



Michigan's Broken Model of Municipal Finance

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Citizens Research Council of Michigan

www.crcmich.org

Citizens Research Council

- Founded in 1916
- Statewide
- Non-partisan
- Private not-for-profit
- Promotes sound policy for state and local governments through factual research – accurate, independent and objective
- Relies on charitable contributions from Michigan foundations, businesses, and individuals
- *www.crcmich.org*

Eric Lupher, President of Citizens Research Council of Michigan



- 30 years with Citizens Research Council
- Expert on Michigan local government, including
 - intergovernmental cooperation
 - governance issues
 - municipal finance
- Also has researched such issues as
 - state taxes
 - state revenue sharing
 - highway funding
 - unemployment insurance
 - economic development incentives
 - stadium funding

Michigan Local Government

Numbers

Structures

Issues

Michigan Local Government

General-Purpose v Special-Purpose

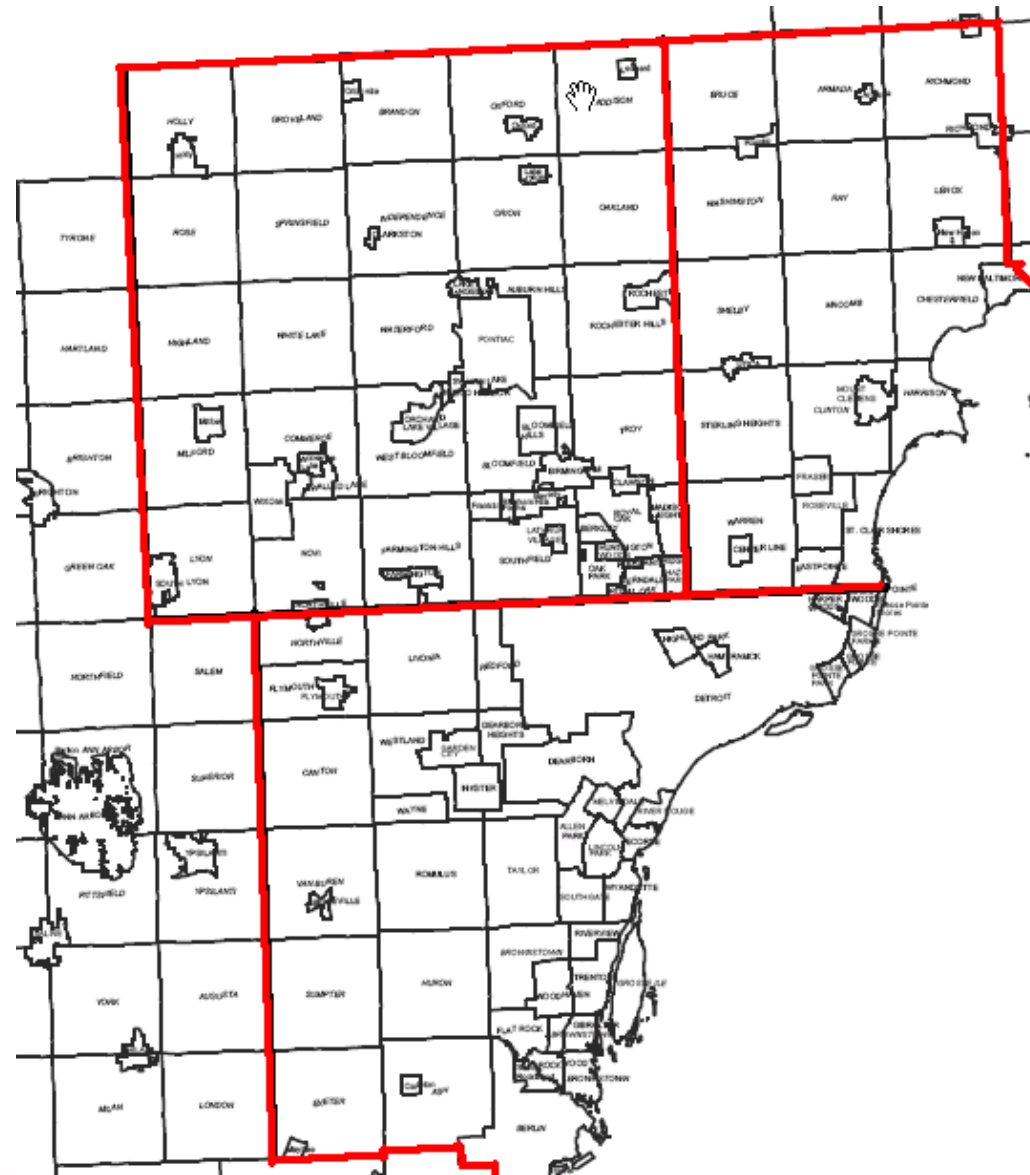
- General Purpose – Authorized to provide a broad range of government services
 - Counties
 - Cities
 - Villages
 - Townships
- Special Purpose – Authorized to provide a single government service
 - School Districts (K12, ISDs, Comm Coll)
 - Special Authorities/Districts

Michigan Local Government: General Purpose

Counties		83
Townships		1,241
Cities	276	
Villages	<u>259</u>	
Sub-total Cities and Villages		<u>535</u>
Total General Purpose Units		1,859

Michigan Local Government Geographic Structure

- Based on:
 - Need for towns in horse and buggy days
 - Artifact of survey of counties to create townships
 - Very few consolidations of units of local government



Michigan Local Government: Special Purpose

Education

School Districts (K-12 + charter)	~800	
Intermediate School Districts	57	
Community College Districts	<u>28</u>	
Sub-total Education		875
Special Authorities (as of 2002)		<u>366</u>
Total		1,231

Duplicative Services

	State	Counties	Cities	Villages	Townships	Spec Auth	Schools
Parks and Rec	X	X	X	X	X	X	X
Libraries	X	X	X	X	X	X	X
Roads and Bridges	X	X	X	X	X*		
Water		X	X	X	X	X	
Sewerage	*	X	X	X	X	X	
Police Protection	X	X	X	X	X		
Mass Transit	*	X	X		*	X	
Refuse Collection		X	X	X	X	X	
Fire Protection			X	X	X	X	
Corrections	X	X	X				

Duplicative Functions

- Accounting
- Tax Collection
- Elections
- Property Assessing
- Computers
- Vehicle Maintenance
- Purchasing
- Building Inspection
- Records and Archives
- Human Resources
- Legal Services
- Zoning and Planning
- Permits

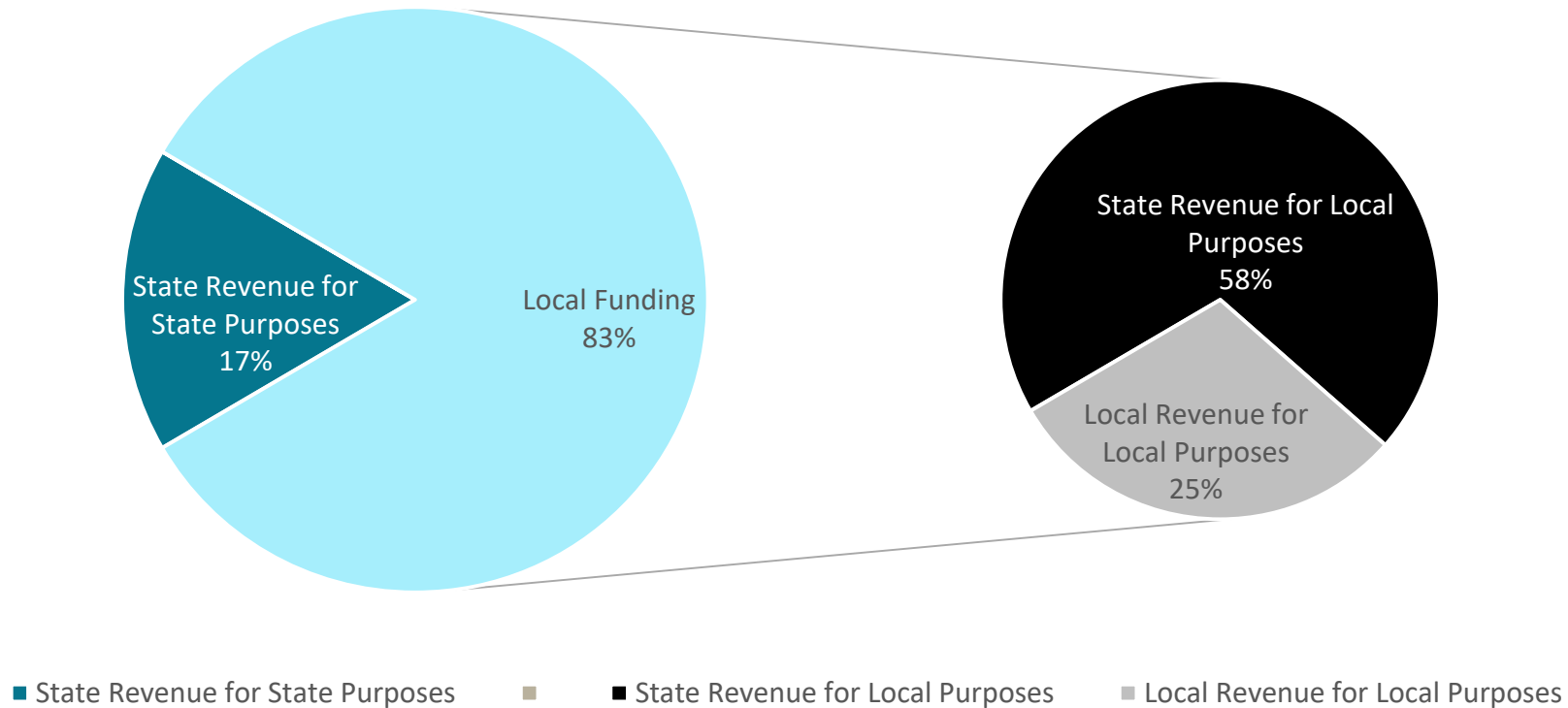
Big Picture Issues

Big Picture #1

- The state of Michigan is the architect of the local finance system
 - Constitution
 - Statutes / Administrative Rules
- The structure is flawed and makes the financial management of local governments very difficult

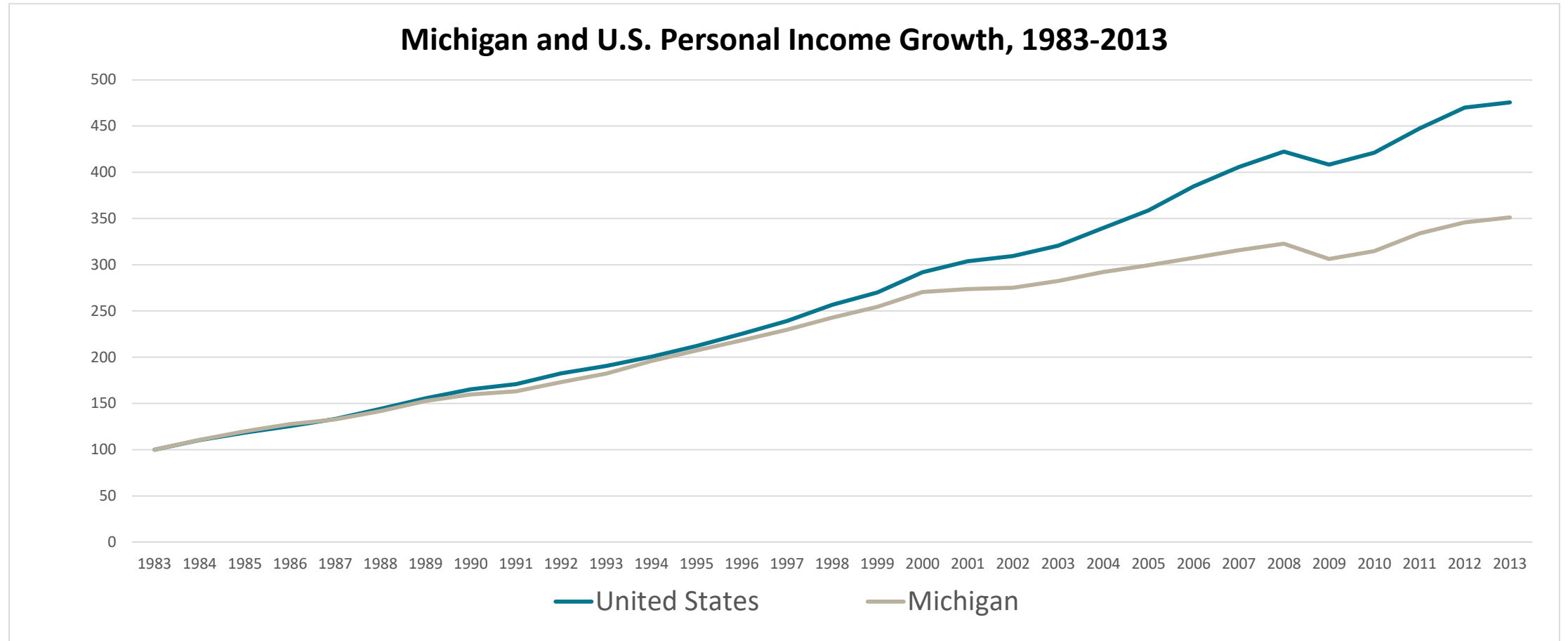
Big Picture #2: System of dependence

Use of Michigan Tax Revenues



Big Picture #3:

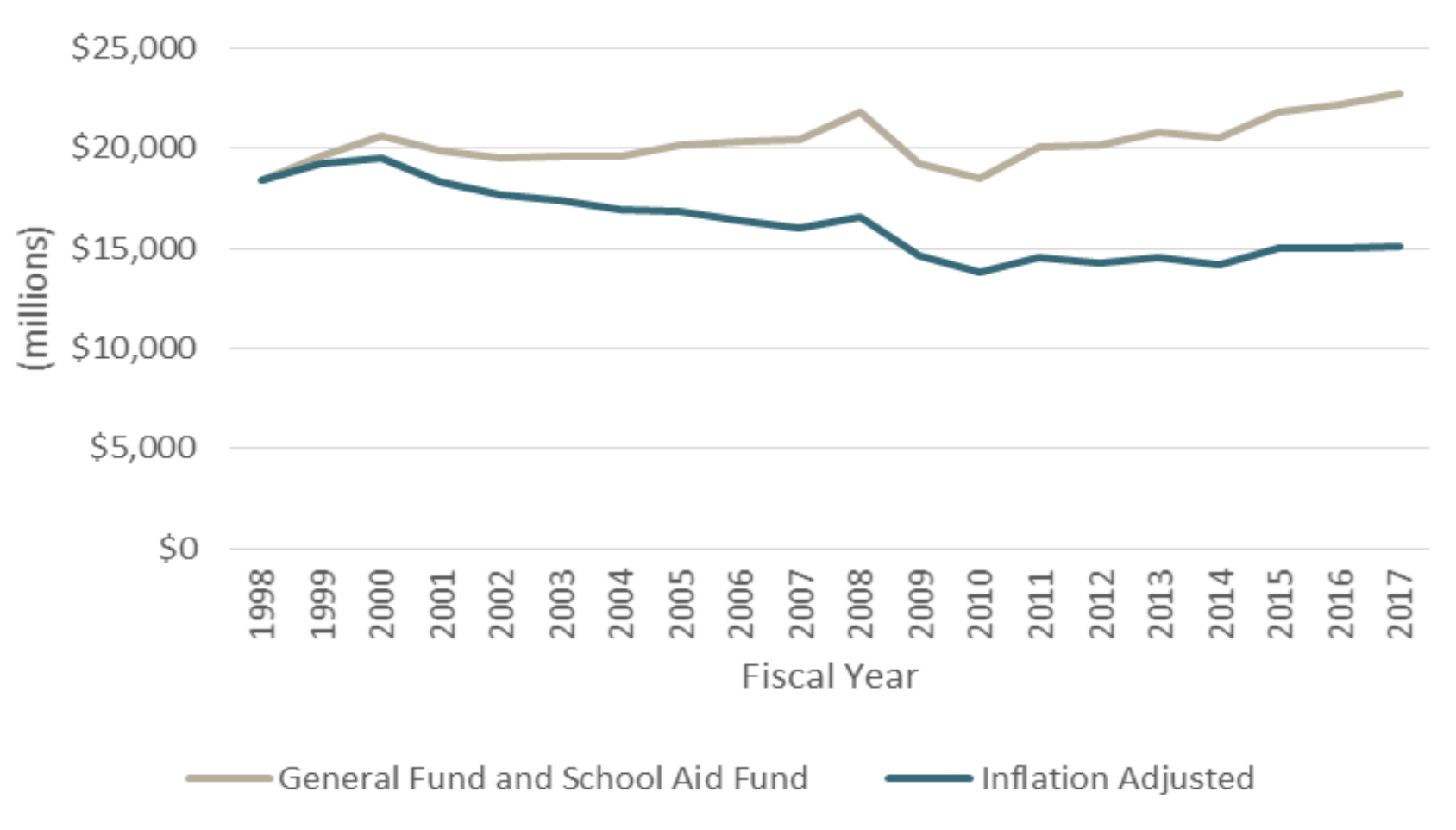
Michigan economy growing at a pace slower than rest of the nation



Michigan Total State and Local Government Tax Collections as Percent of U.S. Average

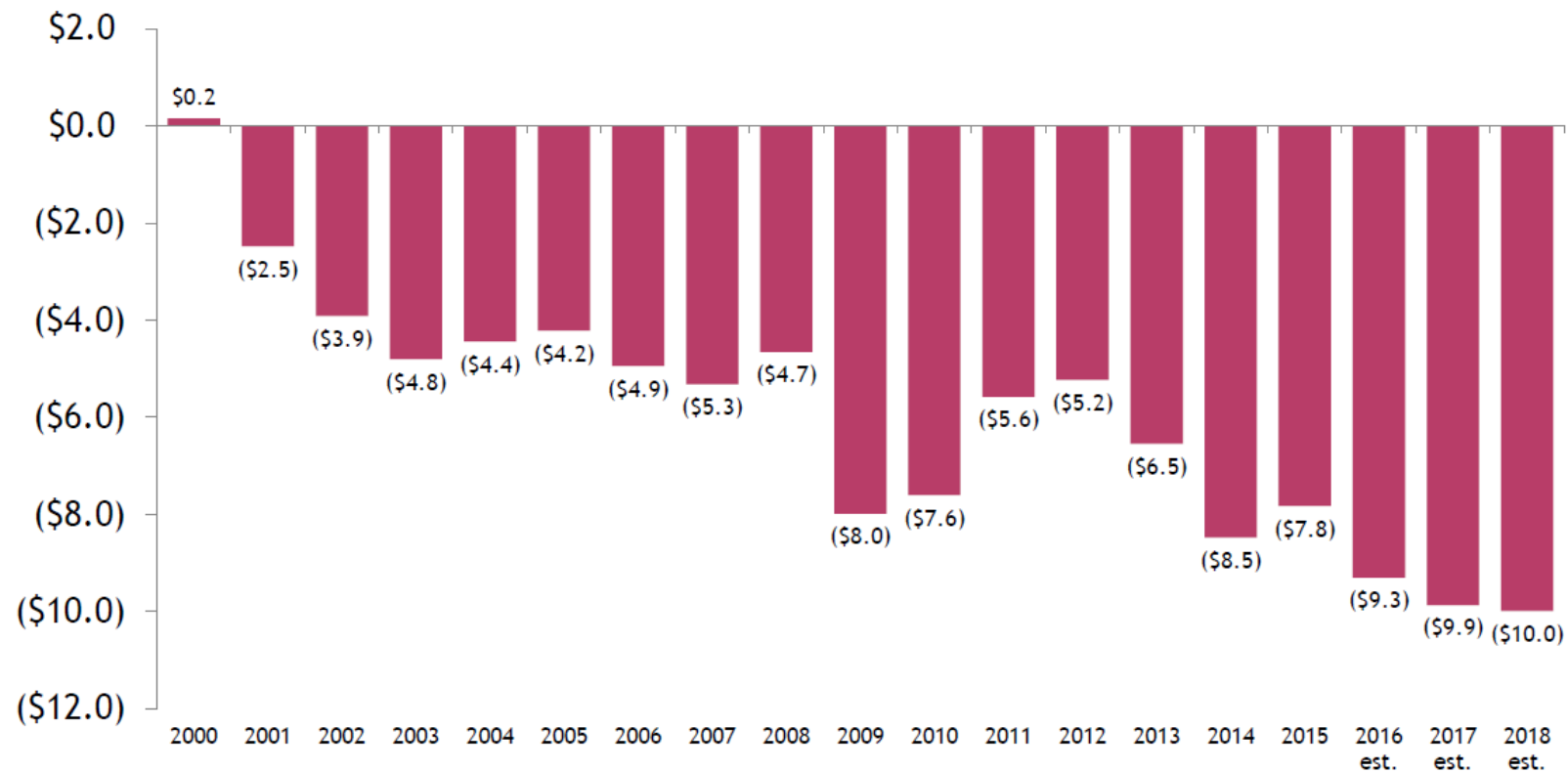
Year	<u>Per Capita</u>				<u>Per \$1,000 Personal Income</u>			
	<u>U.S. Amount</u>	<u>Michigan Amount</u>	<u>Michigan as Percent of U.S. Average</u>	<u>Michigan's Rank</u>	<u>U.S. Amount</u>	<u>Michigan Amount</u>	<u>Michigan as Percent of U.S. Average</u>	<u>Michigan's Rank</u>
1983	\$2,847.39	\$3,212.94	112.8%	12	\$ 96.21	\$ 112.52	117.0%	9
1993	\$3,686.09	\$3,784.57	102.7	14	\$ 105.38	\$ 111.23	105.6%	13
2004*	\$4,256.42	\$4,106.14	96.5	25	\$ 58.76	\$ 103.73	176.5%	17
2008	\$4,730.93	\$4,095.54	86.6	30	\$ 106.43	\$ 105.65	99.3%	19
2012	\$4,483.10	\$3,718.91	83.0	34	\$ 99.82	\$ 94.83	95.0%	32
2013	\$4,598.77	\$3,750.40	81.6	35	\$ 103.49	\$ 95.68	92.5	34
Sources: Population data are from intercensal estimates by the U.S. Census Bureau obtained from the U.S. Bureau of Economic Analysis. Personal income data are from the U.S. Bureau of Economic Analysis.								
Per capita amounts have been adjusted to 2013 dollars using the calendar year U.S. CPI-U.								

State revenues have not recovered from the last recessions



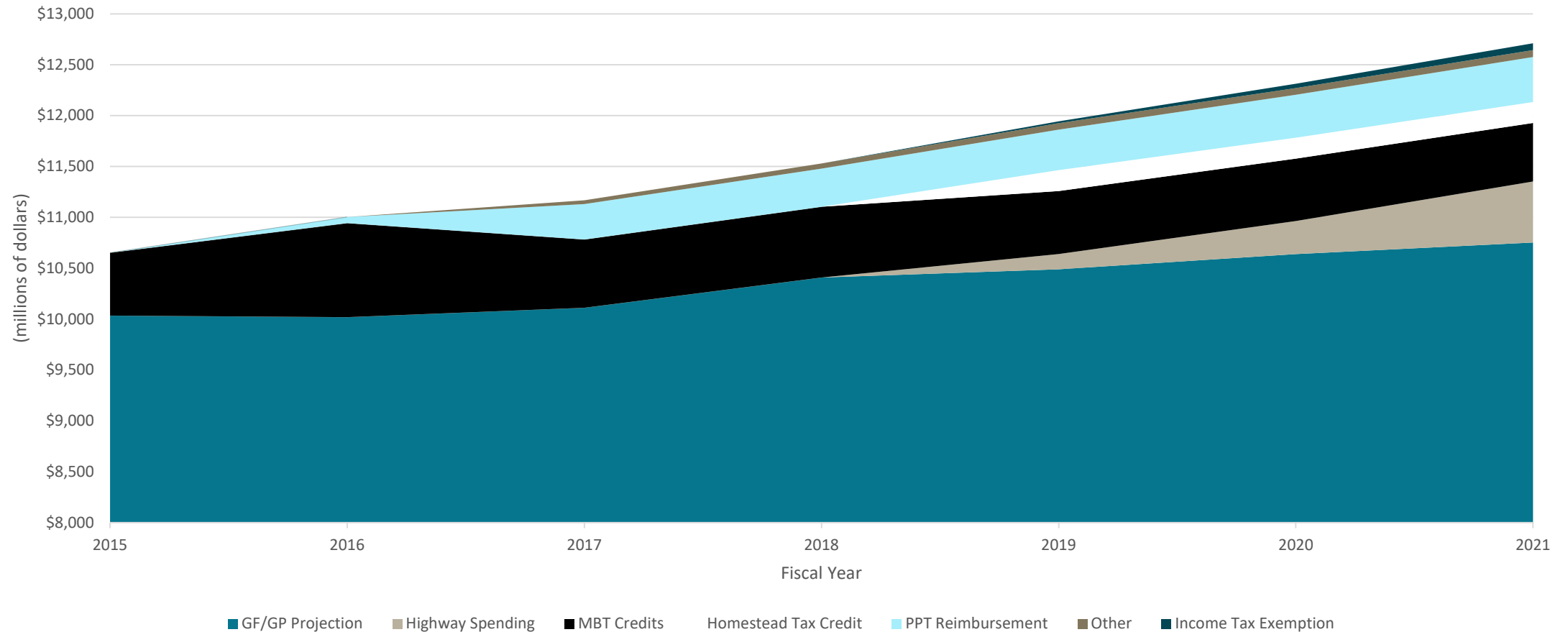
State taxes have not been keeping pace with the economy

By 2018 Total State Revenues \$10 Billion Under Limit



Revenue Outlook

Projected General Fund Revenue and Diversions, FY2015-FY2021



Sources: Senate Fiscal Agency, House Fiscal Agency, and the CREC

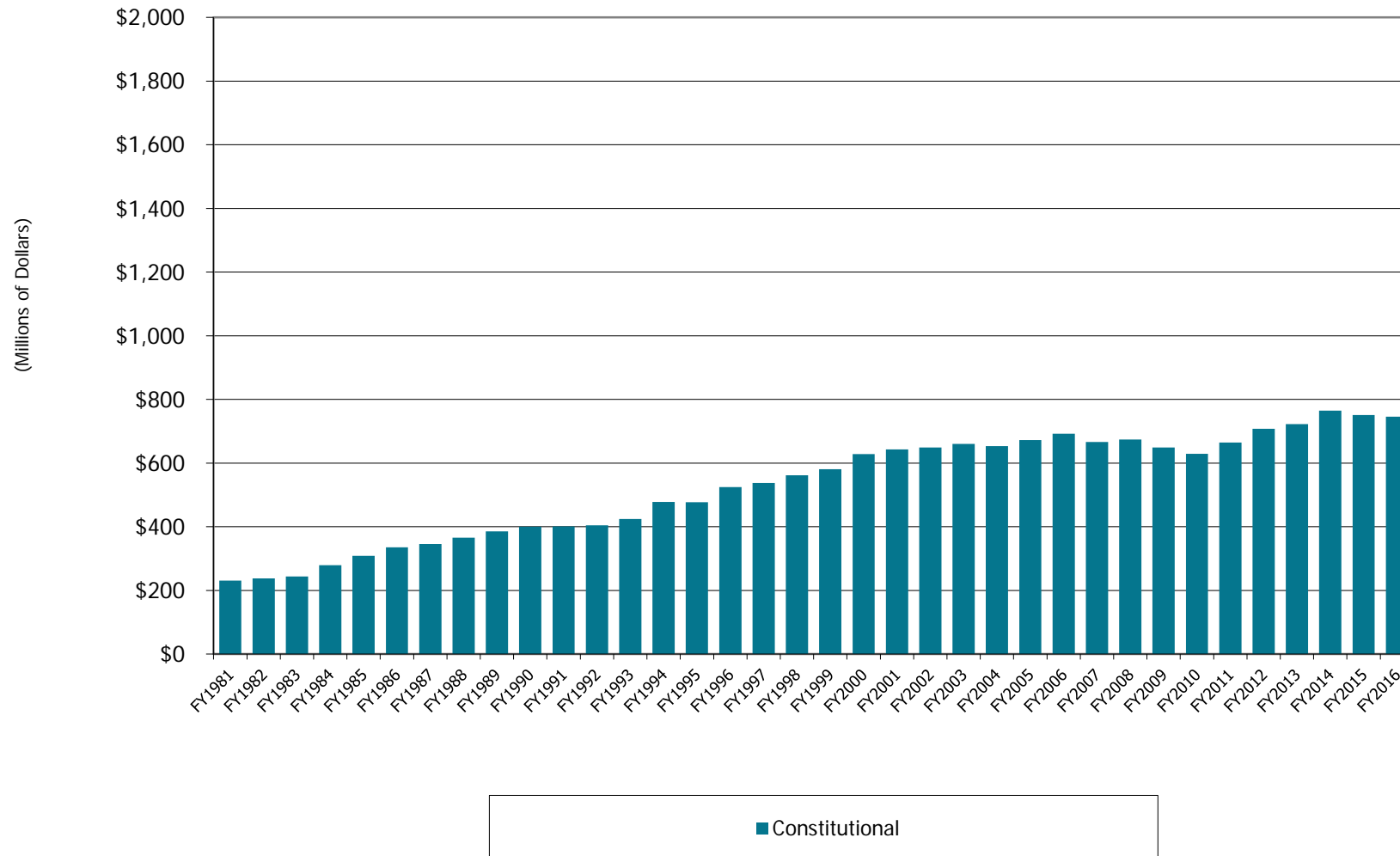
State Funding is not forthcoming

- Unfunded Mandates
- Revenue Sharing
- Meeting Constitutional Requirements

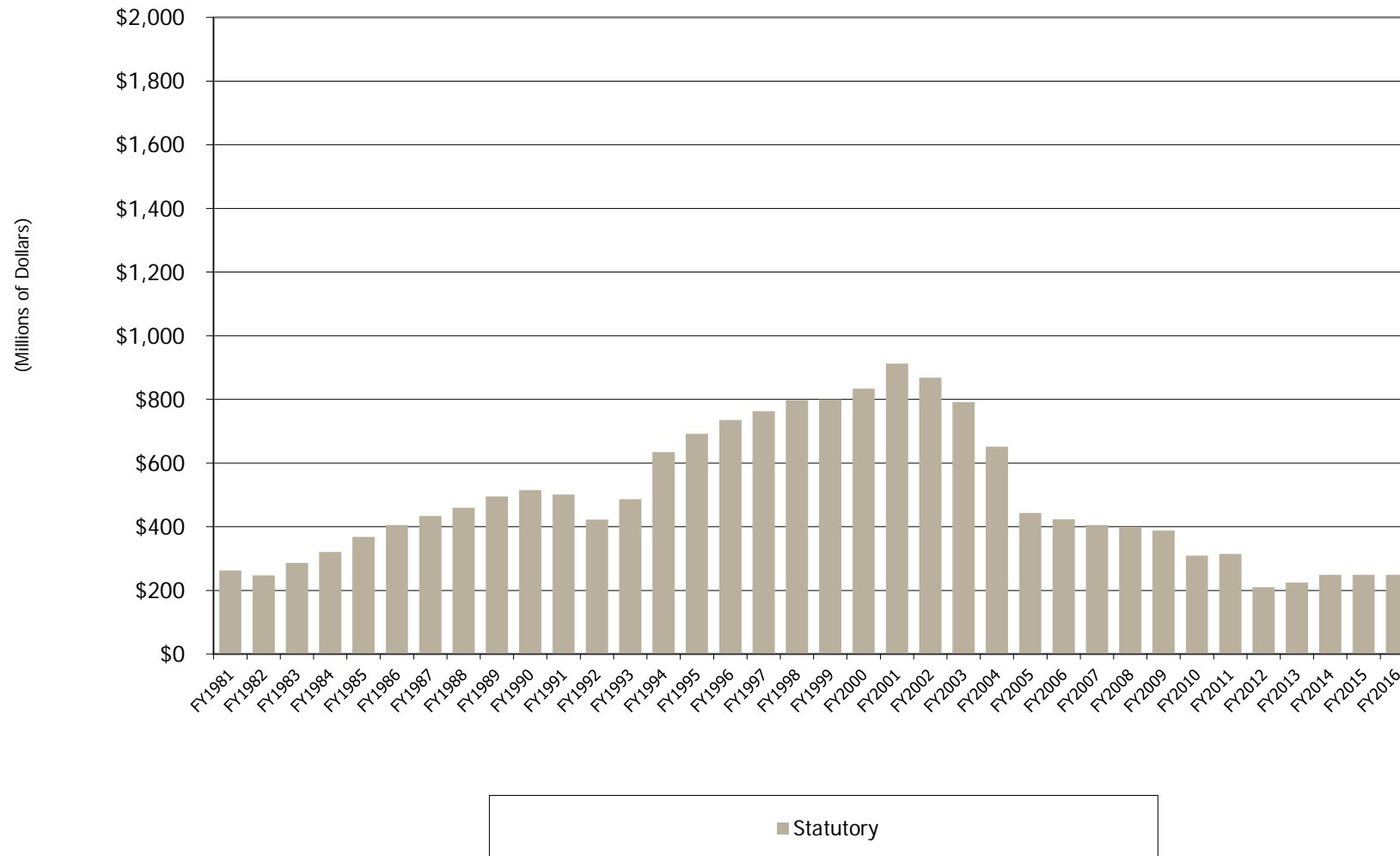
State Revenue Sharing

- 2 paths to sharing state revenues
 - Reimburse local governments for foregone revenues
 - Aid to local governments that suffer with inadequate fiscal capacity
- Long-term history
 - Reimbursement without relation to those foregoing the loss (except PPT)
 - Aid has been per capita and then based on revenue raising abilities
- Recent history
- Budget realities

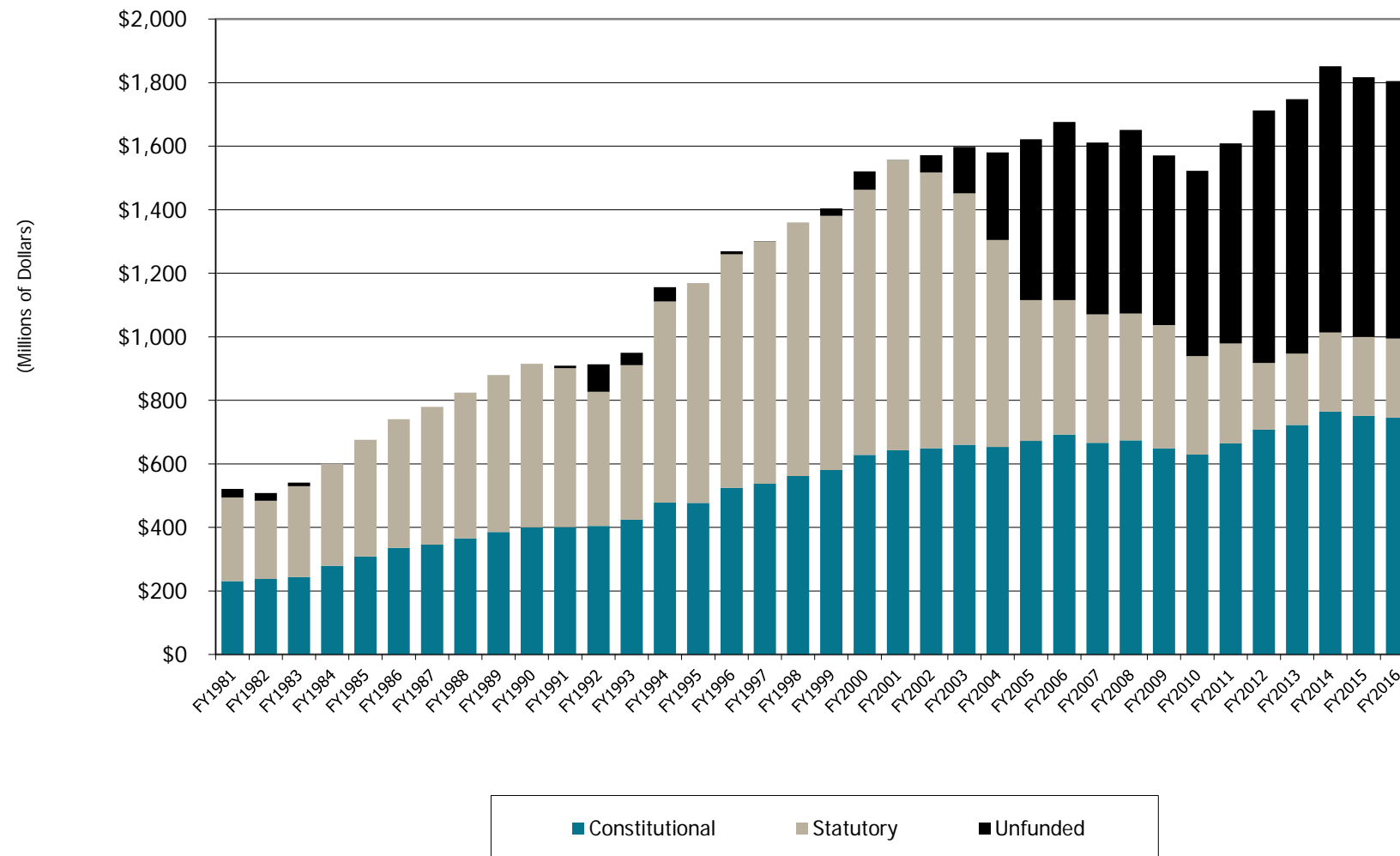
Constitutional State Revenue Sharing



Statutory State Revenue Sharing



Constitutional, Statutory, and Unfunded State Revenue Sharing



Funding Unfunded Mandates

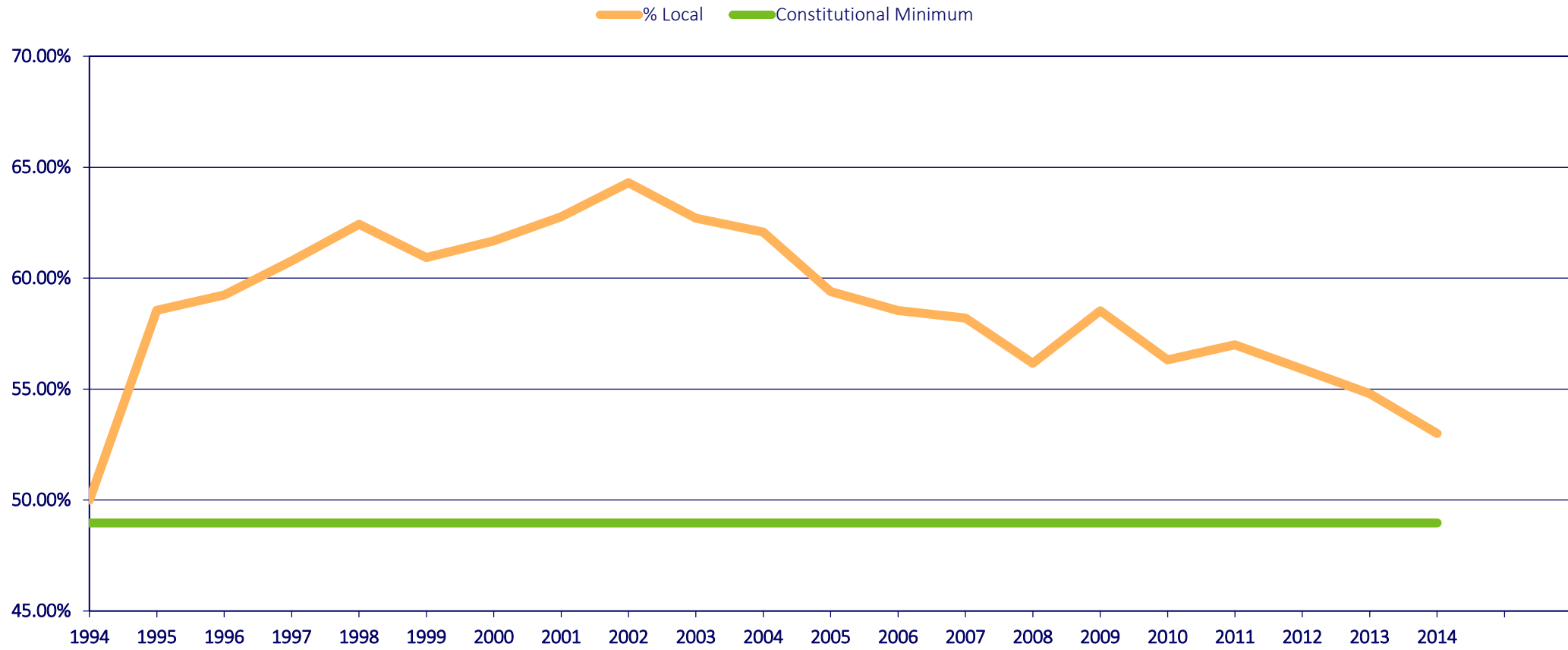
- Headlee Amendment – Article IX, Section 29
 - Limitations on state and local government revenues
 - The state cannot live within its limitations by pushing responsibilities down to local governments
- Relief provided only to school districts – *Durant* and *Adair*
- What requirements are not “mandates”
 - Very narrowly defined
- Relief for local governments requires a new definition of “mandate”
 - Statutory fix that is not in the state’s interest

Headlee: Article IX, Section 30

- § 30 Reduction of state spending paid to units of local government

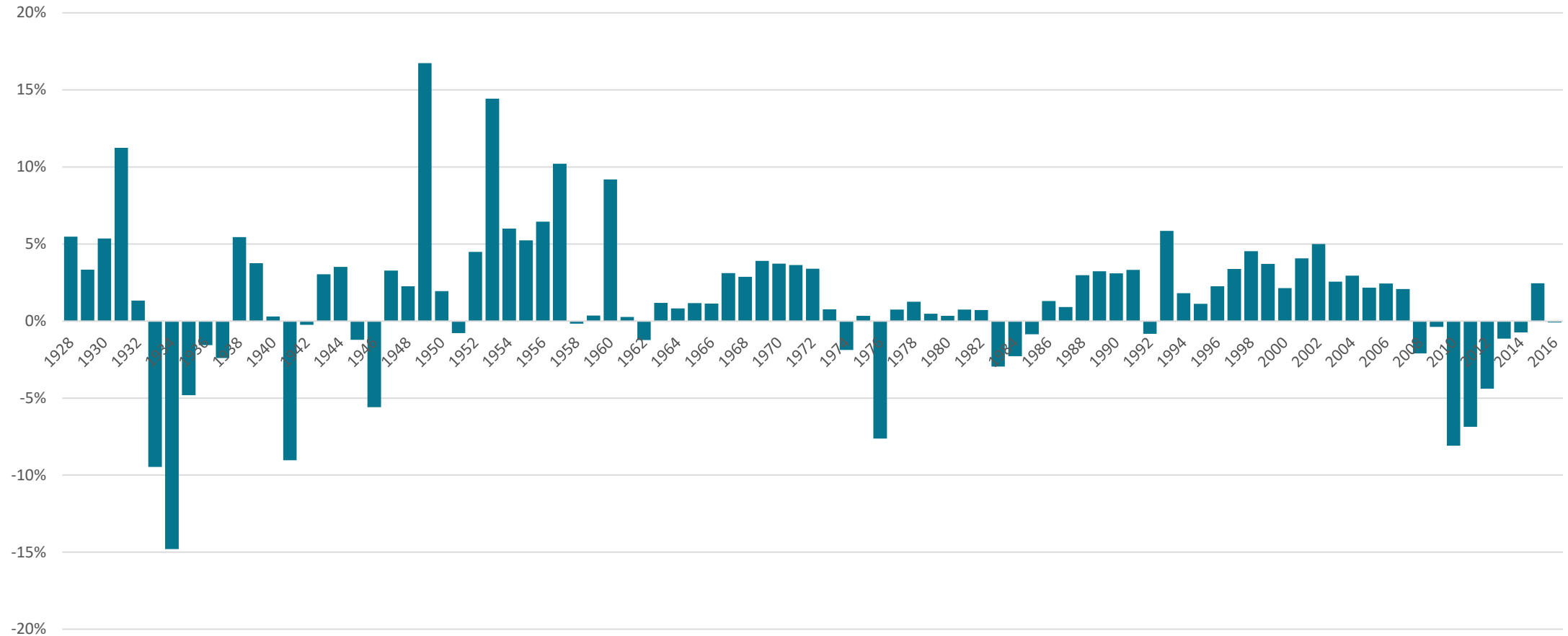
The proportion of total state spending paid to all units of Local Government, taken as a group, shall not be reduced below that proportion in effect in fiscal year 1978-79.

Article IX, Section 30 State Spending

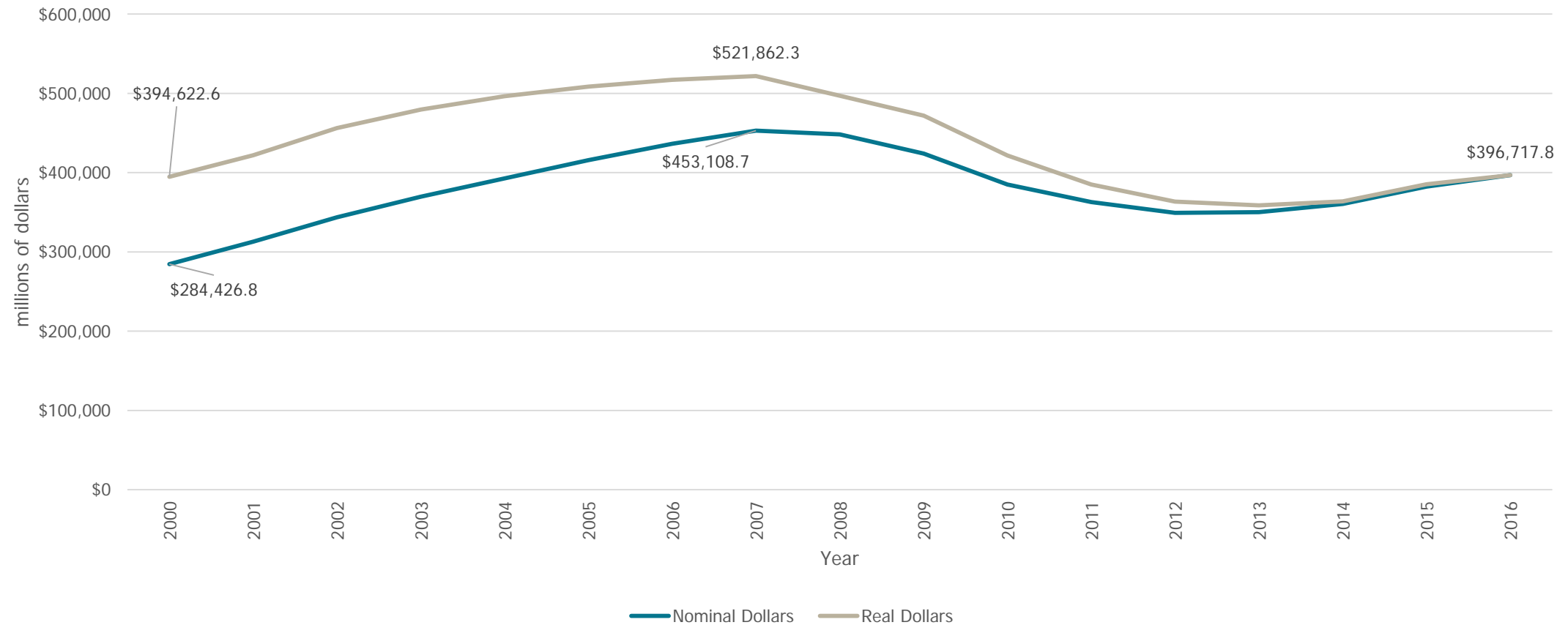


The Effects of Tax Limitations

Year-to-Year Percent Change in Inflation-Adjusted State Equalized Value/Taxable Value, 1928-2016



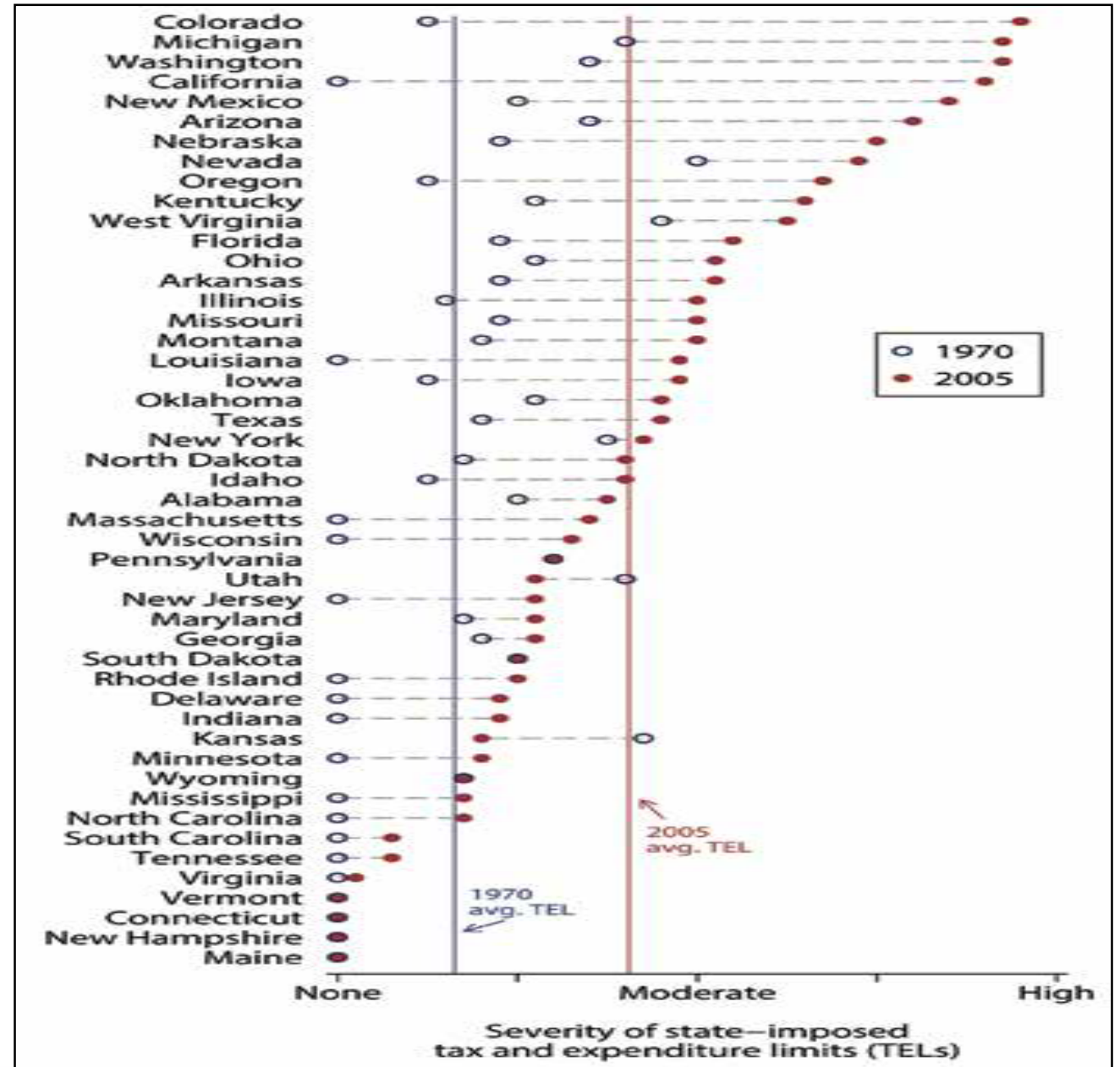
Nominal and Real Statewide Property Values, 2000-2016



Tax Limitations

- Statutory tax rate limits in authorizing laws
- 15/18 mill tax rate limits applies to townships, counties
- Headlee Amendment
 - Voter approval required for new or increased taxes
 - Tax rate rollbacks applied if government's tax base grows faster than rate of inflation
- Proposal A of 1994 Cap on Assessments
 - Limited to lesser of inflation or 5%
 - Reverts to state equalized value (SEV) on transfer in ownership
 - Inflation has been used every year since adopted in 1994 (average 2.3%)

Property Tax Limitations



Headlee Amendment Adjustments

Article IX, Section 31 (Headlee Amendment (1978))

"... If the assessed valuation of property as finally equalized, excluding the value of new construction and improvements, increases by a larger percentage than the increase in the General Price Level from the previous year, the maximum authorized rate applied thereto in each unit of Local Government shall be reduced to yield the same gross revenue from existing property, adjusted for changes in the General Price Level, as could have been collected at the existing authorized rate on the prior assessed value...."

- Article IX, Section 3 (Proposal A of 1994)

"... For taxes levied in 1995 and each year thereafter, the legislature shall provide that the taxable value of each parcel of property adjusted for additions and losses, shall not increase each year by more than the increase in the immediately preceding year in the general price level, as defined in section 33 of this article, or 5 percent, whichever is less until ownership of the parcel of property is transferred. When ownership of the parcel of property is transferred as defined by law, the parcel shall be assessed at the applicable proportion of current true cash value...."

Headlee Amendment



- Tax Yield = Tax Rate x Tax Base
- Headlee attempted to control growth of taxes by controlling the tax rate

If value of existing properties
in a jurisdiction appreciate
faster than rate of inflation



Then that jurisdiction's tax
rates must be "rolled back"



So that net result is an
inflationary growth of tax
revenues



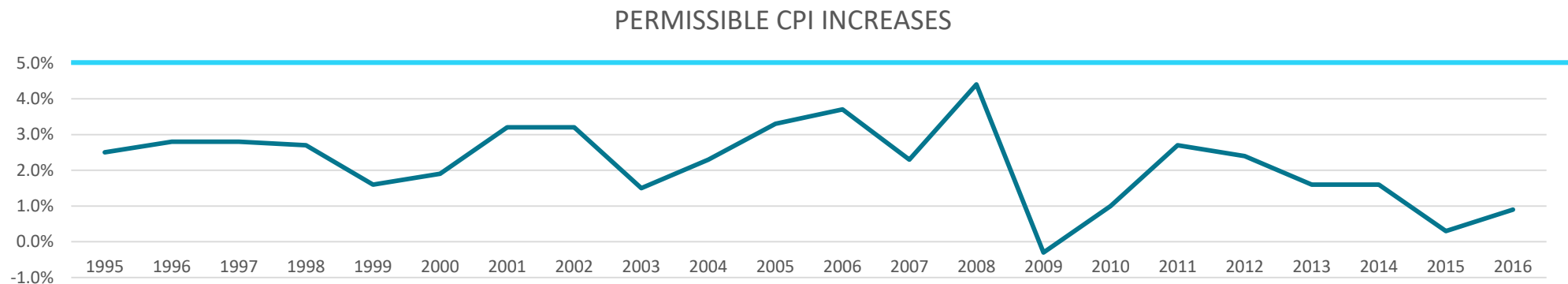
- There is no mechanism to counteract lost tax base

Headlee was not completely successful

- Tax Base growth was measured on a jurisdiction-wide basis
 - The value of properties growing at a rate less than inflation offset growth in the value of properties at rates faster than inflation
 - Some property owners were still experiencing steep increases in property tax bills

Proposal A Taxable Value Cap

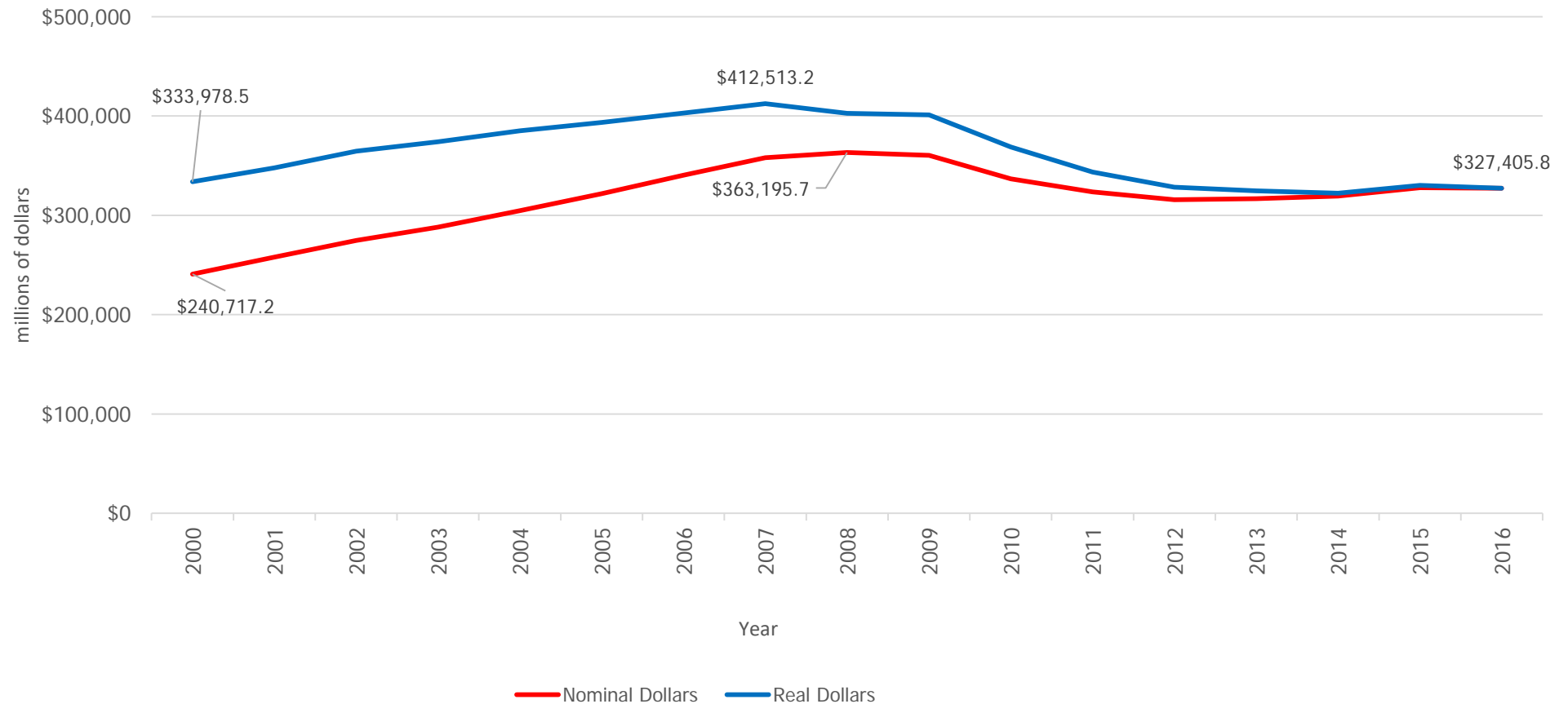
- Modified Acquisition Value Method of determining Taxable Value
 - Annual increases in the taxable value of individual parcels of existing property are limited to the lesser of five percent or inflation
 - When ownership of a parcel of property is transferred (sold), the parcel is reassessed "at the applicable proportion of current true cash value."
 - Additions and modifications to existing property and new property are placed on the tax rolls at 50 percent of current true cash value



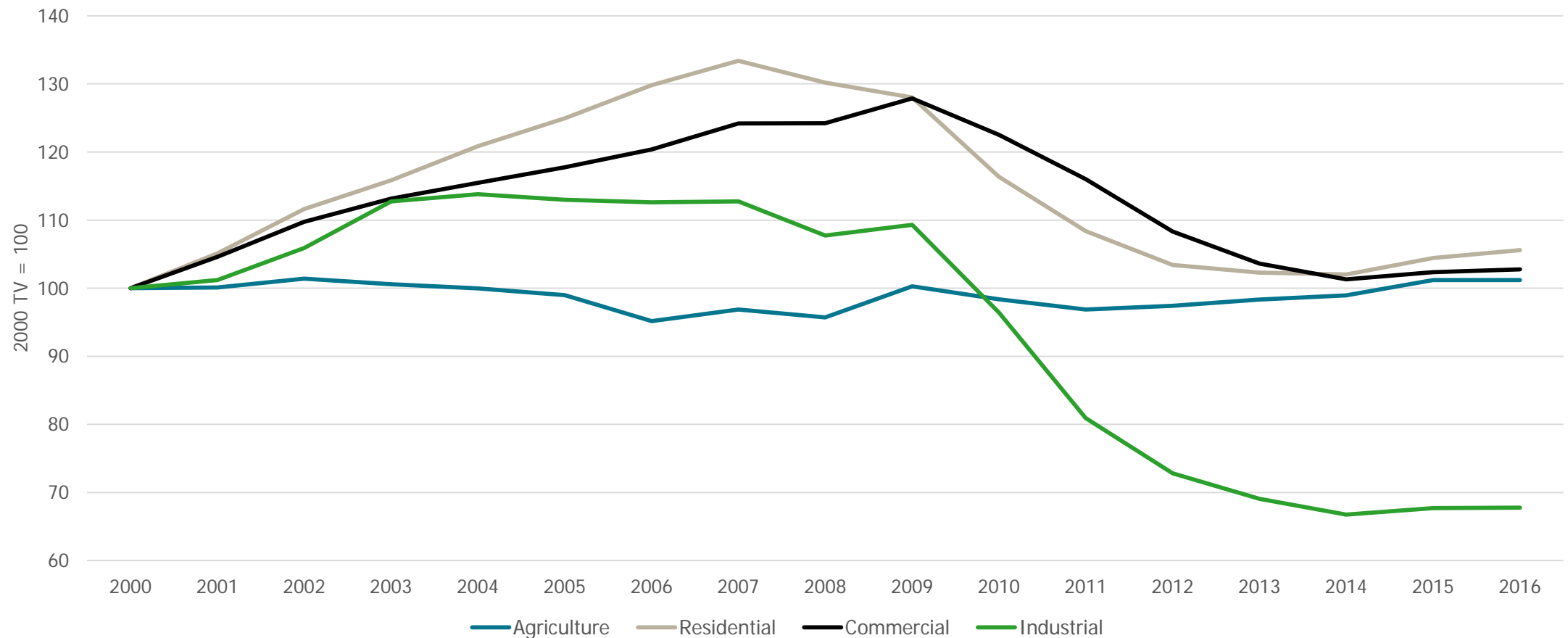
Cumulative Affect of Two Tax Limitations

- Limited to inflationary increases during ownership
- Sale of property triggers “pop up” to state equalized value
- Pop ups can cause taxable value to grow faster than rate of inflation
- Growth faster than inflation triggers a tax rate rollback for all taxpayers in jurisdiction
- Net result can be less than inflationary growth in taxable value for a jurisdiction

Nominal and Real Statewide Taxable Values, 2000-2016



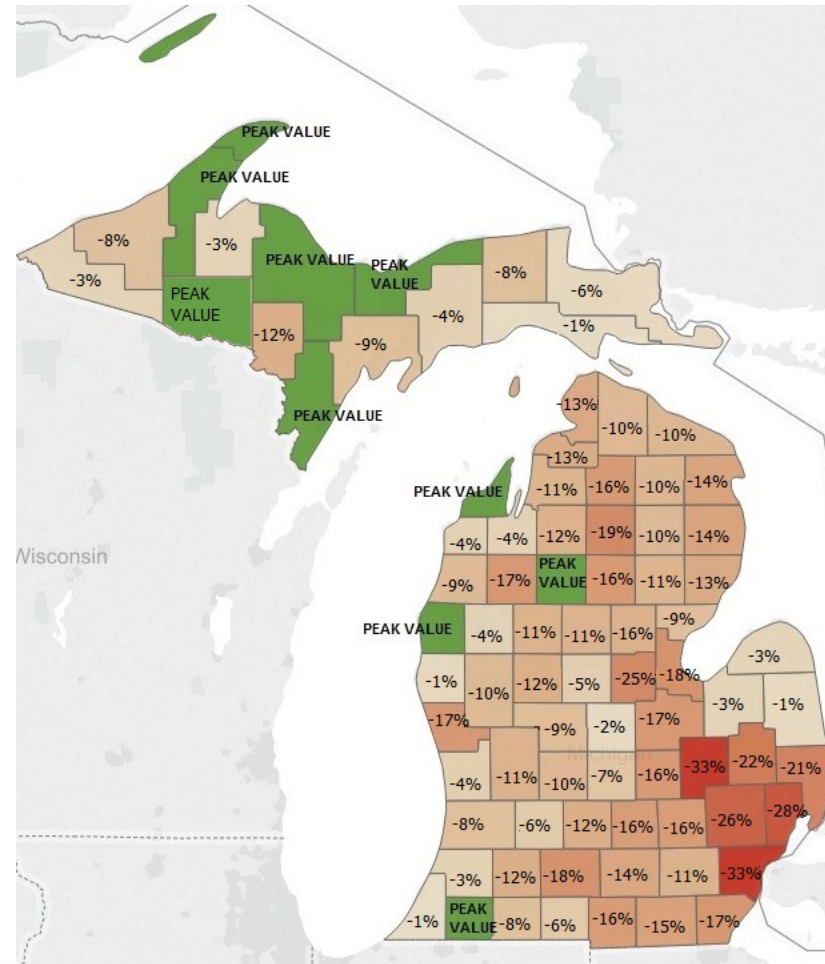
Change in Inflation-Adjusted Taxable Value by Property Class, 2000-2016



2016 Compared to Inflation-Adjusted Peak Values

- The 2016 taxable values in 85% (1,295) of 1,515 cities and townships is less than their inflation-adjusted taxable values at their peak
 - 94.7% of the state population resides in one of these communities
- As a group, they are 22% (\$84.2 billion) below their cumulative peak values
 - Residential ↓11.9%
 - Commercial ↓10.0%
 - Industrial ↓41.9%

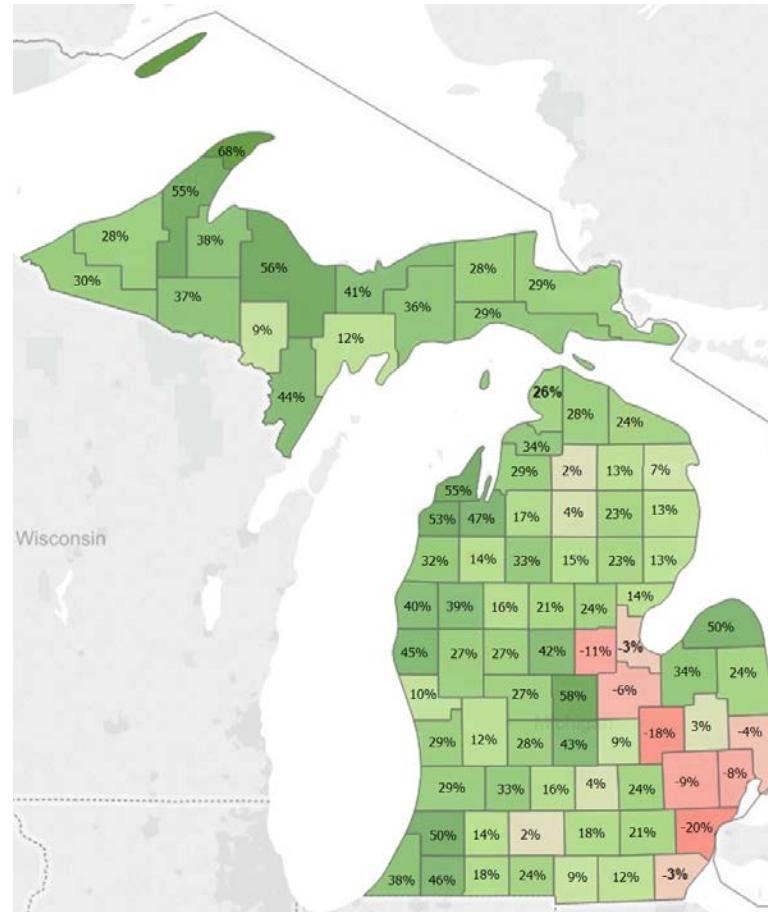
2016 County Taxable Values as a percent of Inflation-Adjusted Peak Values in Each County



Cities and Townships with 2016 Taxable Values below their 2000 Values

- 16.4% (248) of the 1,515 cities and townships have 2016 taxable values that are below their inflation-adjusted 2000 values
 - 169 cities and 79 townships
 - Located in every region
 - Located in 64 of 83 counties
 - Home to almost 48% of the state population
- Cumulatively 22% (\$33.5 billion) below their 2000 values
 - Residential properties ↓20.3% (\$13.8 billion)
 - Commercial properties ↓ 7.9% (\$1.6 billion)
 - Industrial properties ↓51.1% (\$5.6 billion)

2016 County Taxable Values as a percent of Inflation-Adjusted 2000 Values



Why it matters...

- Few funds in reserve to survive next economic downturn
 - 7 years since Great Recession
 - Ability to pay for labor and supplies throughout the year
- Quality of life
 - Public safety
 - Libraries and parks
 - Infrastructure
 - Also tax base for schools, DIA, Zoo, MetroParks
- Economic development
 - Businesses want to know their facilities will be served (public safety)
 - That they can get goods to market (infrastructure)
 - That their workers will be safe at work and at home

Would taxpayers notice?

- 6 mill State Education Tax (SET) levied by state
 - Not subject to Headlee tax rate rollbacks
- Has anyone noticed that the rate has remained at 6 mills 22 years after enacted with adoption of Proposal A in 1994?
- Goal of Headlee Amendment was to limit the growth in state and local government tax revenues
 - Jurisdiction wide implementation did not have desired affect
 - Parcel limitations achieving desired purpose
- Do we need both?

Tax Reform and Diversification

- Property Tax Issues
- Sales Taxes
- Income Taxes
- Motor Fuel Taxes
- Motor Vehicle Registration Taxes
- Alcoholic Beverage Taxes
- Tobacco Products Taxes
- Utility Users Excise Taxes

Problems with need for new development

- Every local government has a finite amount of developable land
- Favors exurbs and rural areas and abandoned inner cities
- Economic development tools call for local governments to give up part of new development for a period of time
 - Tax abatements
 - Tax increment financing

Alternatives

Increase taxing authority

- Every type of local government has a limit on tax rate
 - 15/18/50 mill limits
 - Cities - 20 mills
 - Charter Townships - 10 mills
- Limits were developed as a percent of the value of property
 - Use of taxable value as the tax base erodes that relationship
 - Could give greater taxing authority without taxing a larger percentage of the value of property

Alternatives

End Tax Rate Rollbacks

- The Headlee tax limitations and taxable value cap are duplicative
- Growth in taxable values for individual properties would still be restricted to the rate of inflation
- Would put local taxes on equal footing with State Education Tax

Alternatives



Reauthorize tax rate rollups

- Return to intent of Headlee providing ability of local governments to keep tax revenues at voter-authorized levels
- Would still have to remain within voter-authorized tax rates

Alternatives

Even-out taxable value movement

- If the desire is not there to allow tax rate rollups,
- Use a rolling average of values to minimize the impact of taxable value reductions

Alternatives

Address the service delivery model

- Counties have not suffered same reductions in taxable value as cities and townships
- Enough properties so that loss in some is offset by gains in others
- Other states put responsibility broad range of services at the county level
- Michigan service delivery primarily at city and township level
- Would achieve economies of scale and economies of skill

Alternatives

Fund state revenue sharing

- Two goals of such programs
 - Diversify tax base of local governments
 - Equalize fiscal capacity of local governments
- Many of local governments that lost the most tax base have also suffered most from diversion of funding statutorily dedicated to state revenue sharing for other purposes

Alternatives

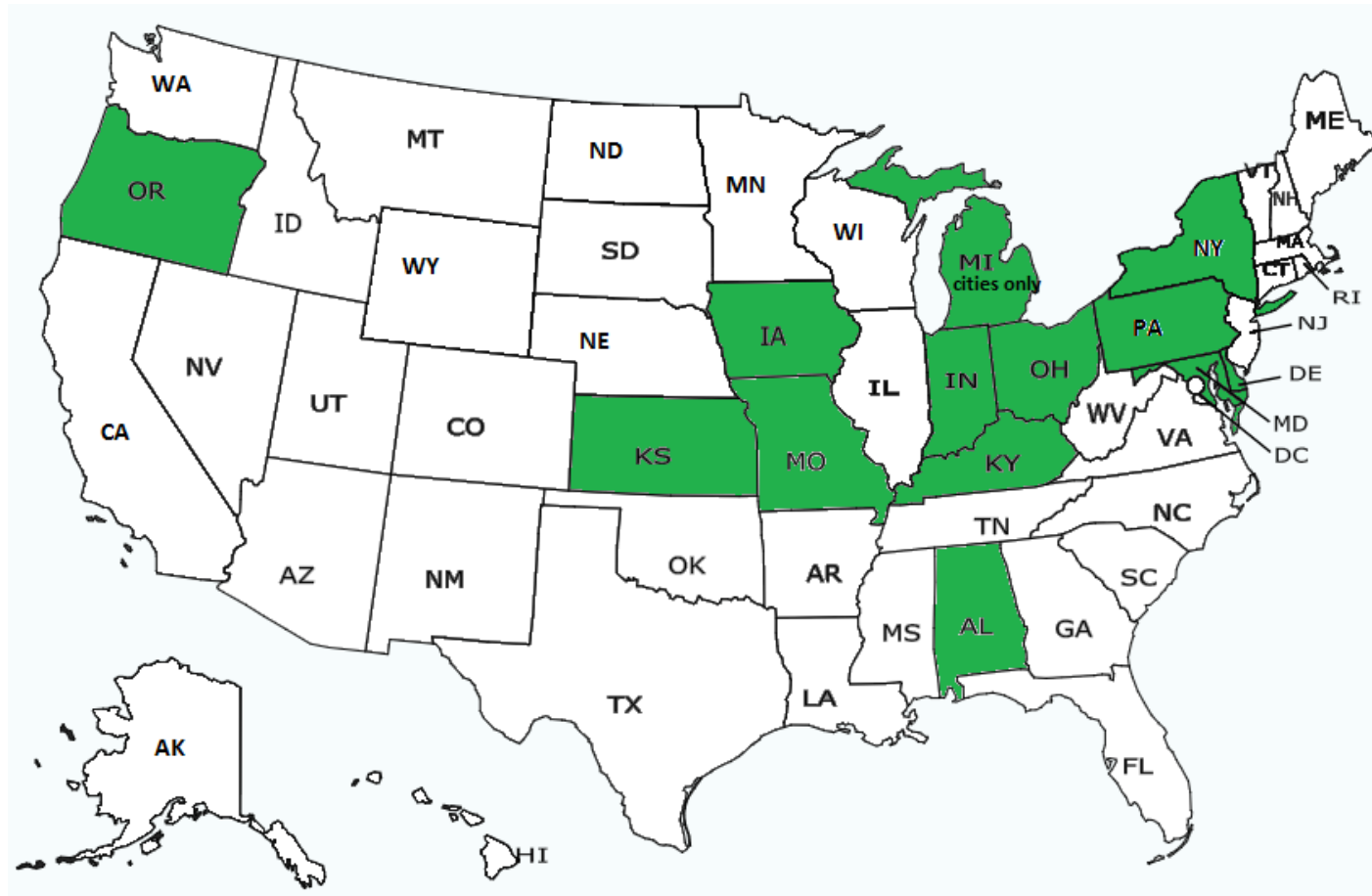
Diversify local government revenue sources

- Local option...
 - Sales
 - Income
 - Motor fuel
 - Motor vehicle registration
 - Alcohol
 - Tobacco
 - Public utility excise

Alternative Local-Option Taxes

- Levied by cities/townships or counties or regions?
 - Cities/Townships
 - Confusion with 1,700+ potential taxing jurisdictions
 - Balkanized structure works against adoption
 - Counties
 - Mismatch those raising revenue and those delivering most services
 - Argues for reform of county government to instill more confidence
 - Could create system of distributing revenues to CVTs
 - Regions
 - Some other states have democratically elected representatives governing regions with taxing authority
 - Michigan's Prosperity Regions are voluntary association of leaders from inside and outside of government

Authorization to Levy Local-Option Income Taxes



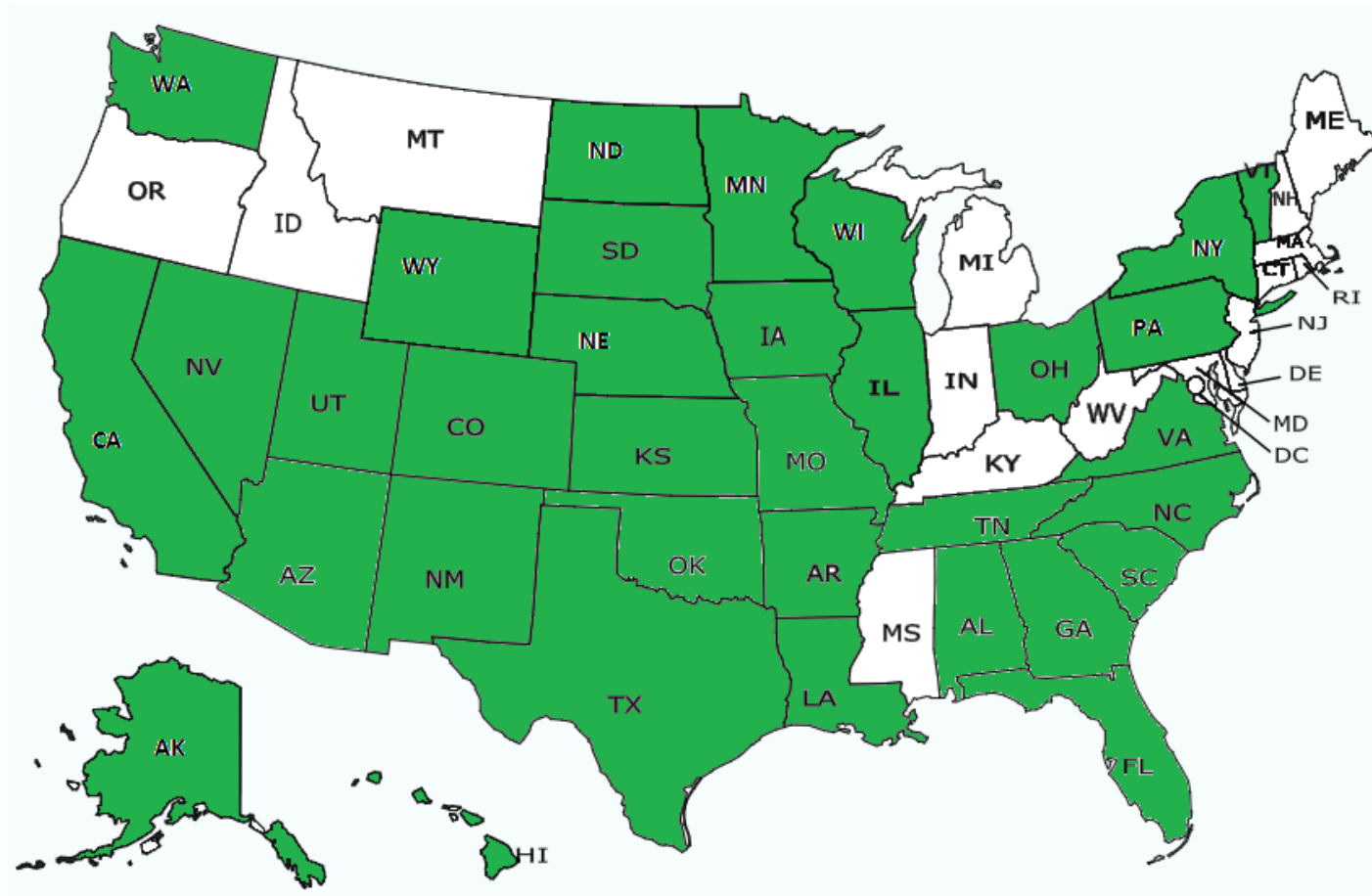
Source: U.S. Census Bureau, 2013 State and Local Government Finance

Local-Option Income Taxes

- City income tax levied before state tax enacted
- Authorized only to cities
 - Not counties, villages, townships, school districts
- Only 22 cities levy the tax
- Adoption requires voter approval
- Several cities have considered and/or proposed but unable to gain support or voter approval
 - Hillsdale, Mt. Pleasant, Ann Arbor, Ypsilanti, Marquette...
- CRC Memorandum #1103, *Local-Option Income Taxation in Michigan*, January 2011



Authorization to Levy Local-Option General Sales Taxes



Source: U.S. Census Bureau, 2013 State and Local Government Finance

Local-Option Sales Taxes

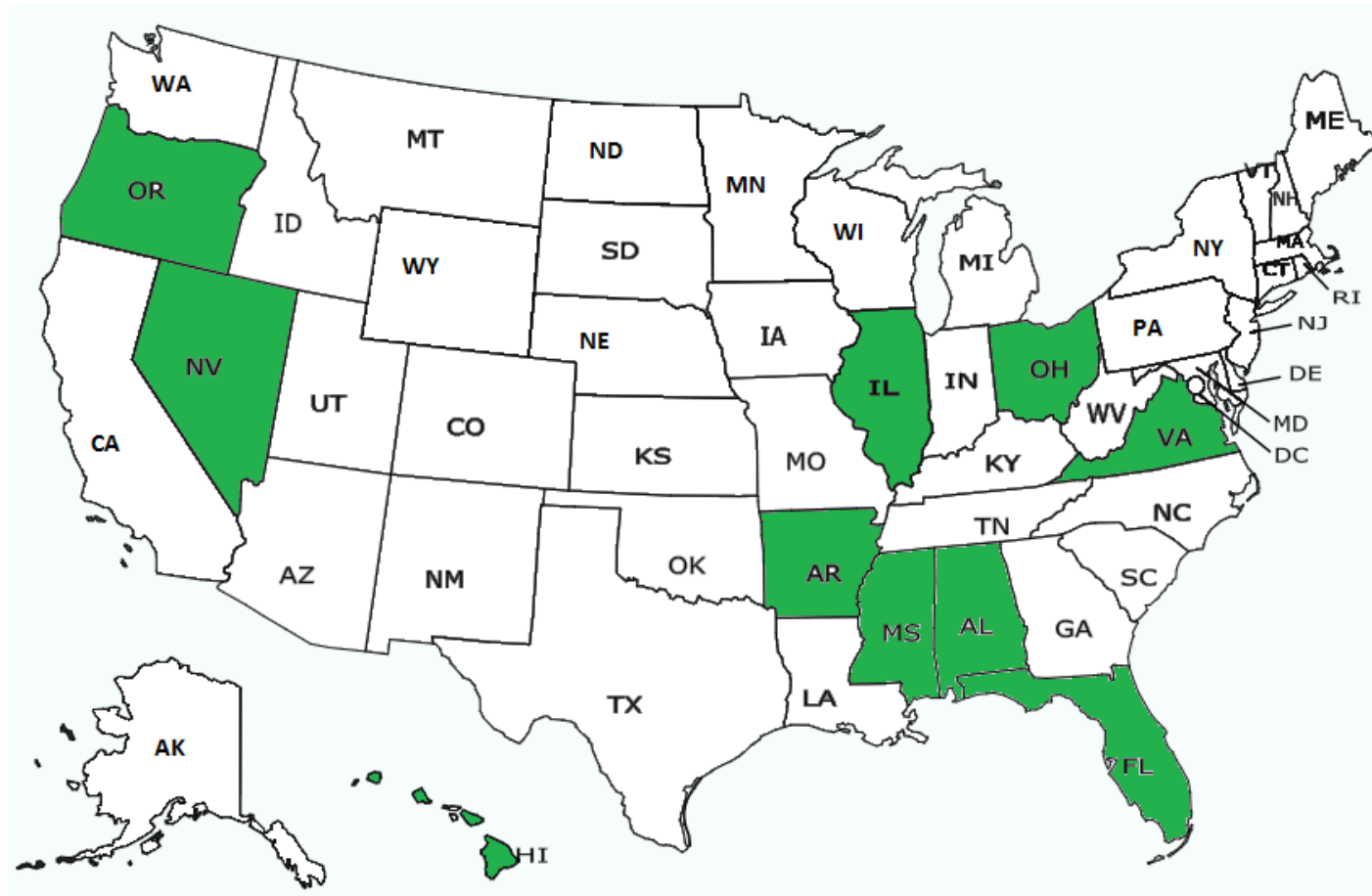
- Greatly desired by local government but multiple constitutional hurdles
 - Tax Rate – Michigan Constitution limits sales tax rate to 6%
 - 2% required for school funding
 - 4% permitted
 - Tax Dedication – Michigan Constitution dedicates funds
 - 72.7% to school funding
 - 15% state revenue sharing
- Even if local governments could levy the tax, they wouldn't get much of the revenues
- AG Opinion 4694 from 1970, CRC Report #305, *Issues Relative to the Constitutionality of Local Sales Taxation in Michigan*, June 1992



Local-Option Hotel/Tourism Tax

- Public Act 263 of 1974 and 106 of 1985 authorize accommodation taxes
 - PA 263 for counties under 600,000 for financing of the acquisition, construction, improvement, enlargement, repair, or maintenance of convention and entertainment facilities
 - PA 106 in SE MI to fund Cobo Center
- PA 263 selectively used
 - As of 2015, Calhoun, Genesee, Ingham, Kalamazoo, Kent, Muskegon, Saginaw, and Washtenaw Counties levy the tax
- PA 106 levied in tri-county area
- No direct benefit to cities, villages, or townships

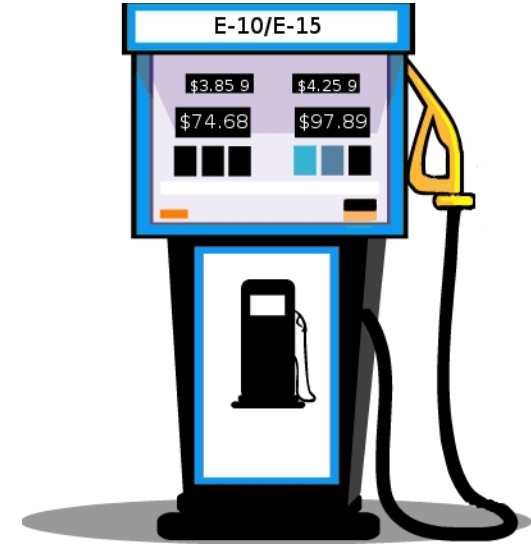
Authorization to Levy Local-Option Motor Fuel Taxes



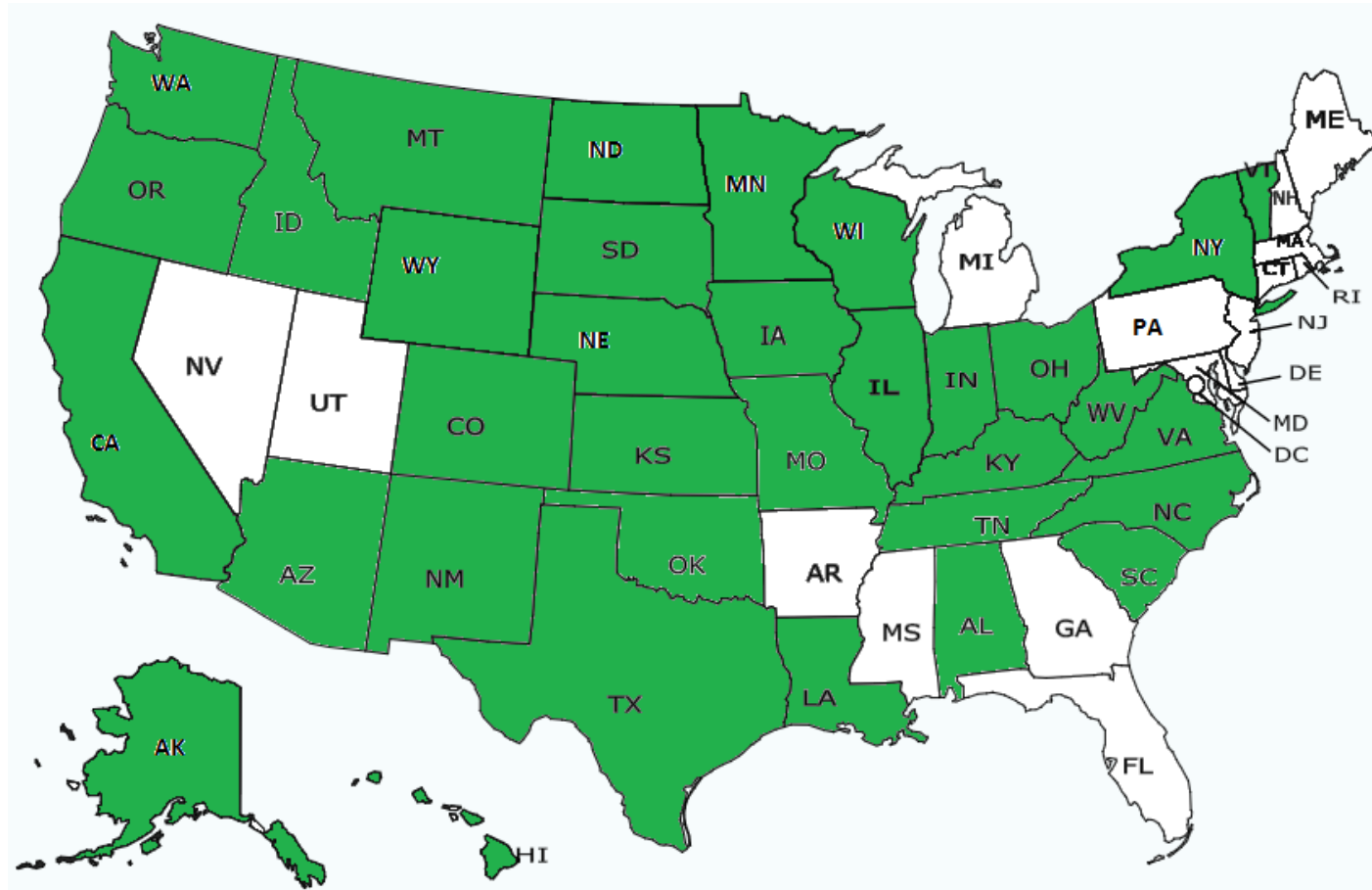
Source: U.S. Census Bureau, 2013 State and Local Government Finance

Local-Option Motor Fuel Taxes

- No serious efforts to authorize local option motor fuel taxes in Michigan
- Would require new method of taxation
 - Tax currently collected at wholesale level
 - Very difficult to know how many gallons purchased within any jurisdiction
- Not a very productive tax
 - Would require 10-15 cent per gallon tax rate to raise significant funds
- Would suffer from same issues as state taxes
 - Requires intermittent rate hikes because of fuel efficiency and alternative transportation methods



Authorization to Levy Local-Option Motor Vehicle License Taxes



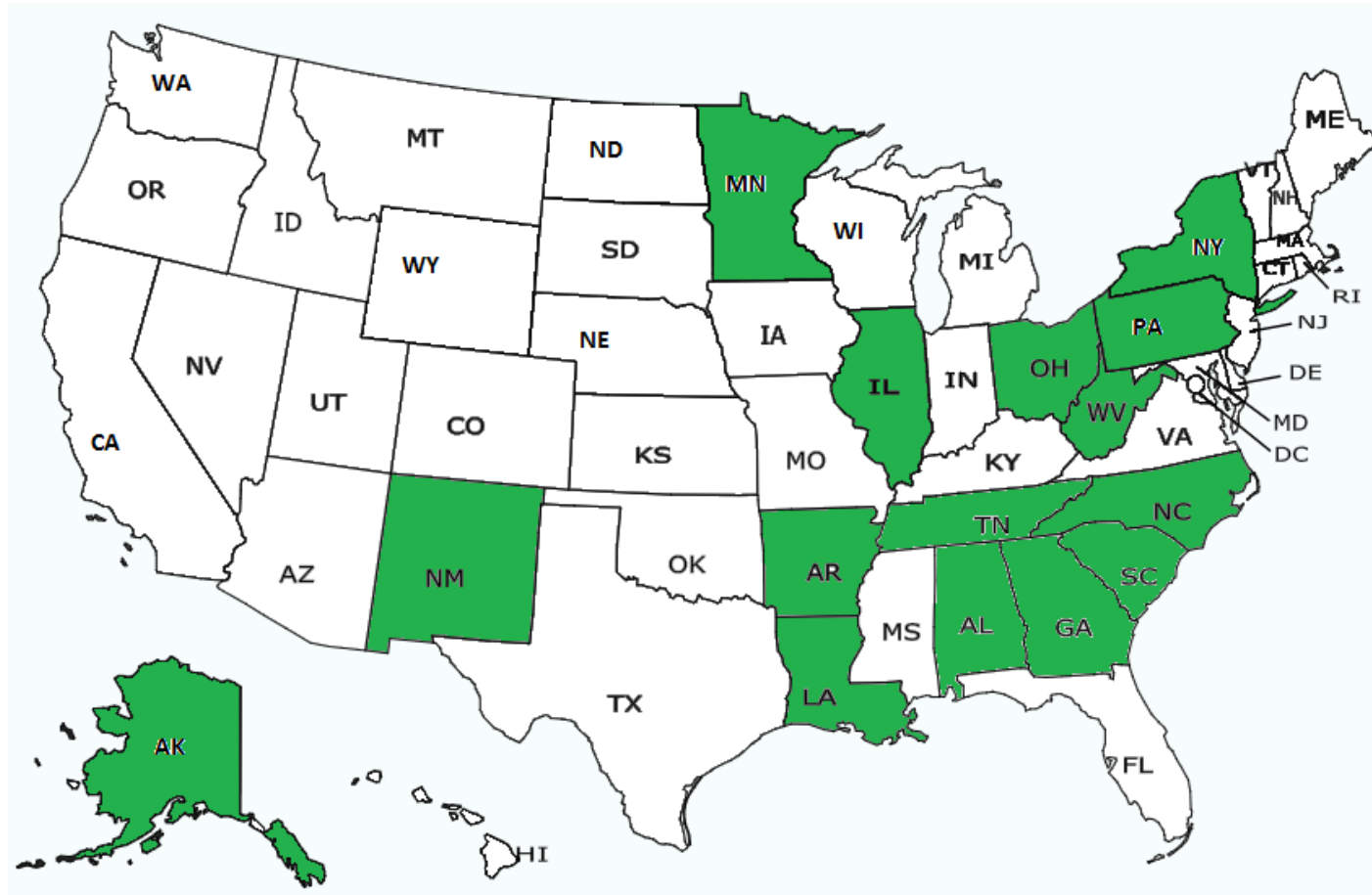
Source: U.S. Census Bureau, 2013 State and Local Government Finance

Local-Option Motor Vehicle Registration Taxes

- Local-option motor vehicle registration fees
 - Authorized 1987- 1992
 - Flat rate fee, \$25, regardless of weight of vehicle
 - Politically unpopular because owners of Ford Pintos and Lincoln Towncars paid same tax
 - Votes held in Alpena, Eaton, Monroe, Montcalm, Oakland, and Tuscola Counties: all unsuccessful



Authorization to Levy Local-Option Alcoholic Beverages Sales Taxes

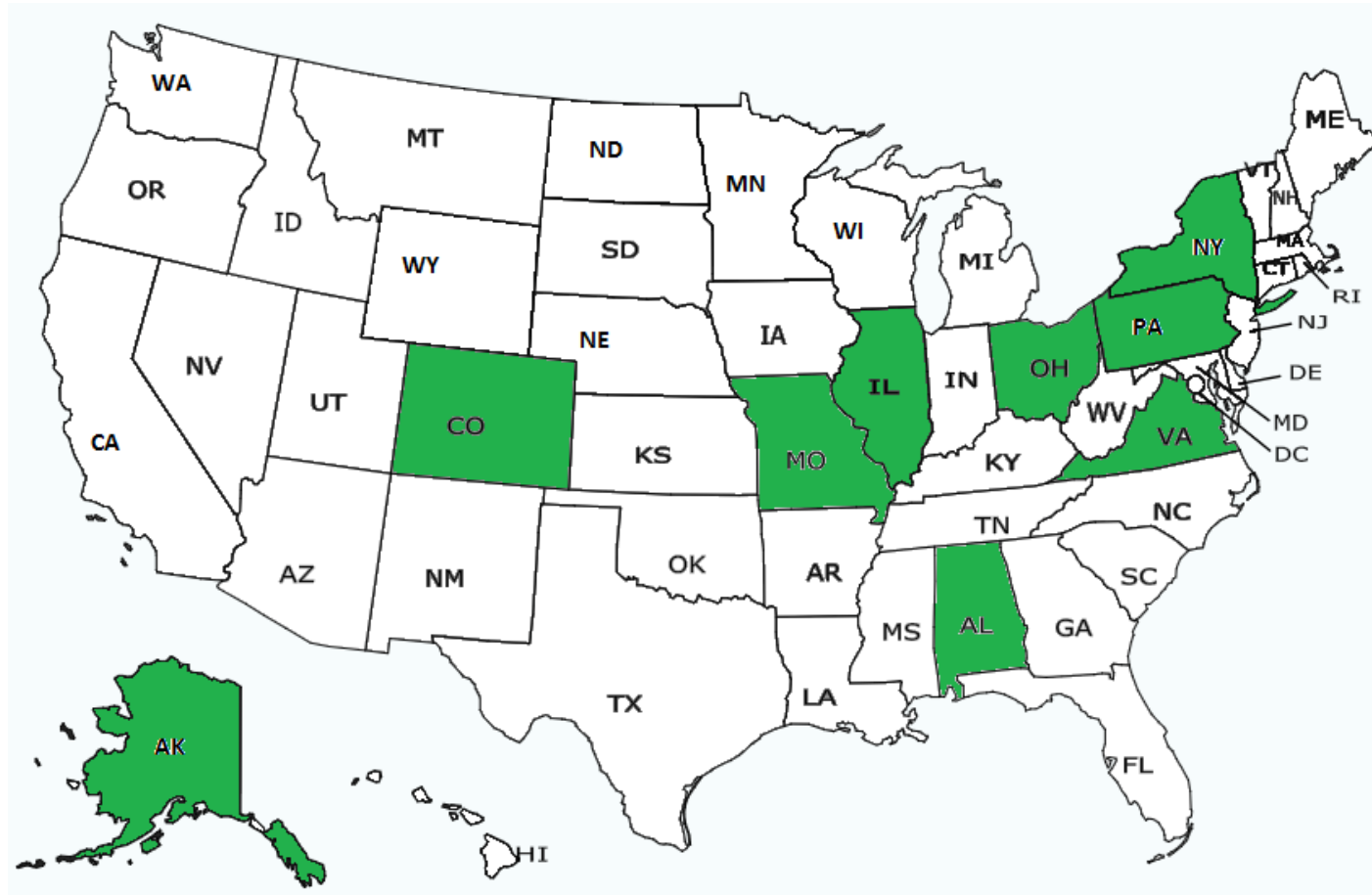


Source: U.S. Census Bureau, 2013 State and Local Government Finance

Local-Option Alcoholic Beverage Sales Taxes

- No effort to implement such a tax in recent Michigan history
- Some revenues shared based on liquor license distribution
- Would capitalize on Michigan as a vacation destination
 - Lake side communities and urban areas could benefit
- Point of sale already reported to Liquor Control Commission
 - Would local taxes differentiate restaurant sales vs. store sales?
- General acceptance of sin taxes

Authorization to Levy Local-Option Tobacco Sales Taxes

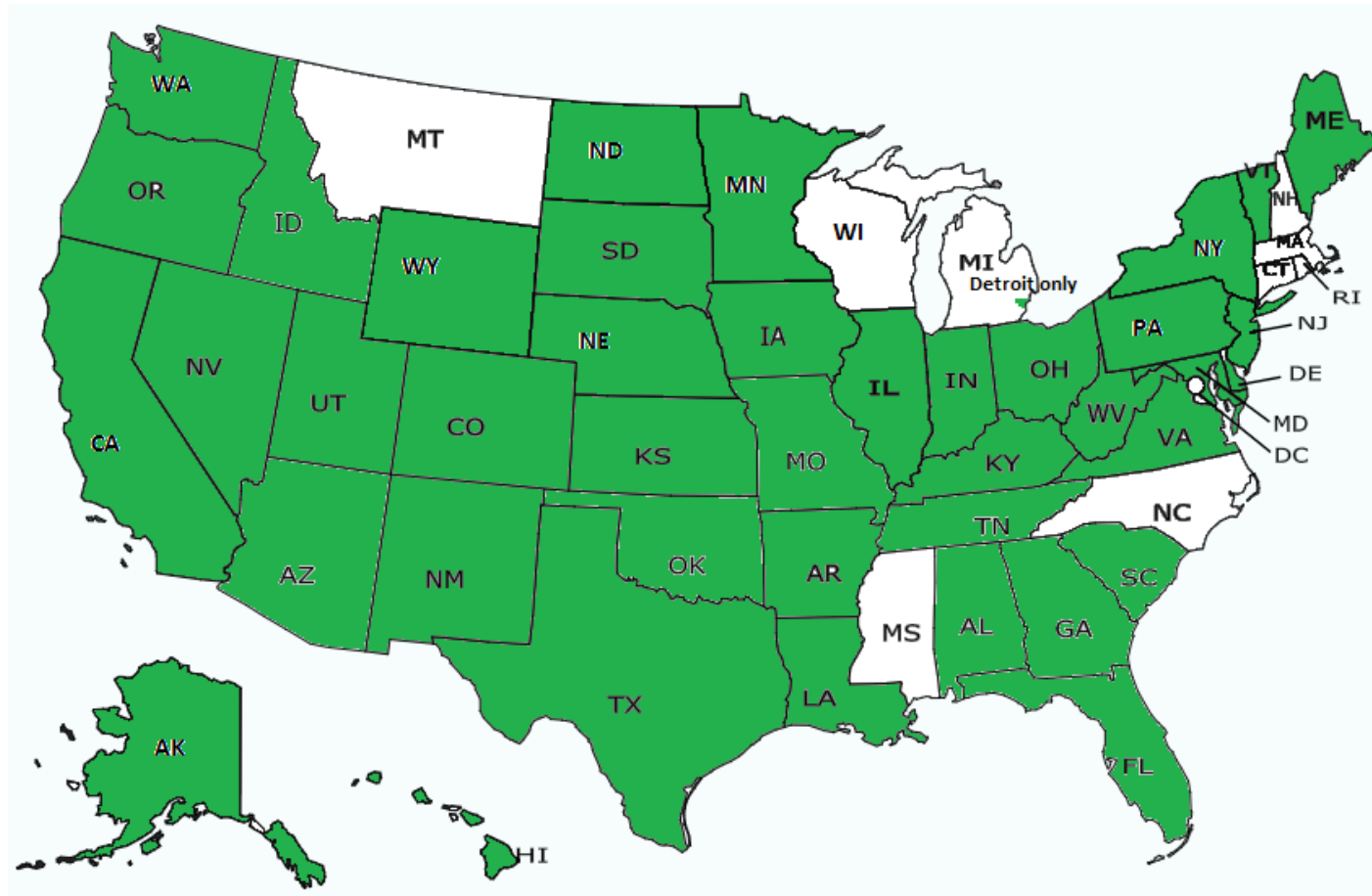


Source: U.S. Census Bureau, 2013 State and Local Government Finance

Local-Option Tobacco Sales Taxes

- No effort to implement such a tax in recent Michigan history
- Point of sales easy to track
- General acceptance of sin taxes

Authorization to Levy Local-Option Public Utility Sales Taxes



Source: U.S. Census Bureau, 2013 State and Local Government Finance

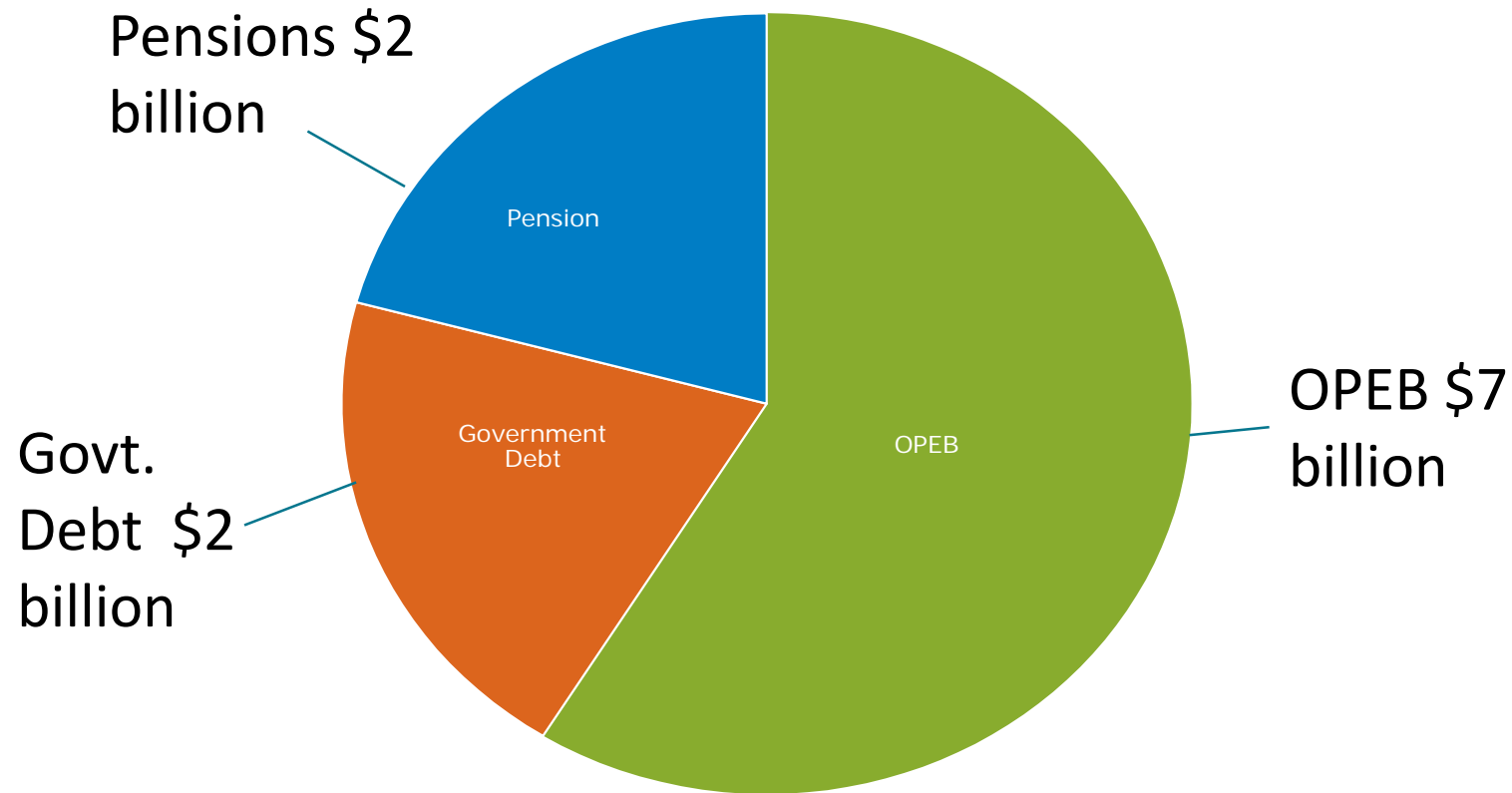
Local-Option Public Utility Users Taxes

- Tax levied on public telephone, electric, steam, or gas services
- Would affect almost all properties
- In Michigan, authorized only for City of Detroit (since 1970)
 - Has not proved to be a very robust tax
- No effort to extend the tax to other local governments
- Common in other states

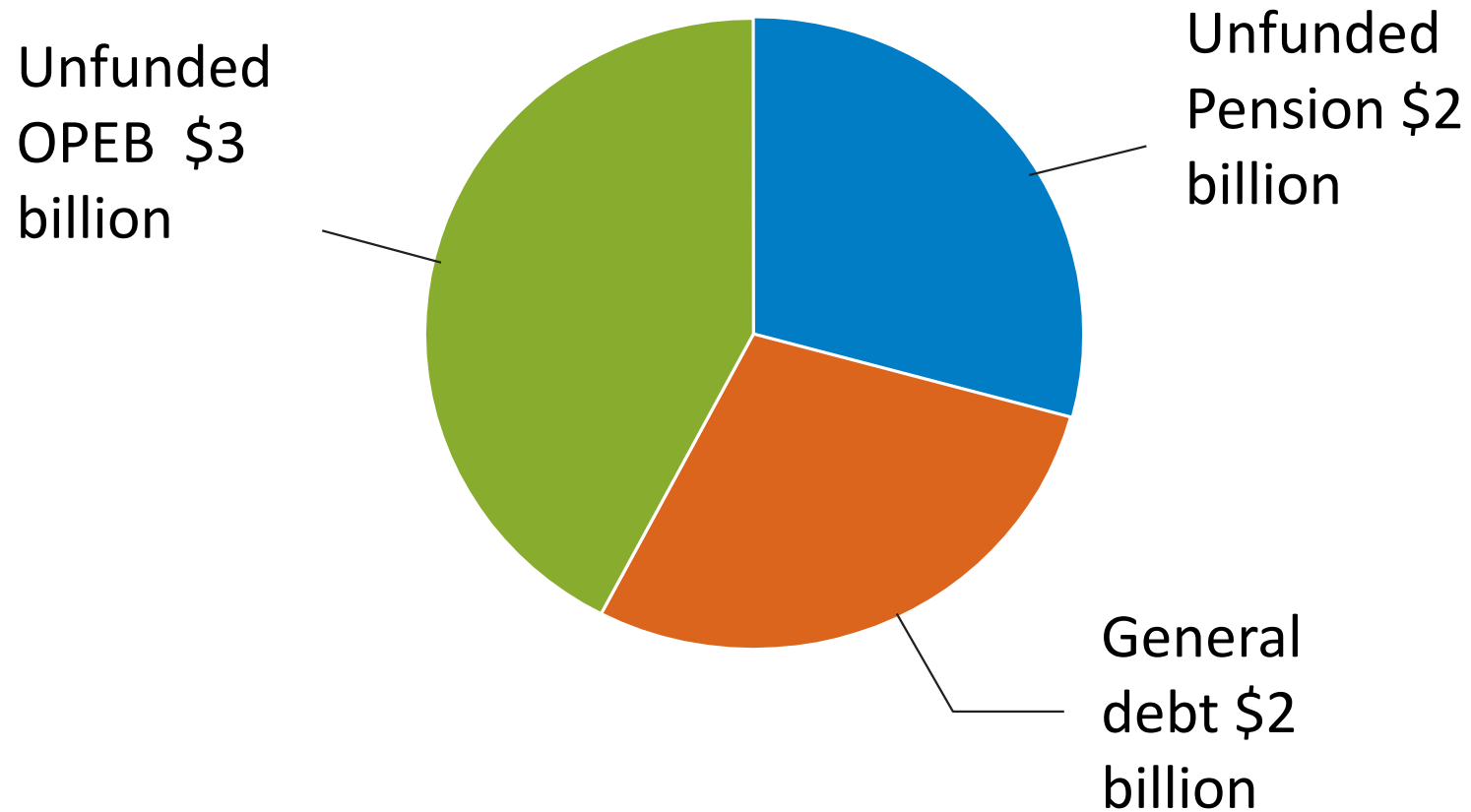
Take Aways

- Fixes will not be easy
 - The state does not have funding nor an inclination to fund state revenue sharing
 - The state has little interest in funding mandates
 - The most effective Headlee Amendment fixes may require a constitutional amendment
 - Consideration of alternative revenue sources shine a bright light on the mismatch between optimal revenue raising level of government and the levels of government responsible for providing key services

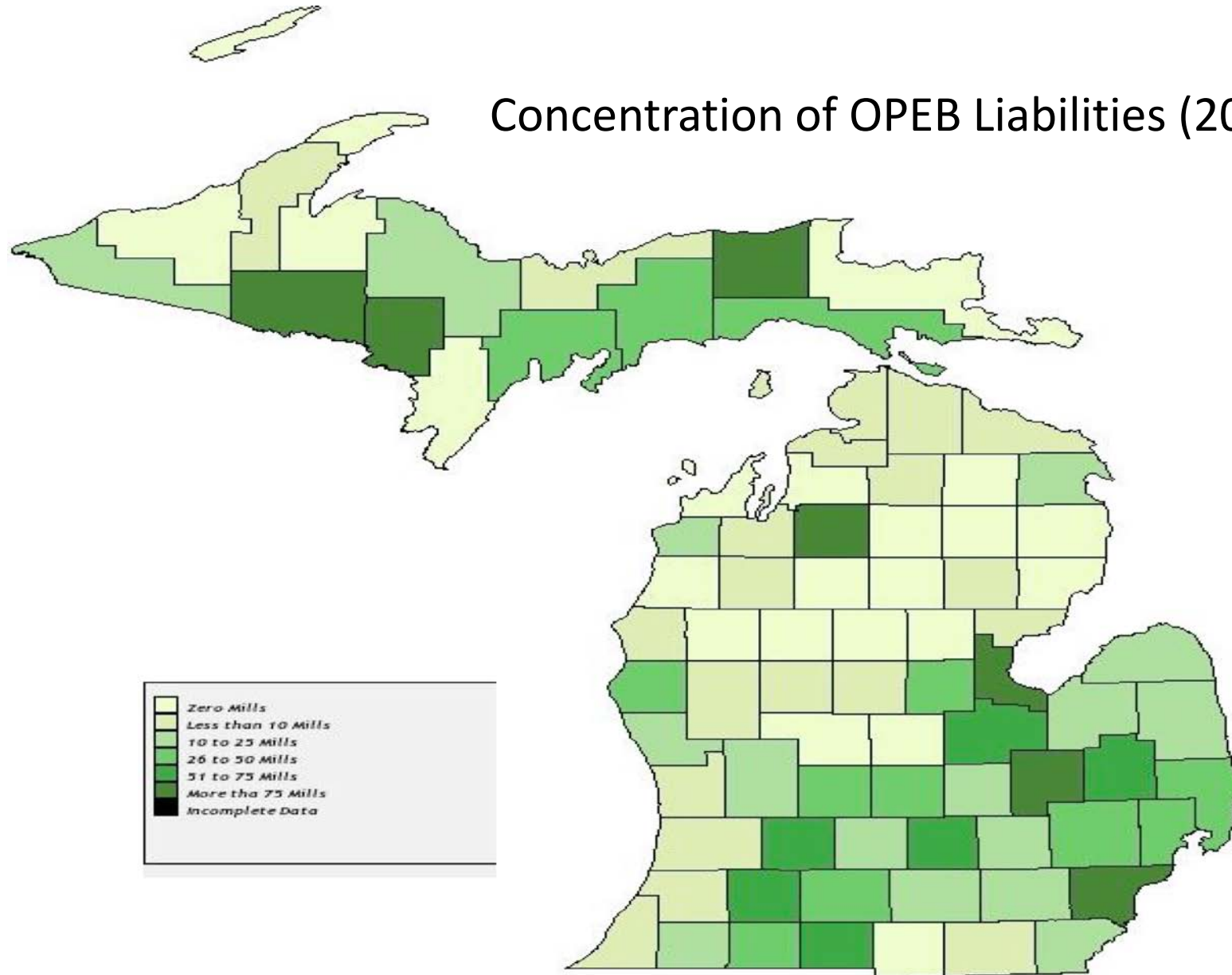
Municipal legacy Costs: \$300 million in additional funding to catch up



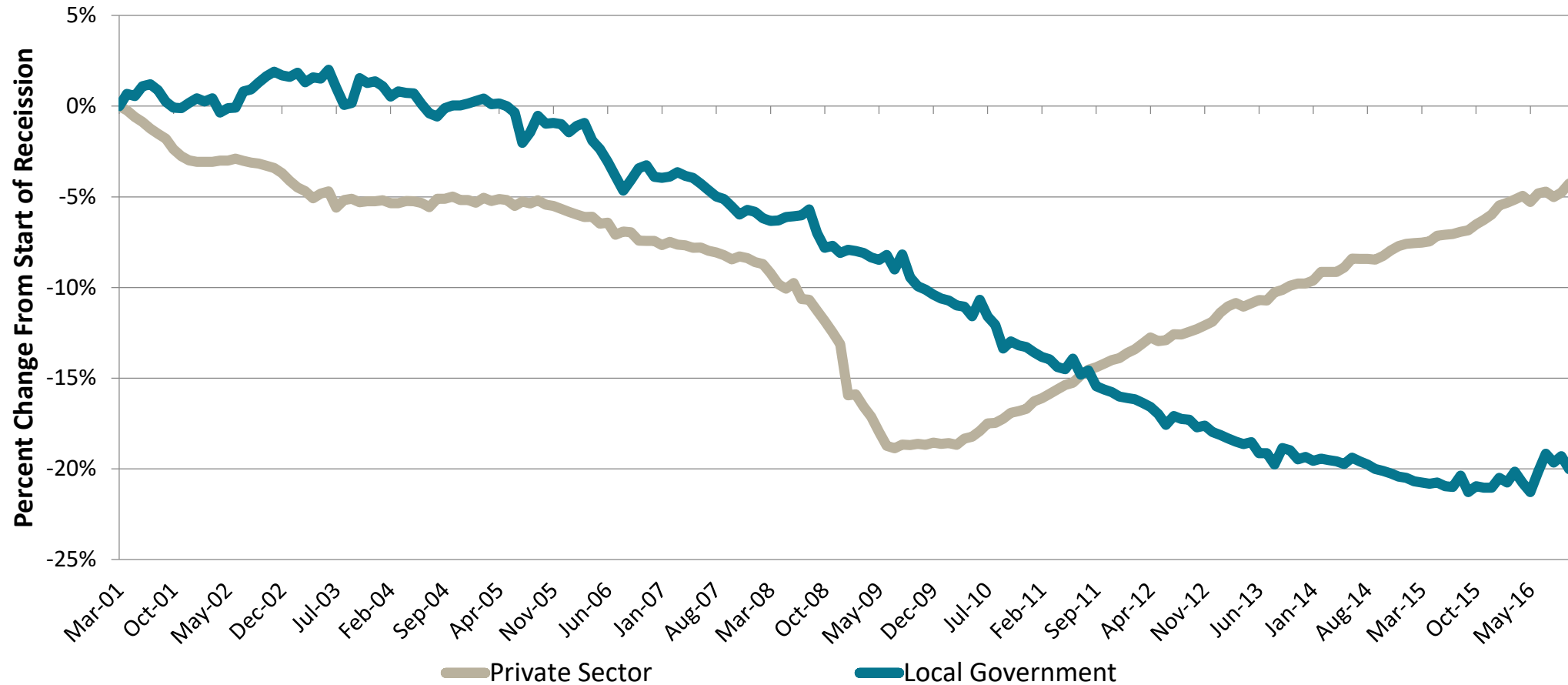
County Legacy Costs: \$120 mil. in additional costs to fully fund



Concentration of OPEB Liabilities (2014)



Local government employment is down more than 20% since beginning of 2001 recession



On behalf of the staff and directors,
may you have a fact-filled 2018

*"The facts, Ma'am.
Just the facts."*



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