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Michigan's FY2015 Budget: Issues for Local Governments

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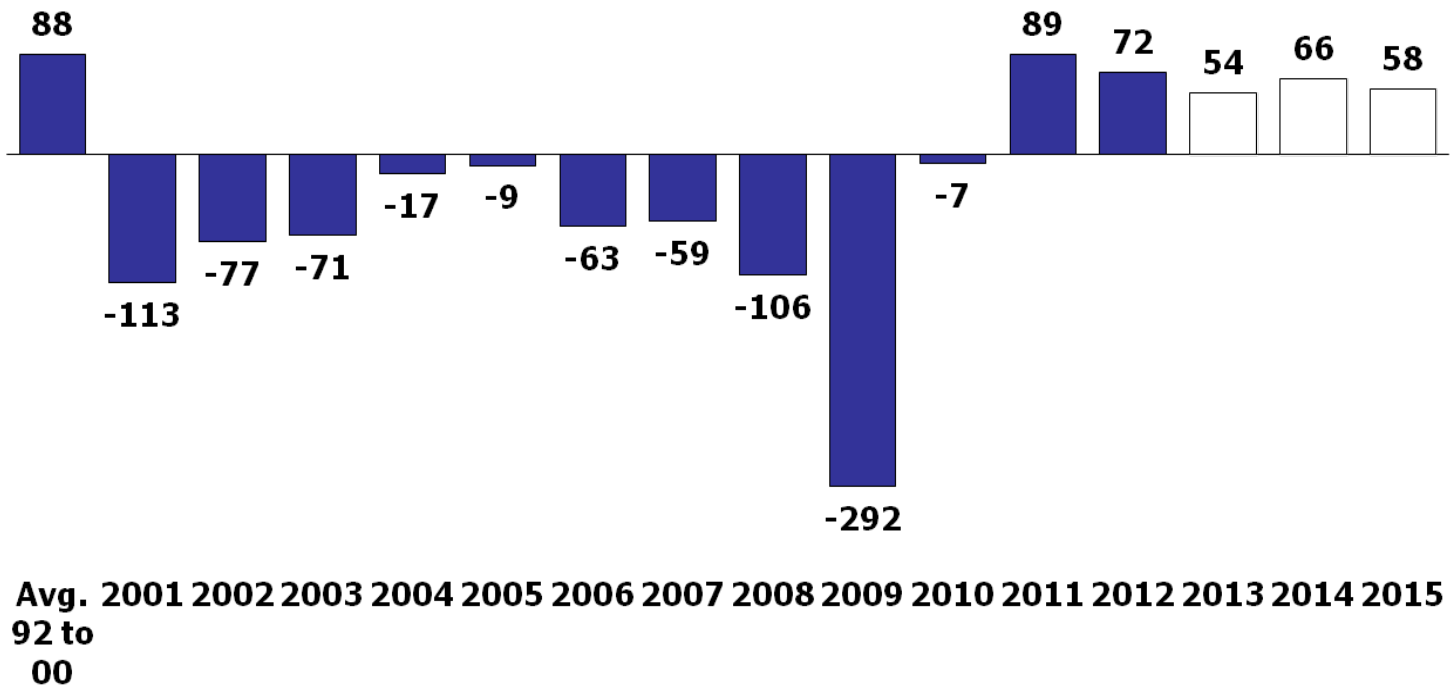
Outline

- Michigan's economy and revenues
- FY2015 Governor's budget: big picture
- Homestead property tax credit proposal
- Highlights of major changes
- Other legislative issues: personal property tax phase-out and local reimbursement
- Assessment of the proposal: impact of budget risks

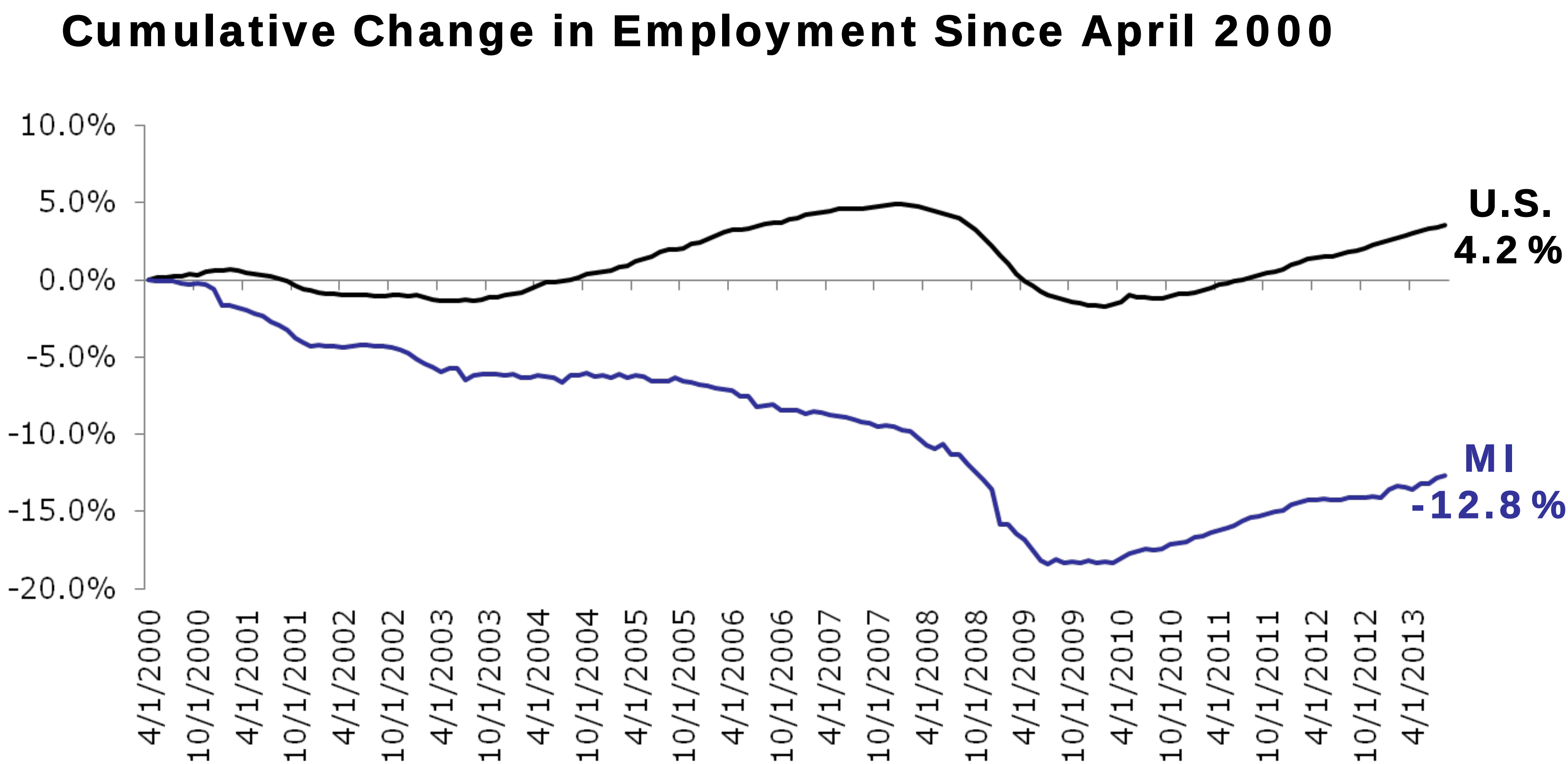
Michigan's Economic and Revenue Picture

Solid Job Growth Forecast For Michigan



Source: U.S. Bureau of Labor Statistics. January 2014 Consensus Conference.

Going Back to 2000 Michigan Trails U.S. By a Wide Margin



Source: U.S. Bureau of Labor Statistics and CRC Calculations.

Good News on Revenue Front: January Forecasts Predict Gains

January Revenue Projections: Gains from May Forecast

	FY2013	FY2014	FY2015	Total Gain
GF/GP	$373.6	$126.3	$206.2	$706.1
Percent Change	4.1%	1.3%	2.1%	
SAF	$56.0	$89.9	$119.1	$265.0
Percent Change	0.5%	0.8%	1.0%	
			Combined Gain:	**$971.1**

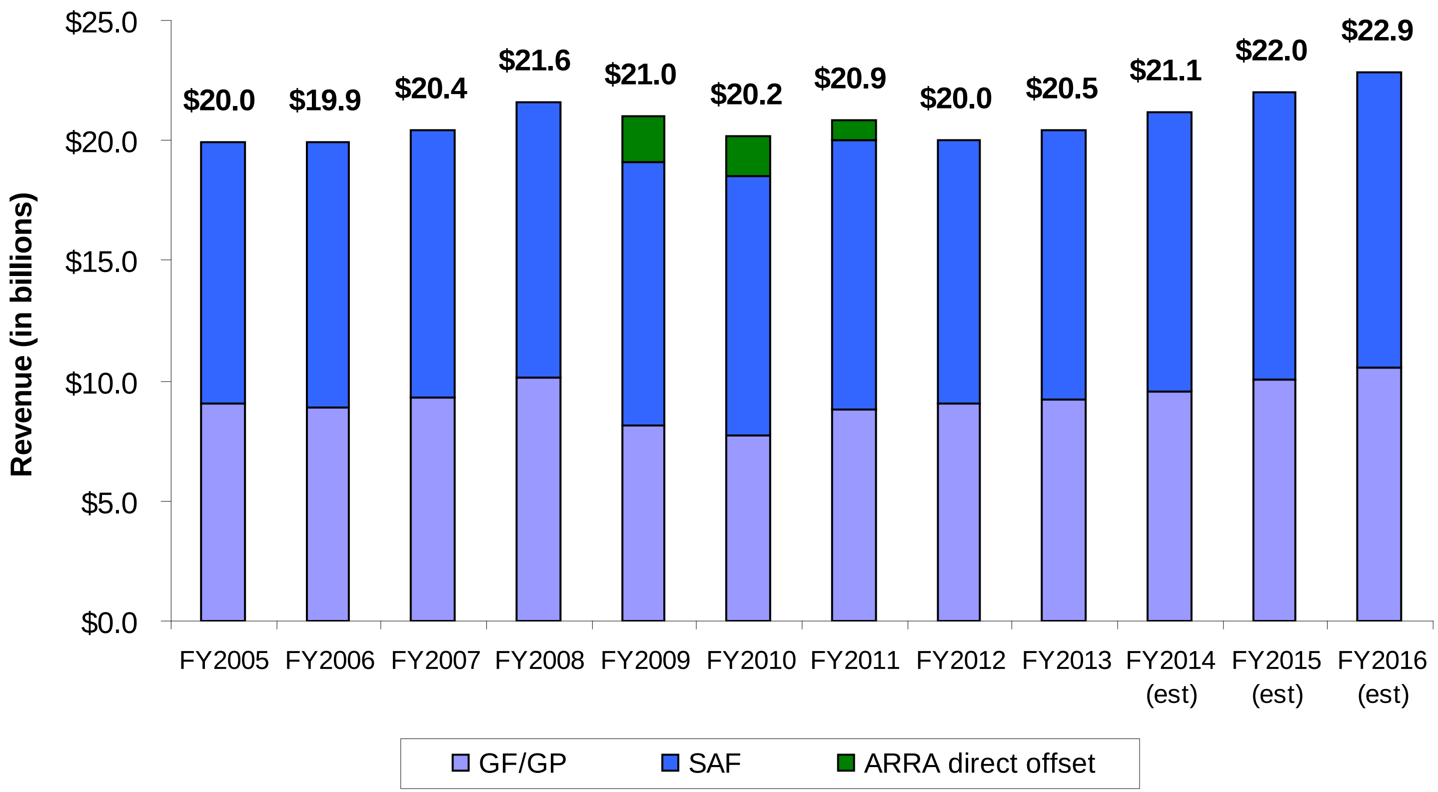
Revenues Going Forward

Uncertainty with Regard to Business Tax Revenue

FY2013 GF/GP REVENUE	May 2013 Estimate	Jan 2014 Estimate	Revenue Gain
Michigan Business Tax Credits	($490.0)	($75.8)	$414.2
Corporate Income Tax	$920.0	$783.1	($136.9)
Personal Income Tax	$5,843.9	$5,931.1	$87.2
Other Revenues	$2,915.3	$2,924.4	$9.1
		TOTAL GF/GP GAIN:	**$373.6**

Recent History of Major Revenue Funds

Forecasts Include Stable Revenue Growth



Source: Michigan Comprehensive Annual Financial Reports

Governor's Budget Recommendation: The Big Picture

Governor's Proposal

Ongoing and One-Time Funding Changes

- Overall budget increases by 2.1% to $51.3B
- Larger increase in general fund/general purpose (GF/GP) appropriations; up 7.1% to $9.8B
- "One-Time" GF/GP appropriations of $394M:
  - GF/GP support for roads increases from $121M in FY14 to $254M in FY15
  - Other one-time GF/GP designations decrease from $210M to $141M
- Rainy Day contributions continue: $120M to Budget Stabilization Fund and $122M to Health Savings Fund (Medicaid savings)

Governor's Proposal

Large Fund Balances Drawn Down During FY2015

	GF/GP		School Aid Fund	
	FY2015	FY2016	FY2015	FY2016
Beginning Balance	**$666.9**	**$41.2**	**$351.6**	**$84.2**
Revenues				
Consensus Revenue Estimates	$10,046.5	$10,535.6	$11,931.8	$12,338.2
Revenue Sharing Adjustment	($488.0)	($459.2)		
Tax Reforms (PPT, Homestead Credit)	($102.7)	($144.4)	($10.0)	($20.9)
Other Revenues/Adjustments	$4.0	$5.0	$2,006.2	$1,988.2
Total Adjusted Revenues	***$9,459.8***	***$9,937.0***	***$13,928.0***	***$14,305.5***
Expenditures				
Ongoing Appropriations	$9,449.0	$9,648.2	$13,478.8	$13,790.7
One-Time Transportation Allocation	$254.0			
Other One-Time Recommendations	$140.5	$23.3	$268.5	
BSF/Health Savings/MPSERS deposits	$242.0	$122.0	$50.0	
SAF: Higher Education			$398.1	$398.1
Total Expenditures	***$10,085.5***	***$9,793.5***	***$14,195.4***	***$14,188.8***
Ending Balance	**$41.2**	**$184.7**	**$84.2**	**$200.9**

All figures in millions

Homestead Property Tax Credit

Governor Proposes Expanded Eligibility for Credit

- Credit against the state income tax for households with property tax bills that are relatively high compared to household income
- Governor's proposal expands eligibility in two ways beginning in tax year 2013:
  - Household resources: cap raised from $50,000 to $60,000
  - Income threshold: credit would equal a portion of property tax payment minus 3.0% of household resources (down from 3.5%)
- Revenue impact: estimated at $102.7 million annually
- 2014 challenge: Reaching those not currently eligible for the credit who won't file for it on 2013 return

Homestead Property Tax Credit

Examples of Impact on Individual Filers

	Senior	Senior	Senior	General	General	General
Household Resources	$15,000	$35,000	$45,050	$40,000	$45,050	$55,500
Property Tax	$1,500	$2,200	$2,500	$2,500	$2,500	$2,500
Credit:						
Pre-2012	$975	$975	$923	$660	$554	$335
Current Law	$975	$585	$277	$660	$277	$0
Governor's Plan	$1,050	$690	$345	$780	$345	$100
Gain from Current Law	$75	$105	$68	$120	$68	$100
Gain/(Loss) from Pre-2012	$75	($285)	($579)	$120	($209)	($234)

- All current recipients under the $1,200 cap would gain under the proposed changes
- Some currently ineligible for the credit become eligible once again.
- Many lower income filers will be better off under the proposal than they were under the pre-2012 credit provisions because of the change in the income threshold from 3.5% to 3.0%; others will fall short of pre-2012 credit levels

Highlights of Major Changes

Transportation Funding

Governor proposes stop-gap funding for FY2015

- No proposal for permanent new road revenues; FY2014 proposal to raise motor fuel taxes and vehicle registration fees was not acted upon by the legislature
- Governor proposes one-time GF/GP appropriation of $254M to buffer current dedicated transportation revenues:
  - $139M to be used to match federal aid
  - $115M for state trunkline road and bridge needs (no PA 51 distribution to local road agencies)
- No proposal yet for GF/GP funding in FY2016

GF/GP Support for Transportation

Status of Current Funding

- Already appropriated for FY2014: $121M in GF/GP for roads and first installment ($115M) from Roads and Risks Reserve Fund
- House and Senate settled question on additional funding for FY2014 last Wednesday (SB 608):
  - $100M for winter road maintenance (through Act 51 formula)
  - $115M for priority road projects (unspent funds may be shared by state and local road agencies)
- Second installment ($115M) of Roads and Risks Reserve Fund remains unappropriated; may be used to fill Medicaid budget hole

Local Revenue Sharing

$121 Million in additional appropriations, but access will vary

- Constitutional payments (cities, villages, twps) up by 2.6% based on sales tax growth - $19.4M
- **Economic Vitality Incentive Program** (EVIP) increased by 3.2% for FY2015 - $7.6M (equals 78.5% of FY10 payment)
- New **one-time appropriation of $28.8M** would supplement funding for some EVIP-eligible communities
- **County revenue sharing** program increased by 44.9% ($65.4M) to allow for payments at full funding level; 80/20 split remains between regular and incentive funding
- Eligibility criteria for incentive-based funding is revised to include an **alternative path for eligibility**

EVIP and County Incentive Program:

Changes in Eligibility Criteria

- Old path to eligibility based on 3 categories remains in place; both paths limited to current EVIP-eligible units
- New path based on meeting four new standards:
  - **Budget reserve** – 6% unrestricted GF balance
  - **Pensions** – meet actuarially required contributions if DB plan exists; or no DB plan
  - **OPEB** - meet actuarially required contributions if OPEB offered; or no OPEB
  - **Bond / Credit Rating** – Either no outstanding GO debt, or achieve at least the following ratings with 2 of 3 agencies: Aa3 (Moody's), AA-(Fitch), or AA1(S&P)
- Units meeting new path requirements receive full EVIP/CIP payment if certified by October 1

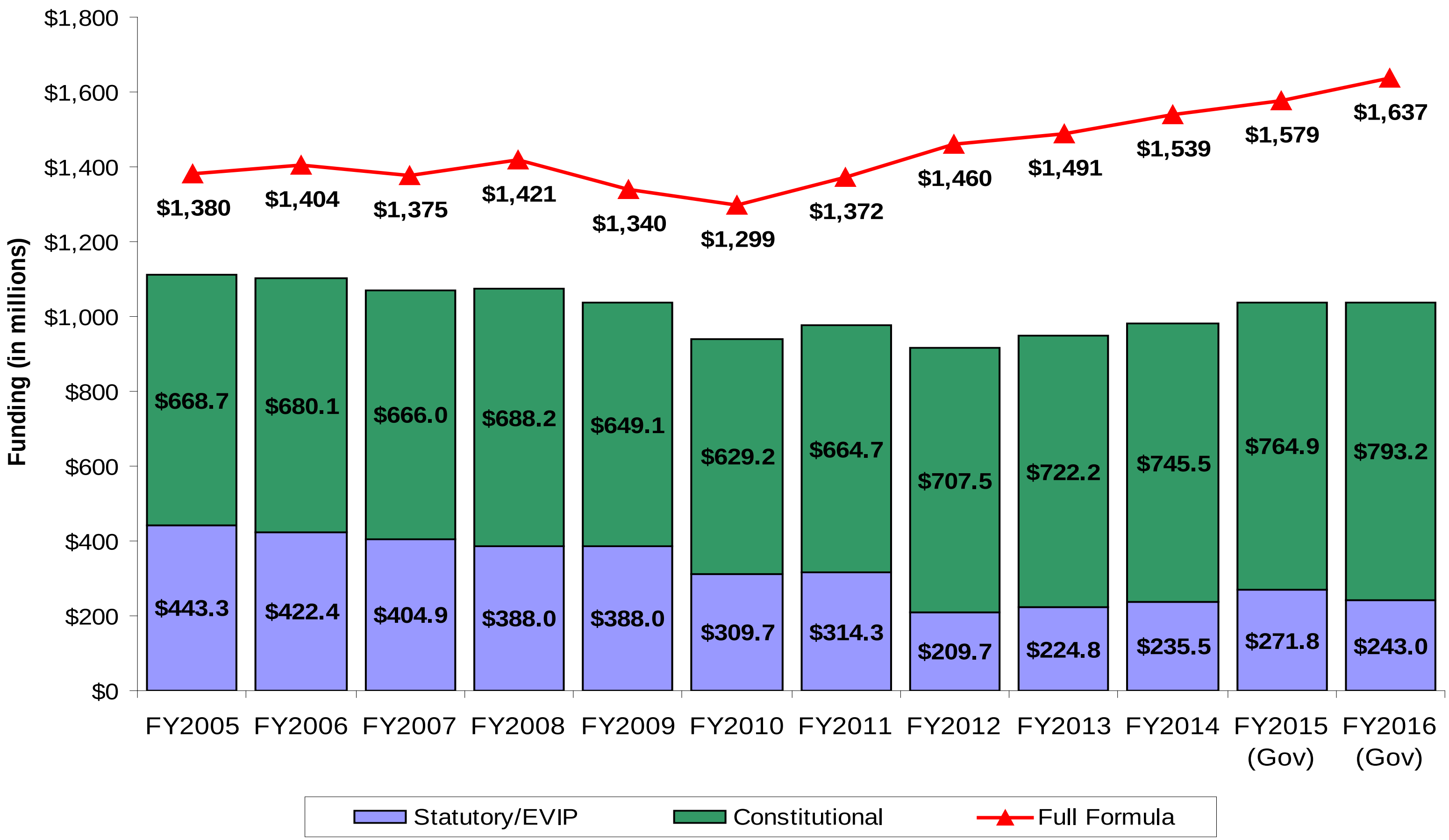
Supplemental EVIP Payments

$28.8 Million in One-Time Funding for Eligible Unit

- Funding limited to units that are currently EVIP eligible
- Distribution based on population, but units are eligible for 10% "population adjustments" for meeting any of the following criteria:
  - Meet "new path" requirements outlined above
  - Within top 25% of communities with 5,000+ population based on jobless rate
  - Within top 25% of communities with 20,000+ population based on violent crime rates
  - Have Treasury-approved deficit elimination plan
- In order to receive payment, unit must qualify for at least $5,000 in supplemental funding

Recent History of Revenue Sharing

Cities, Villages, and Townships – Payment vs. Formula



Funding Reserved for City of Detroit

$17.5 Million in Tobacco Settlement Revenue

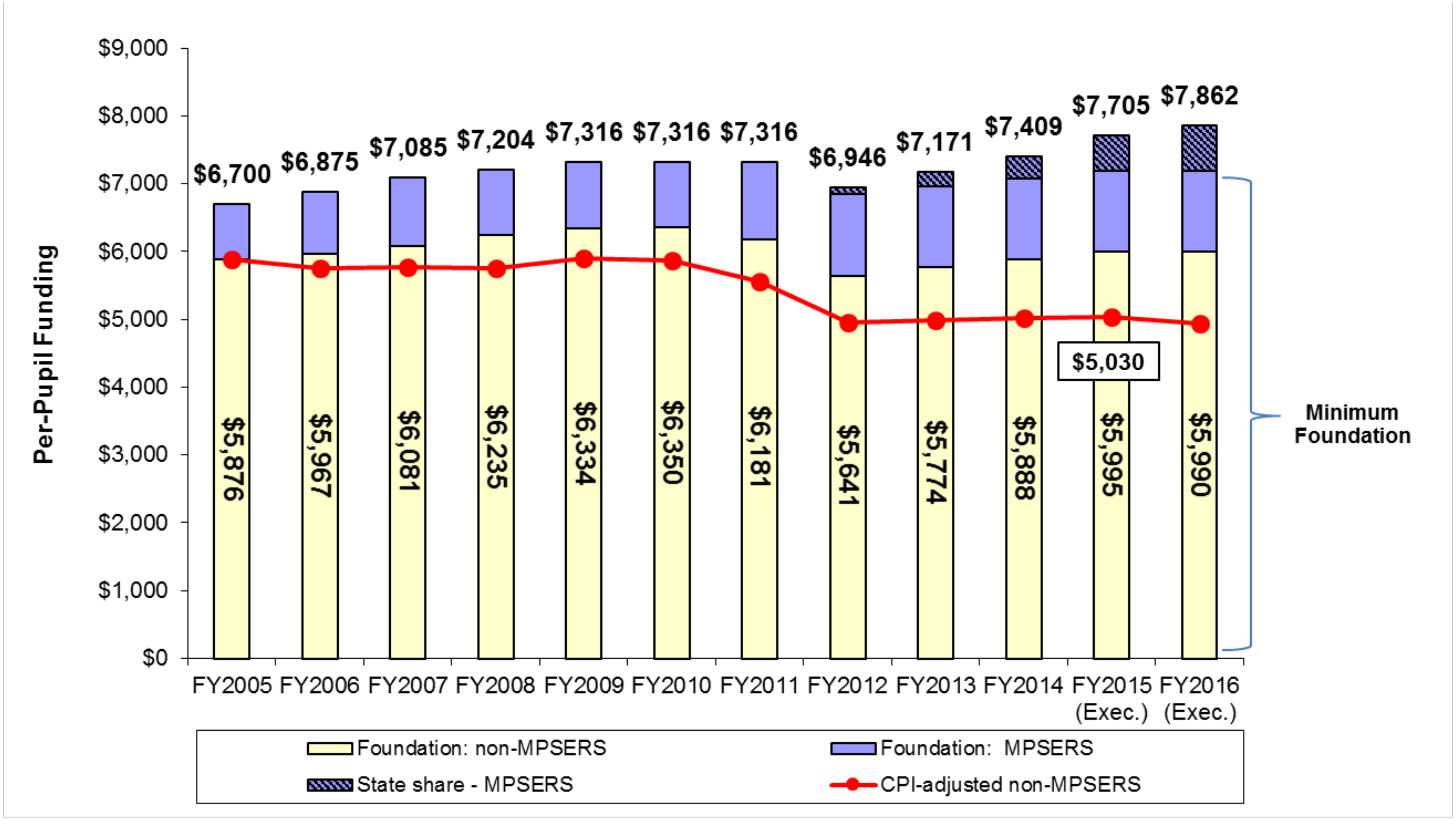
- Funding will come out of tobacco revenues to Michigan under settlement agreement with tobacco companies
- Budget impact: Tobacco dollars are used in the DCH budget to help finance Medicaid; additional allocation requires backfilling with GF/GP
- Indications are that commitment will continue over 20 year period
- No direct appropriation recommended yet; funding is simply reserved for future appropriation

K-12 School Aid

- Total appropriations up 3.2% from FY2014, but $268M is designated as one-time
- **Foundation grant** increase between $83 and $111 per pupil using a modified funding formula – $150M million
  - Minimum grant – increase from $7,076 to $7,187 per pupil
  - Maximum grant – increase from $8,049 to $8,132 per pupil
- Significant increase for **MPSERS unfunded liability costs** - $270M (note: add'l $234M required in FY2016)
- **Great Start Readiness Program** receives second consecutive $65M increase: available half-day slots would increase from 32,140 in FY2013 to 64,300 in FY2015

Effects of MPSERS Costs on Foundation Grant

Estimated Impact on Minimum Grant



Savings for Future Needs

- Planned FY2014 deposit of $140M into state's Budget Stabilization Fund adds to current $506M balance
- Proposal would deposit additional $120M in FY2015 to bring BSF balance to $766M by end of FY2015 – about 3.5% of combined GF/GP and SAF revenues
- Renews proposal to deposit one-half of Medicaid expansion savings to Health Savings Subfund: estimated deposits of $122 million in both FY2015 and FY2016

Personal Property Tax Reforms

Phase-out of PPT through 2023

- Small taxpayers: less than $80,000 in true cash value; effective tax year 2014
- "Eligible manufacturing personal property": eligible for industrial processing exemption under sales tax; tax phased out through 2023

Phase-in Schedule for Existing Eligible Personal Property

Year placed in service	Tax year 2016	2017	2018	2019	2020	2021	2022	2023
2005	☒	☒	☒	☒	☒	☒	☒	☒
2006		☒	☒	☒	☒	☒	☒	☒
2007			☒	☒	☒	☒	☒	☒
2008				☒	☒	☒	☒	☒
2009					☒	☒	☒	☒
2010						☒	☒	☒
2011							☒	☒
2012								☒
2013	☒	☒	☒	☒	☒	☒	☒	☒

☒ = exempt from personal property tax

Reimbursement to Local Units

Current Law Provides for Partial Reimbursement

- New Metropolitan Areas Metropolitan Authority would **levy a portion of the existing state use tax** as a new local tax beginning in FY2016
  - Revenue of $41.7M in FY16 growing to $362M in FY23; adjusted by Treasury annually thereafter
  - Distribution: 100% of school/ISD/community college revenue loss; remainder based on revenue losses related to “non-essential services”
  - “Non-essential services” distribution limited to local units with loss of at least 2.3% of total taxable value
- **Essential Services assessment**: local option to levy special assessment on real industrial and commercial property owned by businesses claiming manufacturing personal property exemption
  - “Essential” = police, fire, jail, ambulance services, equipment

Reimbursement to Local Units

Changes are Coming; Senate Bills 821 through 830

- **Use tax levy** for local reimbursement would be increased and levied by a renamed Local Community Stabilization Authority
  - Initial revenues of $96.1M in FY16 grow to $572.6M in FY28; 1% growth thereafter
  - No more loss threshold to qualify for reimbursement

- **State Essential Services Assessment** replaces local option; assessed on exempted C&I personal property at rate of 2.4 mills phased down to 0.9 mills as property ages

- Lt. Gov. Calley told House Committee last Tuesday that further changes are coming: **reimbursement formula based on actual loss**, rather than phase-in of industrial real property values

Summary of Reimbursement Proposals

Comparison of the Two Plans

Reimbursement provisions for small taxpayer (ST) loss and eligible manufacturing property (EM) loss under the two plans

	Current Law		Senate Bills	
	ST loss	EM loss	ST loss	EM loss
Schools/ISDs/Colleges				
Existing debt loss	100%	100%	100%	100%
Operating loss	100%	100%	100%	100%
Cities/Villages/Townships				
"Essential" services	none	~100%*	none	~100%
Loss for other services	none	~80% X	none	~100%

* = 100% reimbursement assumes implementation of maximum local levy
X = requires minimum loss of 2.3% of total taxable value

August 2014 Ballot Question

Everything (phase-out, use tax changes, reimbursement) remains contingent upon public affirmation of the changes to the use tax allocation in August 2014.

Assessment of Governor's Budget Proposal

Budget Risks Pose Challenges

The Impact of "What Ifs" in Out Years

- Transportation Funding: If no permanent road funding solution is achieved, GF/GP contributions may continue to be needed to fill gaps
- Health Insurance Claims Assessment: Shortfall in Medicaid budget will persist without either a revenue fix or offsetting cuts
- Personal Property Tax Reforms: if approved by voters, GF/GP impacts escalate in out years
- Inflation: even a continuation budget will incur inflationary costs

GF/GP Going Forward

Transportation and HICA bring potential deficits

	FY2014	FY 2015	FY 2016	FY 2017	FY 2018
Beginning Balance	**$1,186.6**	**$571.5**	**($174.1)**	**($420.7)**	**($712.8)**
Revenues					
Estimated Available Revenues	$9,175.3	$9,562.5	$10,081.4	$10,457.3	$10,850.7
Homestead Property Tax Credit adjustment		($102.7)	($102.7)	($102.7)	($102.7)
Personal Property Tax Reforms		($19.9)	($87.8)	($349.5)	($373.7)
Total Adjusted Revenues	***$9,175.3***	***$9,439.9***	***$9,890.9***	***$10,005.1***	***$10,374.3***
Expenditures					
GF/GP Appropriations	$9,500.4	$9,589.5	$9,671.5	$9,648.2	$9,841.2
BSF/Health Savings Contributions	$75.0	$242.0	$122.0	$122.0	$122.0
Budget Pressures					
GF/GP Need for Roads	$215.0	$254.0	**$254.0**	**$254.0**	**$254.0**
GF/GP Need for HICA Shortfall		**$100.0**	**$90.0**	**$80.0**	**$70.0**
2% Adjustment in FY17 and FY18				$193.0	$196.8
Total Projected Expenditures	***$9,790.4***	***$10,185.5***	***$10,137.5***	***$10,297.2***	***$10,484.0***
Ending Balance with Pressues	**$571.5**	**($174.1)**	**($420.7)**	**($712.8)**	**($822.5)**
Ending Balance with 2% Only	***$571.5***	***($74.1)***	***$23.3***	***$65.2***	***$279.5***

All figures in millions

Note: FY2017 and FY2018 revenue estimates based on long-run estimates from January 2014 Consensus Revenue Estimating Conference.

Assessment

- Budget is structurally balanced, but challenges remain
- Any budget surplus has largely been accounted for in the short run; little “excess revenues” to spend or give back without offsetting spending cuts or revenue growth
- Continues to build up reserves in both BSF and new Health Savings Subfund, but additional deposits will be needed to achieve goal of 6-8% of revenues
- Looking forward, if economy and revenues cooperate, picture looks much brighter in FY2018 and beyond

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 35

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