CITIZENS RESEARCH COUNCIL OF MICHIGAN

"The right to criticize government is also an obligation to know what you're talking about."

Lent Upson, First Director of the Citizens Research Council

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Detroit Should Strategically Manage Its Debt to Pursue Tax Reduction

In a Nutshell

- The City of Detroit's debt finance and property tax rate cuts should be coordinated.
- If the general operating millage cannot be lowered, the city should continue to endeavor to lower the debt service millage.
- Cost savings from lower than anticipated pension contributions means more General Fund resources are available for limited tax general obligation (LTGO) bonds that do not require property tax increases.

Under Detroit's Fiscal Year (FY)2024 adopted budget and FY2024–FY2027 four-year financial plan (passed April 28 and in effect July 1), the property tax levy dedicated to debt repayment is cut even as the city is scheduled to issue $100 million in bonds in July to finance blight remediation and other capital projects. The adopted fiscal plans lower the debt service levy to 8 mills from 9 mills and the city plans to cut another mill in FY2025. By the city's estimates, residents in houses with $50,000 in taxable value should see their property tax bill fall by $50 in FY2024 and another $50 in FY2025.

In Detroit, some of the state's poorest residents face high taxes, taxes that entice people to leave for nearby jurisdictions that levy lower taxes. Since bankruptcy, the general operating millage levied for basic services has stayed unchanged at 19.952 mills. The debt service millage on the other hand has moved up and down over the years, falling to its lowest rate of 7 mills in 2019. If the general operating millage cannot be lowered without sacrificing service quality, the city should continue to endeavor to lower the debt service millage.

Bonded debt and property tax rates

Detroit, like other municipalities, is authorized to levy property taxes for both general operations and to repay debts. To finance the basic services provided, the city levies 19.952 mills (a mill equals a dollar of tax for every $1,000 worth of property value), just under the state's 20-mill tax limit. In addition, the city currently levies 9 mills (not subject to the state's tax limit) to make principal and interest payments (debt service) on outstanding debt. In total, residents pay 28.952 mills in city property taxes for basic services and debt repayment, before accounting for the overlapping property tax levies of the school district, the county, and various public authorities.

Detroit's property tax rate is among the highest in the state. For comparison, the City of Wayne levies 14.7240 mills for general operations, the City of Grosse Pointe levies 11.1914 mills, and Canton Township levies 10.4 mills (including property taxes and special assessments for specific services, such as police and fire). Moreover, unlike Detroit, none of these jurisdictions levy an income tax to finance municipal services, which adds to the tax burden.

Still improving on service quality and with hefty pension payments in tow, Detroit may be unable to lower its general operating millage. However, as is illustrated by the property tax cut included in the FY2024 adopted

budget, it may be more feasible to provide tax relief by lowering the debt service levy. After falling to 7 mills in 2019, the debt service millage has increased as the city has issued more debt: the city issued $135 million in 2018, $80 million in 2020, and $175 million in 2021.

Unlimited tax general obligation (UTGO) bonds, the sort of debt to be issued in July, are backed by the debt service millage. The city is required by law and the terms of the bond contracts to collect property tax revenue sufficient to meet the annual principal and interest payments. That means the amount of UTGO debt directly relates to the debt service levy collected by the city.

Yet, in this instance the added debt has not caused a concomitant increase in the debt service levy. In fact, it will be cut and cut again in the fiscal year thereafter. Based on the most recent audited financial statements from FY2022, the city has $491.3 million in UTGO debt outstanding, and annual debt service is scheduled to decline. Debt service on what has already been issued will decline to $46.6 million in FY2025 from $54.9 million, and to $41.3 million for the next few fiscal years. If additional debt is incurred, beyond what is scheduled in July, the city should similarly try to avoid raising the debt service levy.

LTGO bonds and available resources

Like many cities, Detroit has many capital needs. Further public investment is needed and the upfront cost of those public investments will likely exceed what may be afforded by annual revenue, however. So the city will need to borrow.

UTGO debt and the allowed property tax levy in excess of the state's limit on the general operating millage has been important to the city's ability to incur debt and raise revenue to pay that debt off. The city is resource-constrained. It may not raise the income tax rate, and the current property tax rate abuts the state's tax limit. But as debt service on that UTGO debt is scheduled to diminish over the decade, city leaders are encouraged to reduce the debt service levy as well.

Limited tax general obligation (LTGO) bonds are, as the name would imply, limited in the property tax that may be levied to pay debt service. Unlike UTGO bonds for which there is a dedicated levy, the city must repay LTGO debt out of General Fund resources. Understandably, LTGO debt may be costlier in terms of the interest rate charged compared to UTGO debt; lenders expect a higher return on LTGO debt because it is not backed by a dedicated repayment source. Nonetheless, LTGO debt allows the city to borrow for capital projects, but will not increase the city's general property tax rate.

A recent development in the city's projected pension payment schedule provides the incremental General Fund resources needed to use LTGO debt rather than UTGO debt to address its capital needs. On Monday, the city won a case related to its bankruptcy settlement and restructured pension payments, the result of which is the liabilities attributable to the Police and Fire Retirement System (PFRS) will be paid down over 30 years rather than 20 years. Consequently, the estimated FY2024 contribution to PFRS will fall to approximately $70 million from $82 million. The $12 million in cost "saved," for example, may be used for LTGO debt amortization. If further General Fund costs may be reduced, the incremental resources provide space for more LTGO debt.

Conclusion

It is important that Detroit continues to reduce the property tax burden. Under current property tax rates, residents are squeezed, forced to choose between necessities and fidelity to the social contract. Understandably, many choose food and care for loved ones, at risk of losing the roof over their head to tax foreclosure (which has been a widespread problem in the city). Likewise, current property tax rates make commercial and industrial development unattractive without tax breaks. Since it is unlikely that the city will reduce the general operating millage, debt policy and tax policy should be coordinated so that the city may borrow to address capital needs and simultaneously reduce the debt service levy.

ABOUT THE AUTHOR

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