tax Scenarios in Pickford Township (Chippewa County), 1994 to 2020



Source: Michigan Department of Treasury, SEV and TV data from reports L-4028 and L-4029 and Ad Valorem Tax Levy Reports

- Rural community
- Revenues higher with just Headlee prior to Great Recession
- Revenues higher with both limitations after recession
- Revenues never declined in scenario with both limitations
- Rural property does not change hands as often leading to less "pop ups" and tax rate rollbacks

Key Observations from Models

What is Good Tax Policy?

For Taxpayers

- Limits growth in tax burden
- Predictability
- Easily understandable process to determine property value and taxes owed
- Equity with other taxpayers

For Local Governments

- Adequate revenues that can grow with local economy
- Stable and predictable revenues
- Ability to minimize downside risk

Key to good tax policy is that it meets needs of both taxpayers and government

General Observations

- Tax limitation scenarios yield less revenue than no limitations scenario in all cases
- In almost all cases, the scenario with the combination of the Headlee Amendment and Proposal A tax limitations yields more revenue in recent years than the scenario with just the Headlee Amendment
  - Lessened tax rate rollbacks
  - Reservoir of taxable value
  - Mitigating effect on the Headlee Amendment limitation
- Annual growth rate post-recession slower than it was pre-recession
  - Relationship between appreciation of property values and tax revenues is diminishing
  - Most pronounced for rural communities

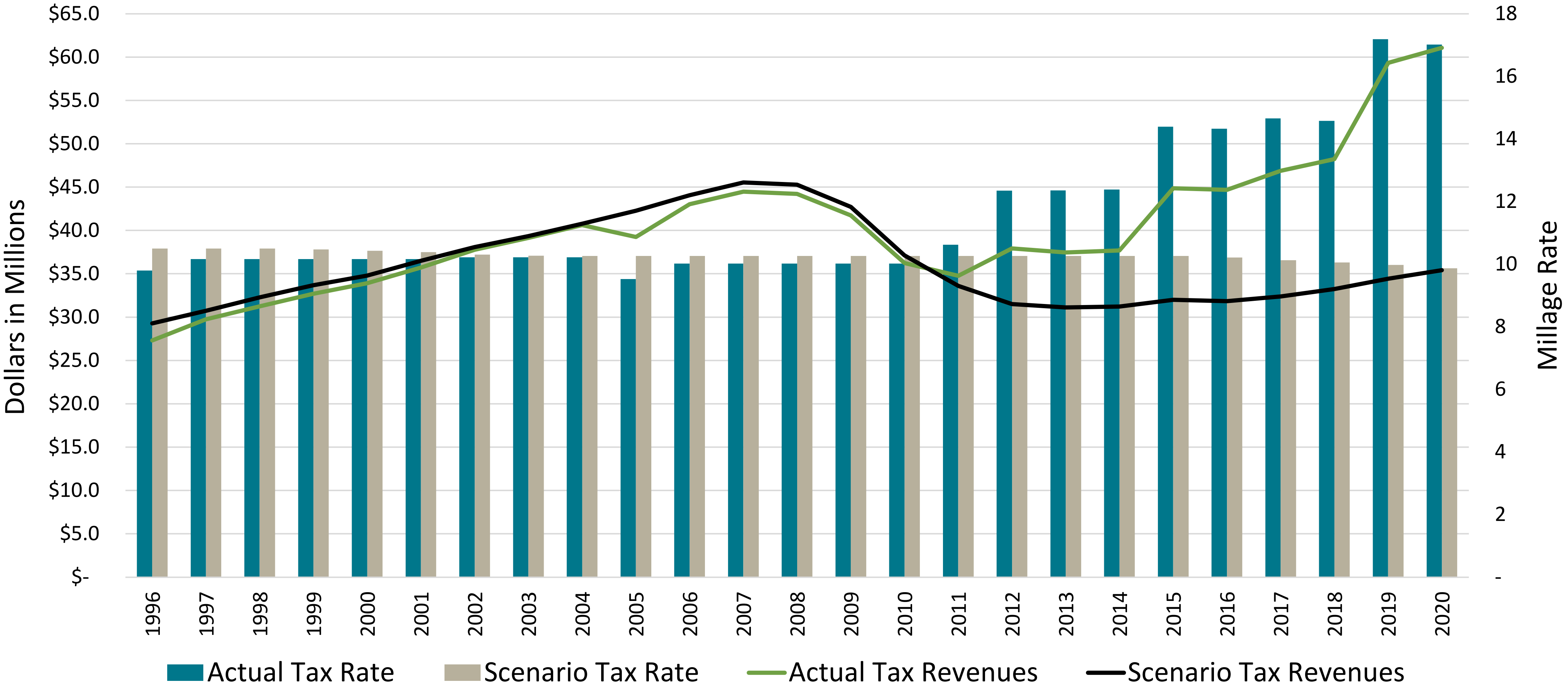
Great Recession was a Turning Point

- Without the Great Recession and its property value declines, numbers might look very different
  - Led to Headlee Amendment limitations being particularly severe
  - End of tax rate rollups enacted in 1993 had the strongest influence on limiting taxes
- Unique situation – only period in recent history that saw severe property value declines
- SEMCOG's study on property tax limitations found the effects of the Headlee Amendment were accelerated a hundred-fold during recession
- Proposal A served to mitigate some of impact of recession
- Should not base tax policy on rare events

Growth is Defined as New Development

- Limitations restrict local governments from increasing revenues beyond inflation for any reason except new development
- Does not reward revitalization or redevelopment of communities
- Encourages urban sprawl
- Unsustainable – land is finite

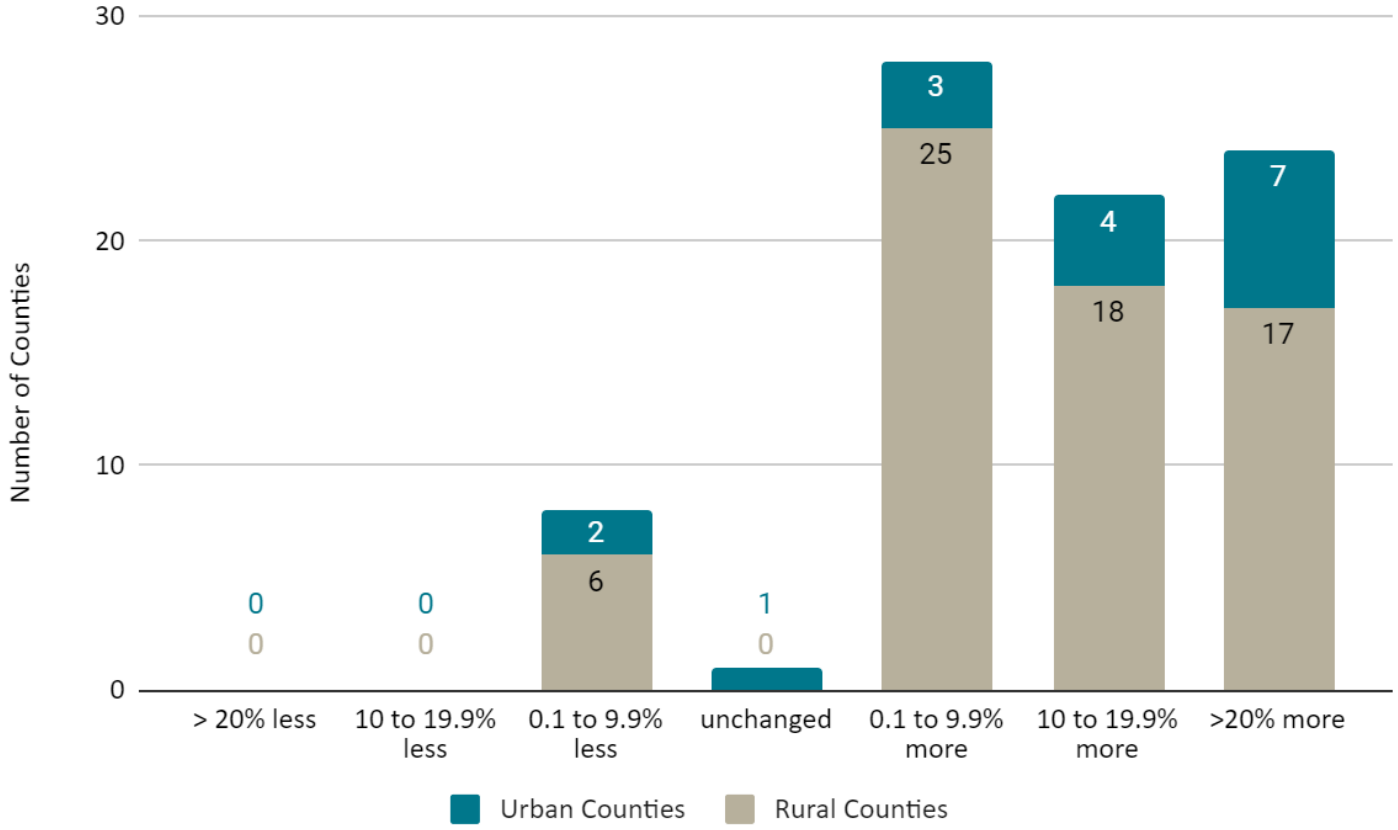
Actual Tax Rates and Revenues versus Scenario Tax Rates and Revenues in Farmington Hills, 1996 to 2020



Source: Michigan Department of Treasury, SEV and TV data from reports L-4028 and L-4029 and Ad Valorem Tax Levy Reports

Changes in County Tax Rates, 2004-2020

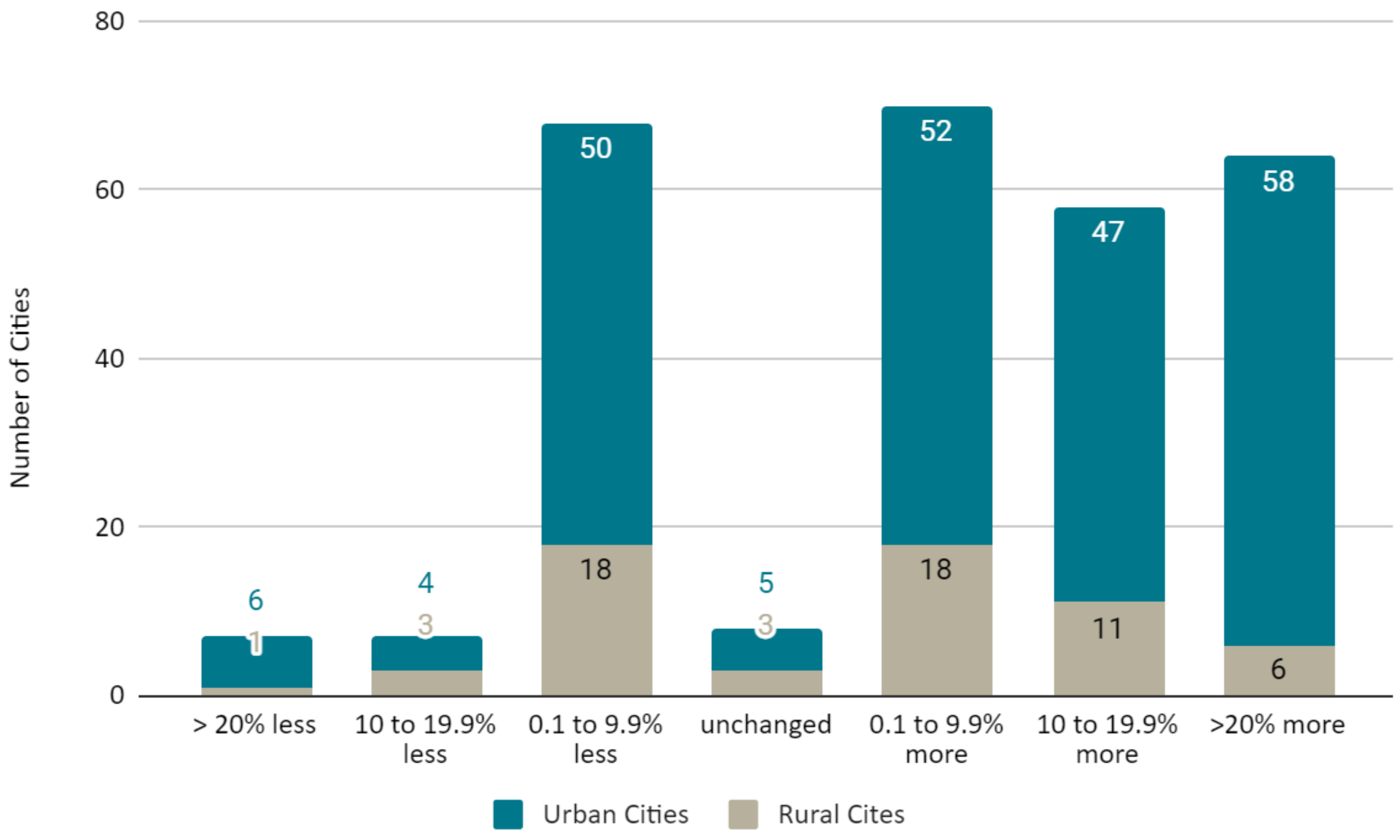
90% of counties have increased tax rates



Source: Michigan Department of Treasury Ad Valorem Tax Levy Reports

Changes in City Tax Rates, 2004-2020

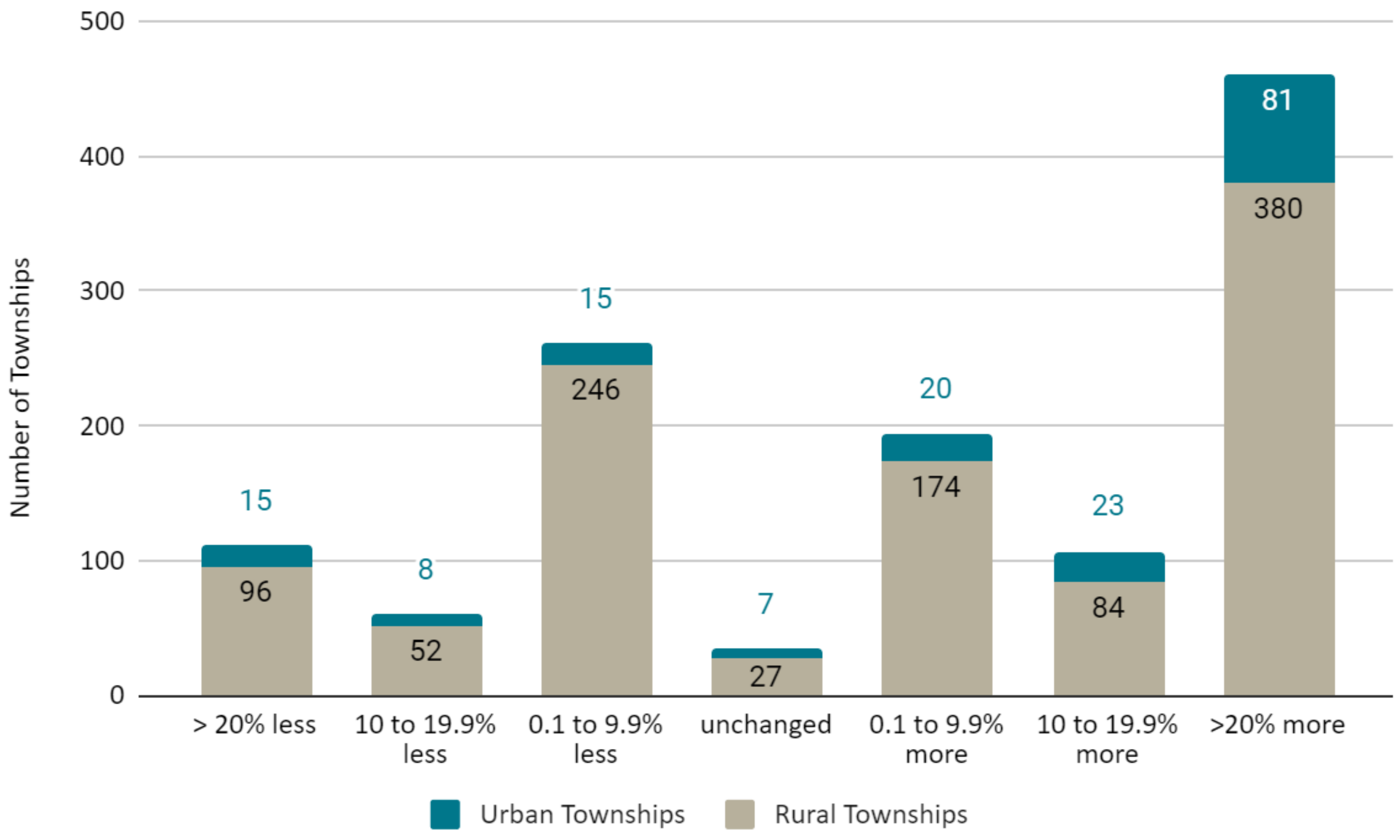
68% of cities have increased tax rates



Source: Michigan Department of Treasury Ad Valorem Tax Levy Reports

Changes in Township Tax Rates, 2004-2020

62% of townships have increased tax rates



Source: Michigan Department of Treasury Ad Valorem Tax Levy Reports

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