

# Michigan's Local Finance Structural Deficit: Analysis of Proposed Solutions

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## Introduction

In the past thirty years, local units of government in Michigan have experienced a triple convergence of significant limitations on their ability to finance municipal services. With the passage of the Headlee Amendment in 1978, local unit taxing jurisdictions were compelled to roll back property tax rates when existing property tax revenue increases exceeded the rate of inflation. In 1994, local units were limited further by Proposal A, which effectively capped tax increases on homestead properties at the rate of inflation. Other limitations on local units' ability to raise revenue include the prohibition against new local income taxes (1967), and reductions in state and federal revenue sharing. Finally, the 1980 U.S. Census was the first in history to result in the loss of a Congressional seat for Michigan, a trend that has continued in every subsequent Census, sound evidence that Michigan is no longer robust in population (and tax base) growth. Collectively, these Constitutional and demographic limitations on local unit tax revenues have compromised municipal services in Michigan.

On the other side of the balance sheet, municipal finances are strained by faster-than-inflation increases in municipal service costs. In particular, personnel benefits are cited as the main culprit, as it is not uncommon for local units to experience double-digit annual increases in health care and pension expenses. In addition, maintenance of aging infrastructure, including sewers, roads, and public utilities have exacerbated local unit financial shortcomings.

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Often cited as a bellwether of local unit financial distress, the City of Ecorse, after a series of financially difficult years, was appointed a receiver under the Local Government Fiscal Responsibility Act of 1990. The Act established criteria of local unit fiscal distress, which, in a worst-case situation, could lead to the appointment of a financial receiver. While a receiver has been appointed in several local units under the Act, financial distress in local units has generally evidenced itself in less apparent ways. For example, the recent 30-year period has seen a marked increase in the

use of fees and special assessments to pay for municipal services, which are not included in Headlee Amendment calculations. In addition, preventative maintenance and improvements to municipal infrastructure are often deferred to future administrations.

## Declining Quality of Municipal Services

Loss of traditional sources of municipal revenue has led to a diminution in quality of municipal services. In many communities, non-essential services, such as parks and recreation programs, have been cut back, if not eliminated entirely. Youth and senior programs have also been scaled back or cut. Essential services such as planning, assessing, and housing programs are subject to budget reductions, or farmed out to private consultants or county governments. Even essential police and fire protection services have been subject to cuts, including reductions in personnel levels, special programs, and training and equipment, which has resulted in increased response times. Last, code and building inspectors, engineering services, road maintenance, and numerous other local services, have, in general, been subject to budget reductions. To varying degrees, the quantity and quality of local unit services has declined across Michigan.

## Policy Proposals

In 2005, Governor Granholm appointed an advisory panel of local governmental interests to devise solutions to local unit financial crises. Among other key findings, the panel concluded that:

- While revenues have been restricted, many expenditures are increasing beyond the control of local government. The expenditures include, but are not limited to, health care, pension liabilities, and public safety costs subject to Public Act 312.
- The existing local government finance system, based on obsolete revenue foundations, is not resilient or flexible enough to withstand out-migration of taxpayers, whether due to economic downturns or availability of developable land.
- Legacy costs of post-employment benefits to retired workers threaten to overtake the majority of available new revenue of local governments.

**Table 1: Optimistic Projections**

Region	Annual Revenue Increase	Revenue Rate	Annual Cost Increase	Cost Rate	Catch-Up Year
Greater Grand Rapids	\$3,373,000	3%	\$1,616,000	8.30%	2021
Tri-Cities	\$1,271,000	1.80%	\$1,108,000	8.20%	2009
Downriver	\$4,300,000	2.60%	\$1,590,000	8.30%	2025
South Macomb	\$11,534,000	2.80%	\$3,372,000	8.70%	2028

- Local units of government deliver essential public services that entice and retain residents and businesses.
- Deferring maintenance on critical local infrastructure, such as roads, sewers, water mains, and buildings in order to meet ongoing increases in operating expenditures, has left many local governments with a crumbling infrastructure and growing future cost liabilities.
- State policies could potentially play an important role in encouraging cooperation and helping local governments to overcome the initial hurdles of consolidation of services.
- There is a lack of sufficient relevant data to analyze the impact of economic change on various types of units of local government.

*The state must recognize that local government needs adequate revenue foundations for essential services in order to retain and attract business.*

Key panel recommendations included:<sup>1</sup>

- A permanent state-supported institution to address local government issues and encourage cooperation. Included in the formal structure would be the standardization of financial reporting and collection and review of relevant comparative data.
- The General Property Tax Act can and should be amended to exempt increases in Taxable Value from Headlee millage rollback requirements following the transfer of property.
- State legislation must encourage regional cooperation among local units of government and eliminate regulatory obstacles at the local and state level to consolidating services with incentives and mandates.
- Public Act 312 of 1969 must be reviewed to better-define ability to pay and require specific, impartial actuarial cost information for pension modifications. Arbitrators must be better trained in municipal finance and legacy costs.
- Policy mandates to assure local governments have a long-term financial plan to adequately fund post retirement benefits should be considered. The state should adopt

legislation allowing municipal bond obligations as a strategy to manage and reduce long-term liabilities.

- The state must rebuild its commitment and partnership with local government by fully funding the Revenue Sharing Act under the current statutory formula.
- The state must recognize that local government needs adequate revenue foundations for essential services in order to retain and attract business.
- The state should commission an independent evaluation of all components of government infrastructure to assure a long-term reinvestment strategy.

In the 2007 State of the State address, Governor Granholm proposed:

*Cities and townships that want to see their revenue sharing increase this year will need to show us they are sharing services or consolidating with other units of government to save taxpayers money.<sup>2</sup>*

**Legislative Proposal**

Resulting from the speech was a provision in a 2007 appropriations bill that sought to earmark \$27 million (2.5%) of the statutory revenue sharing pool for communities “that achieve greater efficiencies in the delivery of essential public services.” Given the work of the Task Force on Local Governmental Services and the findings of the Land Policy Institute and the State and Local Government Programs at Michigan State University,<sup>3</sup> the legislation, while considered a step in the right direction, was viewed by some stakeholders as an insufficient response to a large problem.

*The General Property Tax Act can and should be amended to exempt increases in Taxable Value from Headlee millage rollback requirements following the transfer of property.*

Nonetheless, the legislation raised two discrete policy questions: (1) how far does \$27 million go in terms of promoting cooperation in local unit service provision; and (2) how, precisely,

**Table 2: Less Optimistic Projections**

Region	Annual Revenue Increase	Revenue Rate	Annual Cost Increase	Cost Rate	Catch-Up Year
Greater Grand Rapids	\$3,373,000	3%	\$1,616,000	9.50%	2018
Tri-Cities	\$1,271,000	1.50%	\$1,108,000	9.40%	2008
Downriver	\$4,300,000	2.30%	\$1,590,000	9.50%	2021
South Macomb	\$11,534,000	2.40%	\$3,372,000	10.00%	2024

are “greater efficiencies” defined? This research examines, in part, the first question.

**General Research Design**

Implicit in the legislative proposal to earmark a portion of state revenue sharing for intergovernmental cooperation agreements is the assumption that local units require an incentive over and above the financial efficiencies gained through service-sharing.

According to stakeholders, this is attributable to significant statutory and administrative barriers that prevent local units from merging or otherwise seeking service provision efficiencies. These barriers include funding costs for efficiency studies, Public Act 312 provisions, and political intransigence to mergers and service sharing agreements. However, a longer-term question is whether local unit financial stress can be stopped or significantly forestalled with service-sharing agreements, incentivised or not.

To test this, it is necessary to make long-range hypothetical assumptions about local unit finances in Michigan, including the continuance of revenue limitations and rising municipal costs. Specifically, this research examines 32 local units of government in four homogenous metropolitan regions in Michigan, arbitrarily chosen as prime areas for increased intergovernmental cooperation. These areas are: Grand Rapids (Metropolitan Council of Governments), the Tri-Cities area (Bay City, Midland, Saginaw, and outlying townships), Downriver Detroit (communities in the Downriver Community Conference), and cities in Southern Macomb County. The local units of government in each are as follows:

Grand Rapids Communities

- East Grand Rapids
- Grand Rapids
- Grand Rapids Township
- Grandville
- Kentwood
- Wyoming
- Walker

Tri-City Communities

- Bay City
- Essexville

- Midland
- Saginaw
- Saginaw Township

Downriver Community Conference

- Allen Park
- Brownstown Township
- Lincoln Park
- Melvindale
- Riverview
- Southgate
- Taylor
- Trenton
- Woodhaven
- Wyandotte

Southern Macomb County

- Centerline
- Clinton Township
- Eastpointe
- Fraser
- Harrison Township
- Mount Clemens
- Roseville
- Sterling Heights
- St. Clair Shores
- Warren

**Selection of Urbanized Regions**

These four regions were selected with the following criteria in mind:

- Older, generally disinvested areas of the state (median housing unit age over 50 years for the region as a whole)
- Relatively homogenous communities within a single county (except for Bay City-Midland-Saginaw); likely to explore enactment of service-sharing agreements
- Large enough to capture a significant proportion of state population, small enough to be a manageable study area (32 cities and townships, containing 13.5 percent of the state population)

**Table 3: Pessimistic Projections**

Region	Annual Revenue Increase	Revenue Rate	Annual Cost Increase	Cost Rate	Catch-Up Year
Greater Grand Rapids	\$3,373,000	2%	\$1,616,000	10.90%	2016
Tri-Cities	\$1,271,000	1.30%	\$1,108,000	10.80%	2008
Downriver	\$4,300,000	2.00%	\$1,590,000	10.90%	2019
South Macomb	\$11,534,000	2.00%	\$3,372,000	11.50%	2020

**Methods**

Financial data on the 32 cities and townships was taken from Certified Annual Financial Reports (CAFRs) and State of Michigan property tax and revenue sharing reports. These reports were researched for fiscal trends, such as increases in health care costs, personnel, pension costs, and associated costs. Specifically, the following data was obtained, for the years 1997 and 2006, for all 32 local units in the study:

- Health care and retirement contributions
- Property tax revenues
- Revenue sharing figures

These data allow for the computation and comparison of annualized rates of major costs and revenues in the four regions. Projections based on previous long-term financial histories can be made, and can test the efficacy of incentives for local unit service sharing.

In essence, this study treats the four regions as unified areas, by collectivizing the financial information of the component local units. It is important to bear in mind that health care and retirement contributions are not the sole costs associated with local unit administration; however, they are often cited by finance directors as rising faster than other local unit expenditures. Conversely, property taxes and state revenue sharing are not the sole sources of local unit revenue, but are, in most of the local units in this study, the two largest sources of local revenue.<sup>4</sup>

**Assumptions**

Given the hypothetical nature of this research, it is assumed that:

- There are no administrative or political barriers to intergovernmental cooperation
- Property taxes and state revenue sharing are the two largest sources of revenue for all local units
- Local units already doing so will continue to pay health and retirement costs from their general funds
- Property tax revenues are based on the 1997-2006 period in all local units in the study, and are characterized in nominal (non-inflation adjusted) dollars
- Revenue-sharing payments assume no change from 2006 levels (although statewide, there was a 2.9 % decline from

2005-2006 to 2006-2007, and a 31 % decline from 2000-2001 to 2006-2007)

- Future health care and retirement costs are based on the 1997-2006 period, and include premiums and payments only, and do not include local administrative costs
- Cost savings resulting from increased service sharing will range from three to five percent of the average annual gain in property tax revenues in each area

*Under the most optimistic scenario, Grand Rapids, Downriver and South Macomb will not have major costs that exceed revenues until 2018 at the earliest.*

**Results**

Tables 1-3 are summary results using three sets of financial assumptions; optimistic, less optimistic, and pessimistic. These assumptions all use, as a basis for future projections, the 1997-2006 financial history of major costs and revenues. For example, the Annual Revenue Increase for Greater Grand Rapids, \$3,373,000, represents the average collective gain in revenues, on an annualized basis, for all of the local units therein. Rates are derived from the actual rate of change over the 1997-2006 period. Table 2, Less Optimistic Projections, has the actual rates of change over this period, while Tables 1 and 3 arbitrarily adjust the rates (rates adjusted 15 percent up or down).

Under the most optimistic scenario, Grand Rapids, Downriver and South Macomb will not have major costs that exceed revenues until 2018 at the earliest. Table 2, which represents the actual revenue and cost picture for the four selected areas, offers good news for those same three areas, but has the Tri-Cities area with major costs and expenses at parity at the close of this year. Table 3, with pessimistic projections (slower-than-historic revenue increases and faster-than-historic cost increases), has revenues and costs in all areas at parity by 2020.

**Columns in Tables 1-3**

**1. Annual Revenue Increase** represents the projected annual increase in local revenues attributable to three revenue components: property taxes, revenue sharing, and savings incurred through

service sharing agreements.

**2. Revenue Rate** represents the blended average rate increase of the three local revenue components that comprise the Annual Revenue Increase.

**3. Annual Cost Increase** represents the projected annual increase in local costs attributable to two cost components: health care and retirement.

**4. Cost Rate** represents the blended average cost increase of the two local cost components that comprise the Annual Cost Increase.

**5. Catch-Up Year** represents the year when the annualized costs catch up with the annualized revenues, assuming no rate changes.

### Conclusion

These findings should in no way be interpreted to suggest that local unit finances are in good shape in the selected areas or across the state. Indeed; this hypothetical analysis of regions necessarily has financially healthy local units supporting distressed ones, and it does not include the full set of local unit costs and revenues. Revenue and cost analysis has been vastly oversimplified here. However, these findings do suggest that local units seeking to economize on service provision through service-sharing

agreements can probably afford do so without the help of legislative earmarks. Last, it is imperative that administrative and statutory barriers to service-sharing agreements are lifted or reformed to allow such agreements to occur organically.

### Notes

- 1 State of Michigan Task Force on Local Governmental Services and Fiscal Stability. (2006, May). *Final Report to the Governor*.
- 2 Gov. Granholm. (2007, February 6).
- 3 Land Policy Institute and State and Local Government Program at Michigan State University. (2007, May 18). *Intergovernmental Cooperation: A Policy Conference Final Report*.
- 4 Three local units in the study, Grand Rapids, Saginaw, and Walker, levy local income taxes that produce revenues that exceed state revenue sharing funding.

### About the Authors:

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Visit <http://ced.msu.edu/> to obtain a copy of the full report summarized in this brief.

### About the Series:

The **Urban Policy Research Series** addresses critical urban policy issues facing our State by connecting Michigan's core city mayors and legislative leaders with its finest urban scholars. By supporting of policy research on priority issues identified by mayors themselves, the Policy Research Series mobilizes practical scholarship concerning urgent issues facing Michigan's older central cities. In 2007, with support from the W. K. Kellogg Foundation through the MIHELP consortium, Michigan scholars were invited to propose policy research and analysis projects concerning specific issues identified as of high priority to members of the Urban Core Mayors. Six projects were selected, and researchers were commissioned to conduct the first of what is intended as an annual cycle of targeted policy research.

The resulting policy forums, Policy Briefs, and Research Reports is intended to provide current, credible and practical information for local and state officials as they consider important public policy decisions that will affect Michigan cities. By supporting the development of a growing network of scholars actively researching issues that have practical implications for urban and metropolitan Michigan, the Urban Policy Research Series is also intended to increase the capacity of the higher education community to contribute its unique added value to the ongoing civic discourse that shapes Michigan's local and state policy environment.

### About the Partners:

The Urban Policy Research Series is the result of a partnership between elected leaders in local and state government and Michigan's higher education community. Special thanks to Faron Supanich for his leadership in coordinating this project, and Graham L. Pierce for preparing this report for publication.

The **Urban Core Mayors** is a bipartisan, multi-regional group established in 1992 to work together for local and state solutions to common problems facing Michigan's core cities. Urban Core Mayors members include the Mayors of Ann Arbor, Battle Creek, Bay City, Dearborn, Detroit, Flint, Grand Rapids, Jackson, Kalamazoo, Lansing, Muskegon, Pontiac, and Saginaw.

The **Bipartisan Urban Caucus** is a bicameral, bipartisan network of legislators, established in 1995 by legislators seeking to develop a state policy agenda to support the revitalization of Michigan's core cities.

The **Center for Community and Economic Development** is a Lansing-based unit of Michigan State University's Office of University Outreach and Engagement. Established in 1969 to initiate and support innovative problem-solving strategies to improve the quality of life in distressed communities throughout Michigan, CCED provides a multidisciplinary capacity to respond to the complex, interrelated issues of communities. In fulfilling its mission to engage university resources in support of Michigan communities, CCED has provided assistance and information to the Urban Core Mayors since 1993. For more information visit <http://www.ced.msu.edu/>

The **Michigan Higher Education Land Policy Consortium (MIHELP)** is a public-private, multi-university, inter-disciplinary partnership between Michigan State University, Wayne State University, Grand Valley State University, and Public Sector Consultants, headquartered at MSU's Land Policy Institute. Established in 2005 with generous support from the W. K. Kellogg Foundation, the mission of MIHELP is to help make Michigan's urban and metropolitan areas vibrant and successful communities by addressing the fundamental research and outreach void in urban and metropolitan issues in the State. For more information

