CITIZENS RESEARCH COUNCIL OF MICHIGAN CELEBRATING 100 YEARS

CLOSUP Center for Local, State, and Urban Policy

Gerald R. Ford School of Public Policy University of Michigan

Is Michigan's System of Funding Local Government Broken?

Joint Webinar

September 13, 2016

CLOSUP

The Center for Local, State, and Urban Policy (CLOSUP), housed at the University of Michigan's Gerald R. Ford School of Public Policy, conducts and supports applied policy research designed to inform state, local, and urban policy issues. Through integrated research, teaching, and outreach involving academic researchers, students, policymakers and practitioners, CLOSUP seeks to foster understanding of today's state and local policy problems, and to find effective solutions to those problems.

Learn more at closup.umich.edu

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*

Thomas Ivacko, Administrator & Program Manager
CLOSUP at Ford School in University of Michigan

Sarah Mills, Project Manager & Postdoctoral Fellow
CLOSUP at Ford School in University of Michigan

Eric Lupher, President
Citizens Research Council of Michigan

CLOSUP
Center for Local, State, and Urban Policy

Gerald R. Ford School of Public Policy

Funding local government in Michigan: a broken system?

Webinar

September 13, 2016

The Michigan Public Policy Survey

- **Census survey** – all counties, cities, townships, and villages (over 70% response rates); twice/year
- **Respondents** – chief elected and appointed officials
- **Topics** – wide range, such as fiscal health, budget priorities, economic development, intergovernmental cooperation, employee policies, labor unions, state relations, environmental sustainability, citizen engagement, much more.

Warning Signs

"Within five years all of our urban cores are going to be where Flint is at today, unless some significant changes are made.

The way we finance cities today is broken."

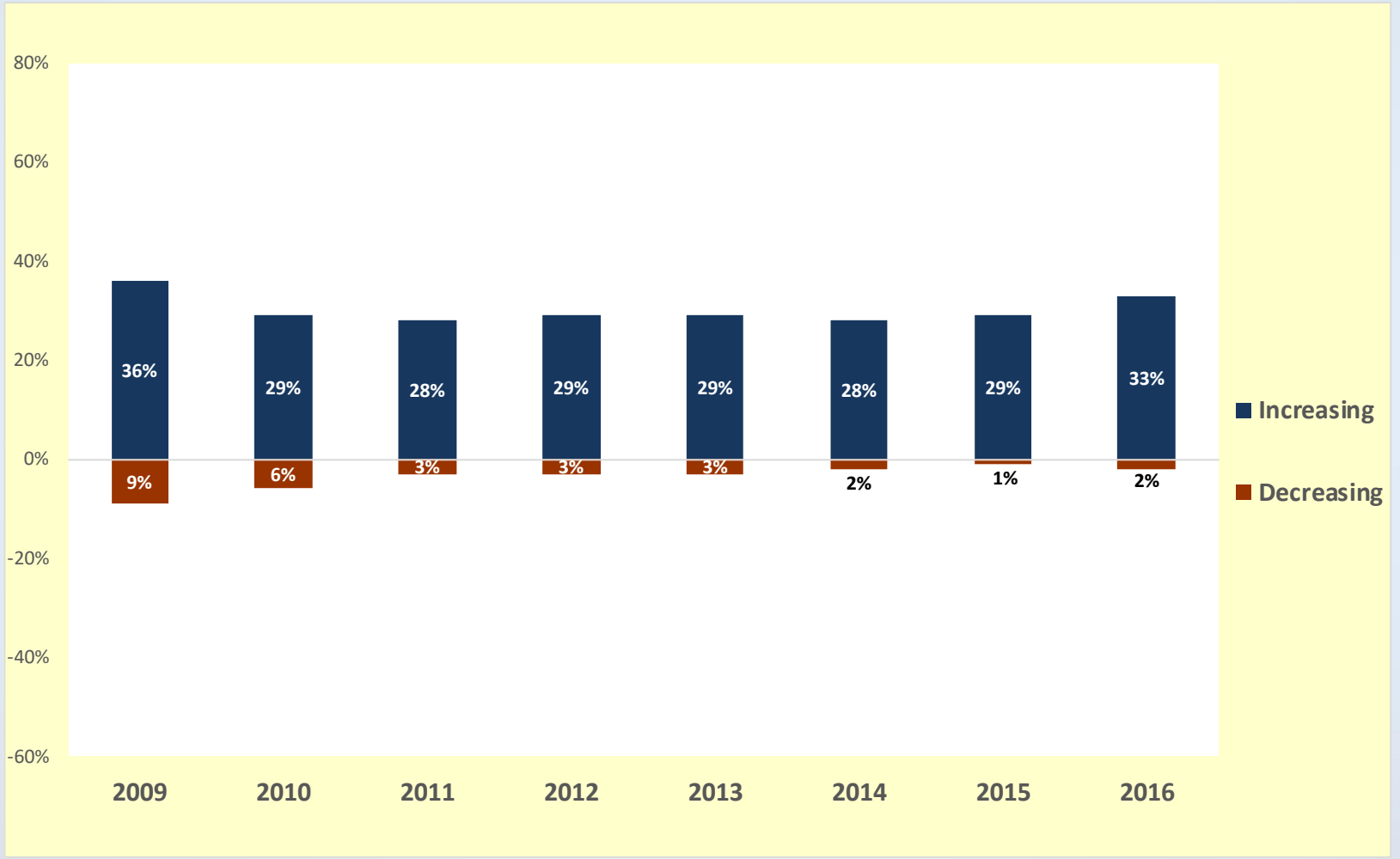
- **Ed Kurtz, Emergency Financial Manager, City of Flint**
(Michigan Radio, 1/30/2013)

Presentation Outline

- Service demands increasing, costs increasing, but revenues not keeping pace?
- Local leaders' views on whether Michigan's system of funding local government is broken
- What local leaders say should be done

Increasing Needs and Demands

% of jurisdictions with changing **public safety demands**

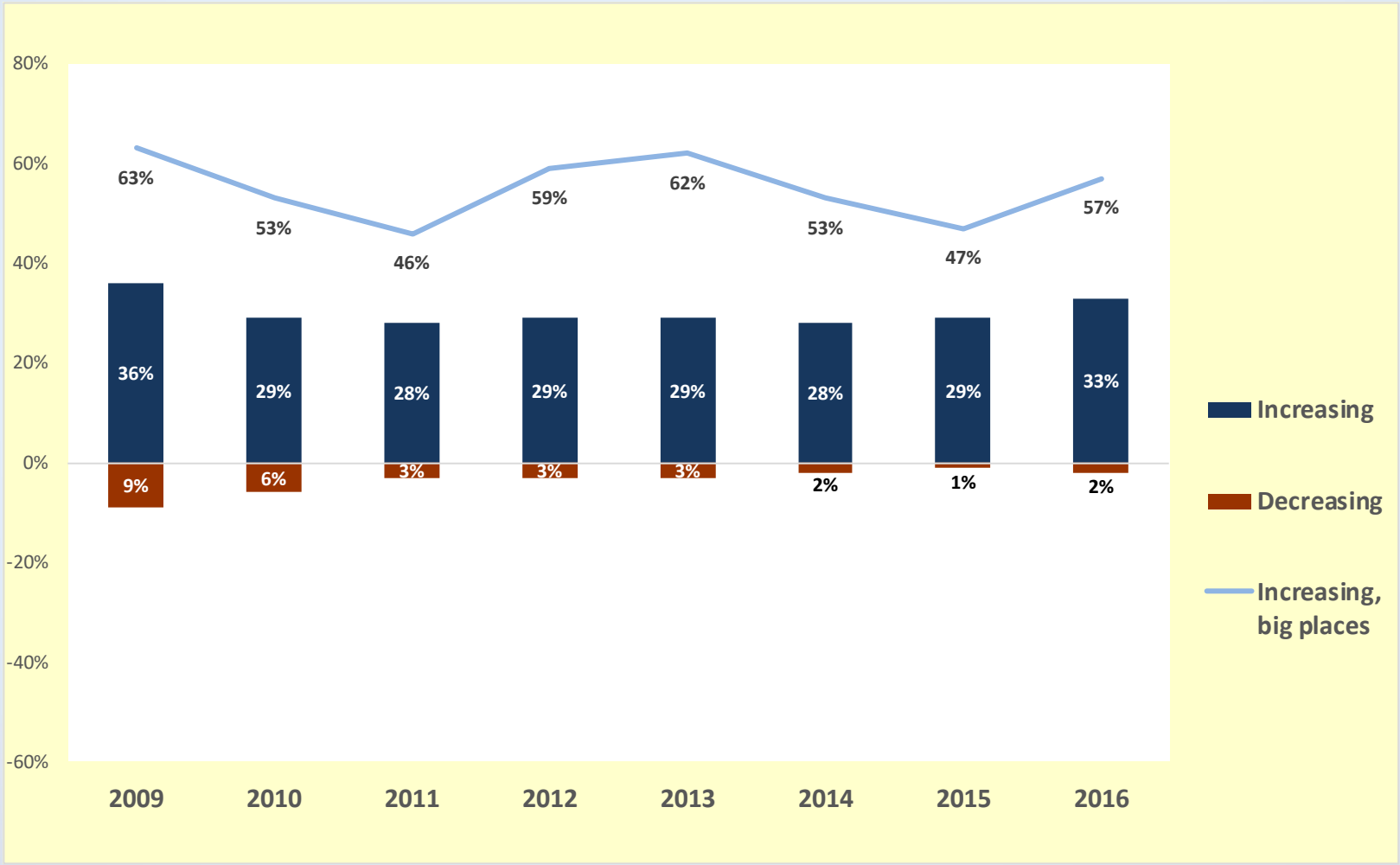


CLOSUP Center for Local, State, and Urban Policy

Gerald R. Ford School of Public Policy

Increasing Needs and Demands

% of jurisdictions with changing **public safety demands**,
(line shows % of **largest communities** with increasing needs)

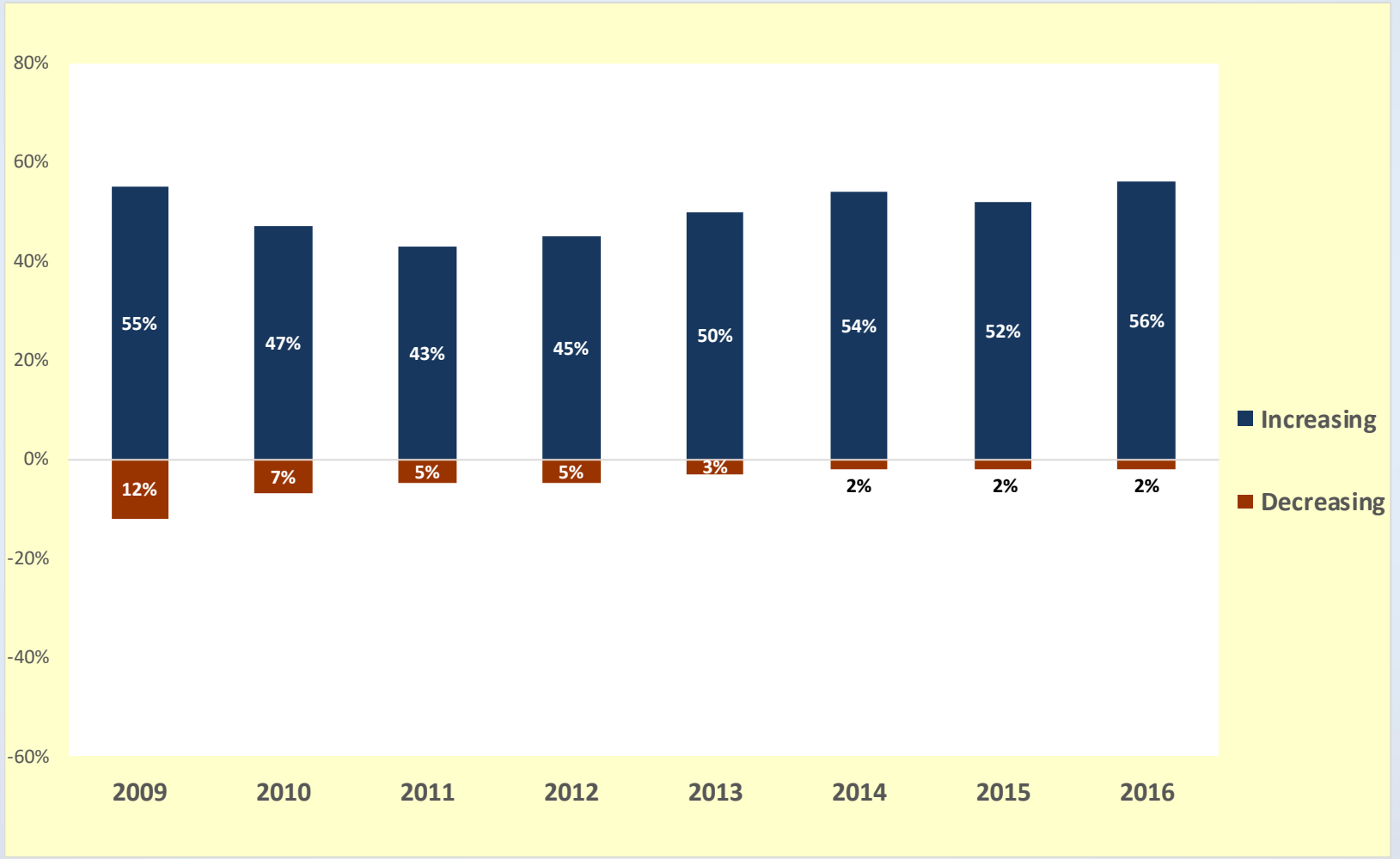


CLOSUP Center for Local, State, and Urban Policy

Gerald R. Ford School of Public Policy

Increasing Needs and Demands

% of jurisdictions with changing **infrastructure demands**

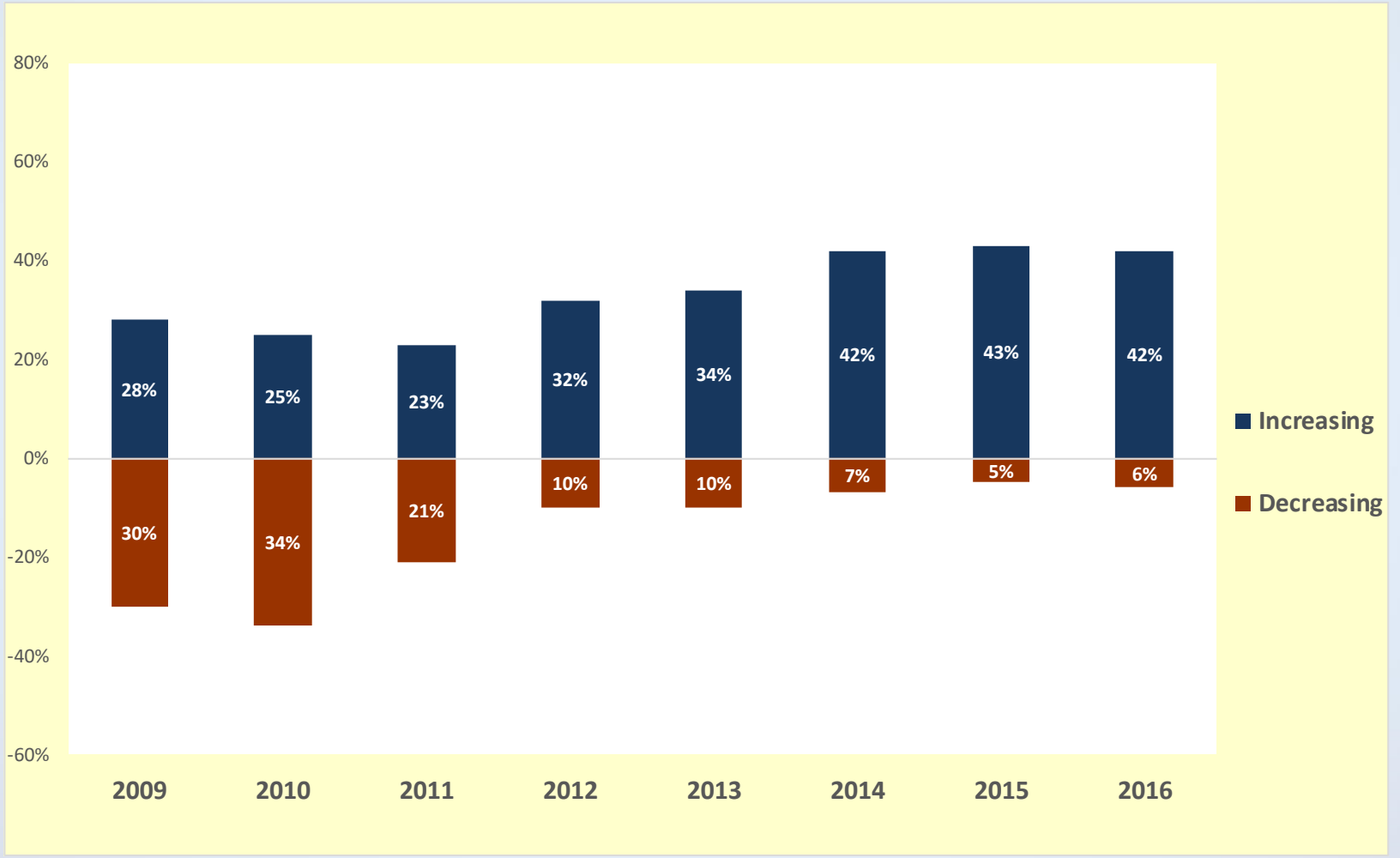


CLOSUP Center for Local, State, and Urban Policy

Gerald R. Ford School of Public Policy

Increasing Costs

% of jurisdictions with changing **infrastructure spending**

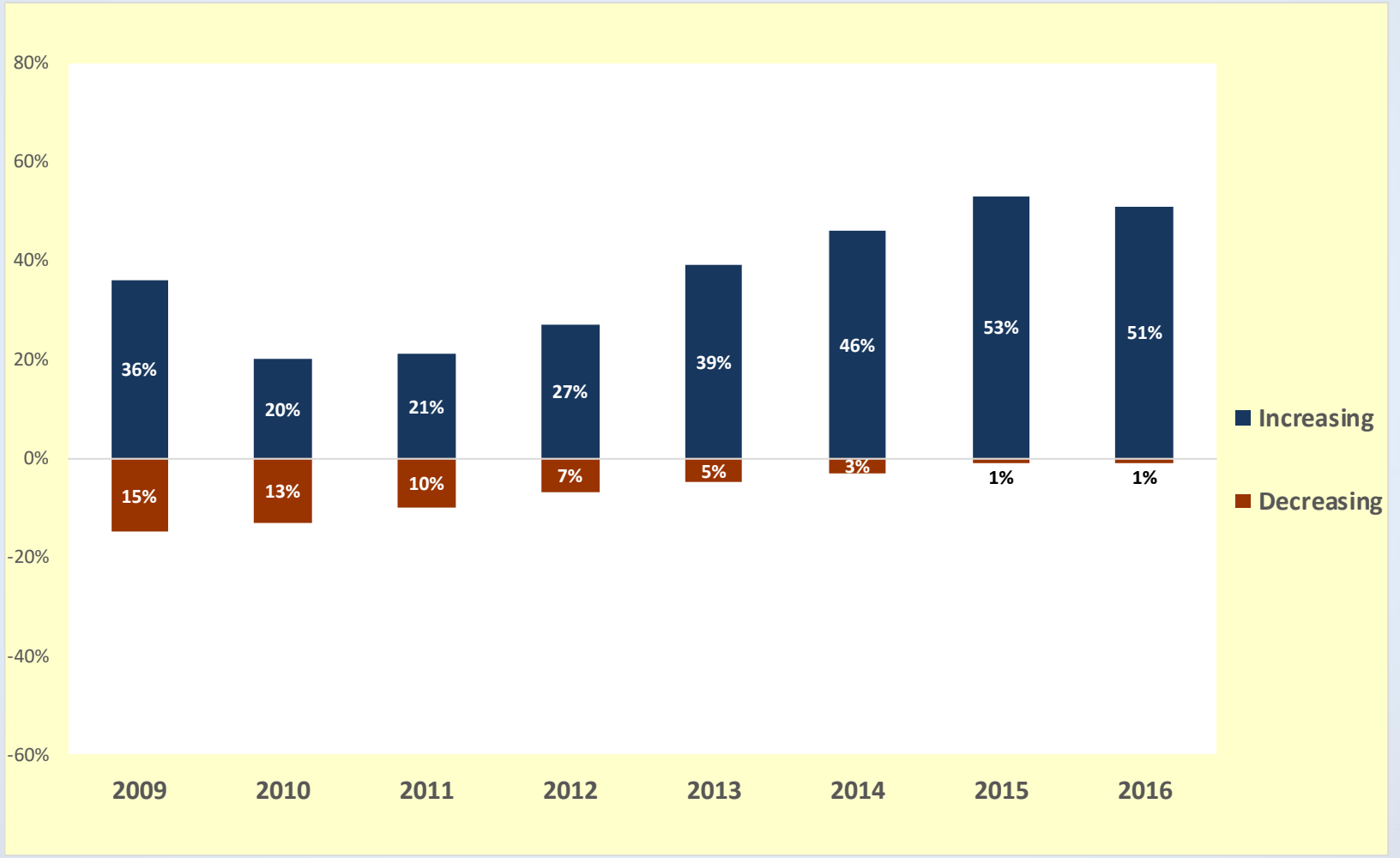


CLOSUP Center for Local, State, and Urban Policy

Gerald R. Ford School of Public Policy

Increasing Costs

% of jurisdictions with changing **employee pay rates**

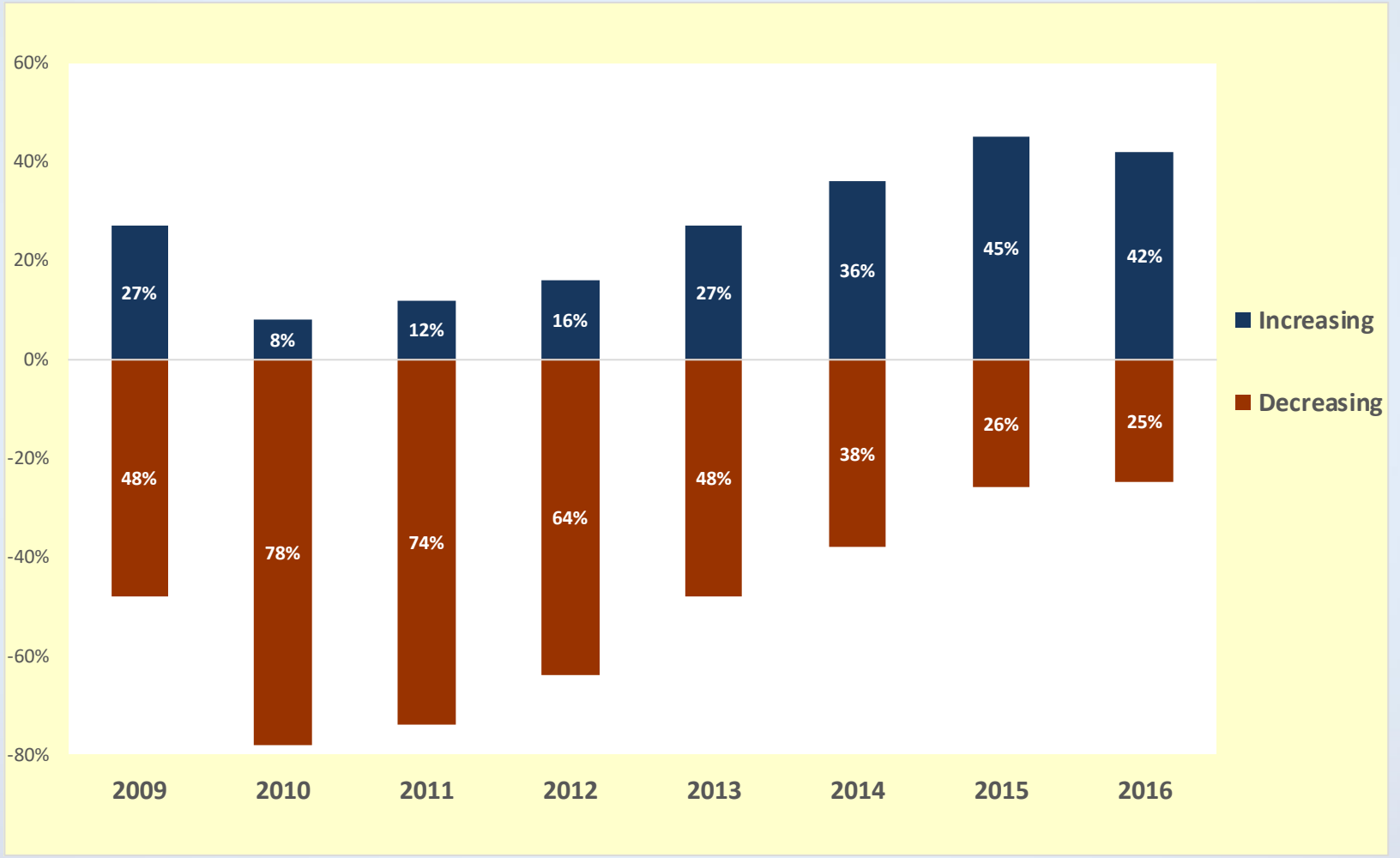


CLOSUP Center for Local, State, and Urban Policy

Gerald R. Ford School of Public Policy

Changing Revenues

% of jurisdictions with changing **property tax revenues**

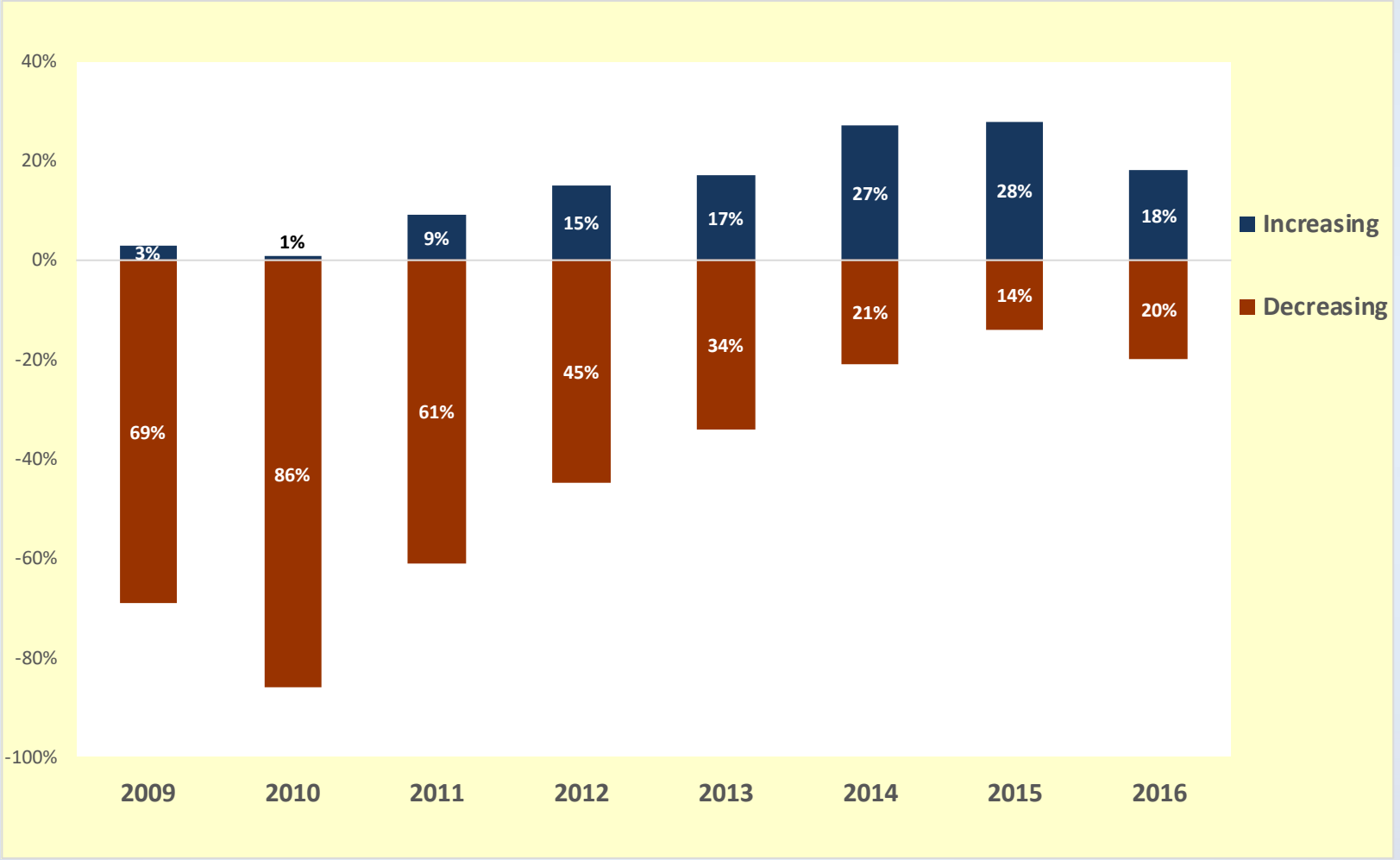


CLOSUP Center for Local, State, and Urban Policy

Gerald R. Ford School of Public Policy

Changing Revenues

% of jurisdictions with changing **state aid**

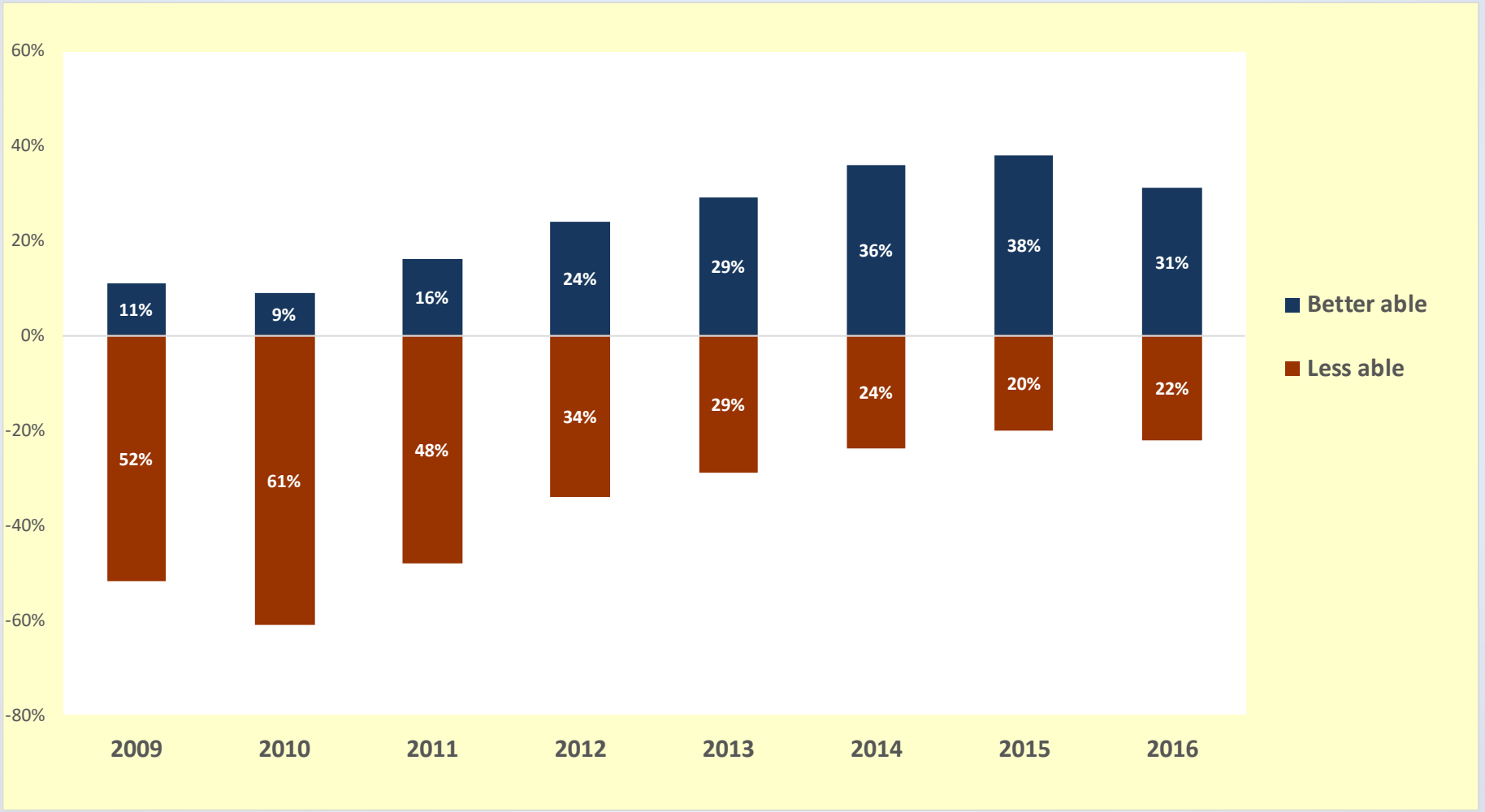


CLOSUP Center for Local, State, and Urban Policy

Gerald R. Ford School of Public Policy

Changing Fiscal Health

% of jurisdictions better vs. less **able to meet fiscal needs**

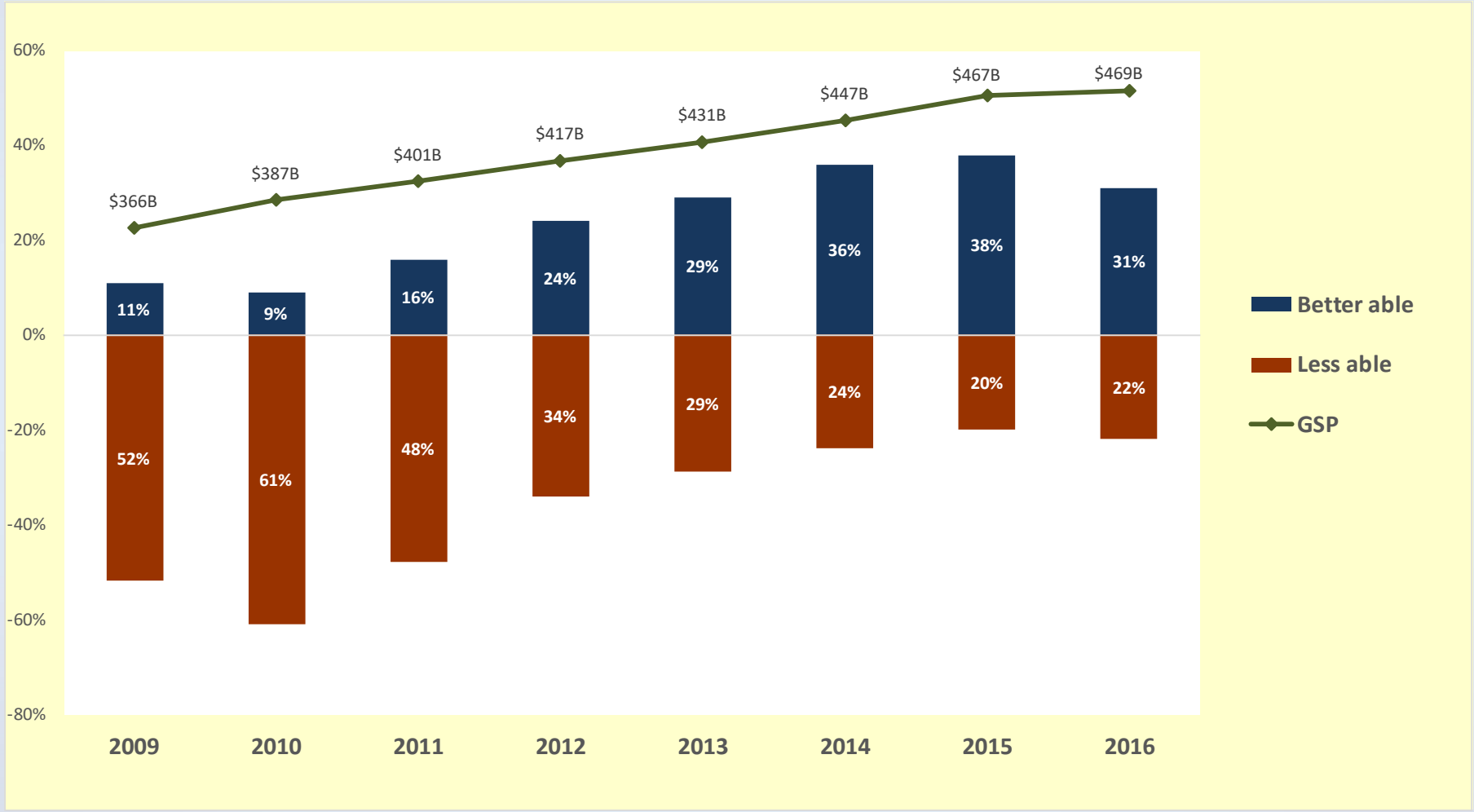


CLOSUP Center for Local, State, and Urban Policy

Gerald R. Ford School of Public Policy

Changing Fiscal Health

% of jurisdictions better vs. less **able to meet fiscal needs, with Michigan Gross State Product**



CLOSUP Center for Local, State, and Urban Policy

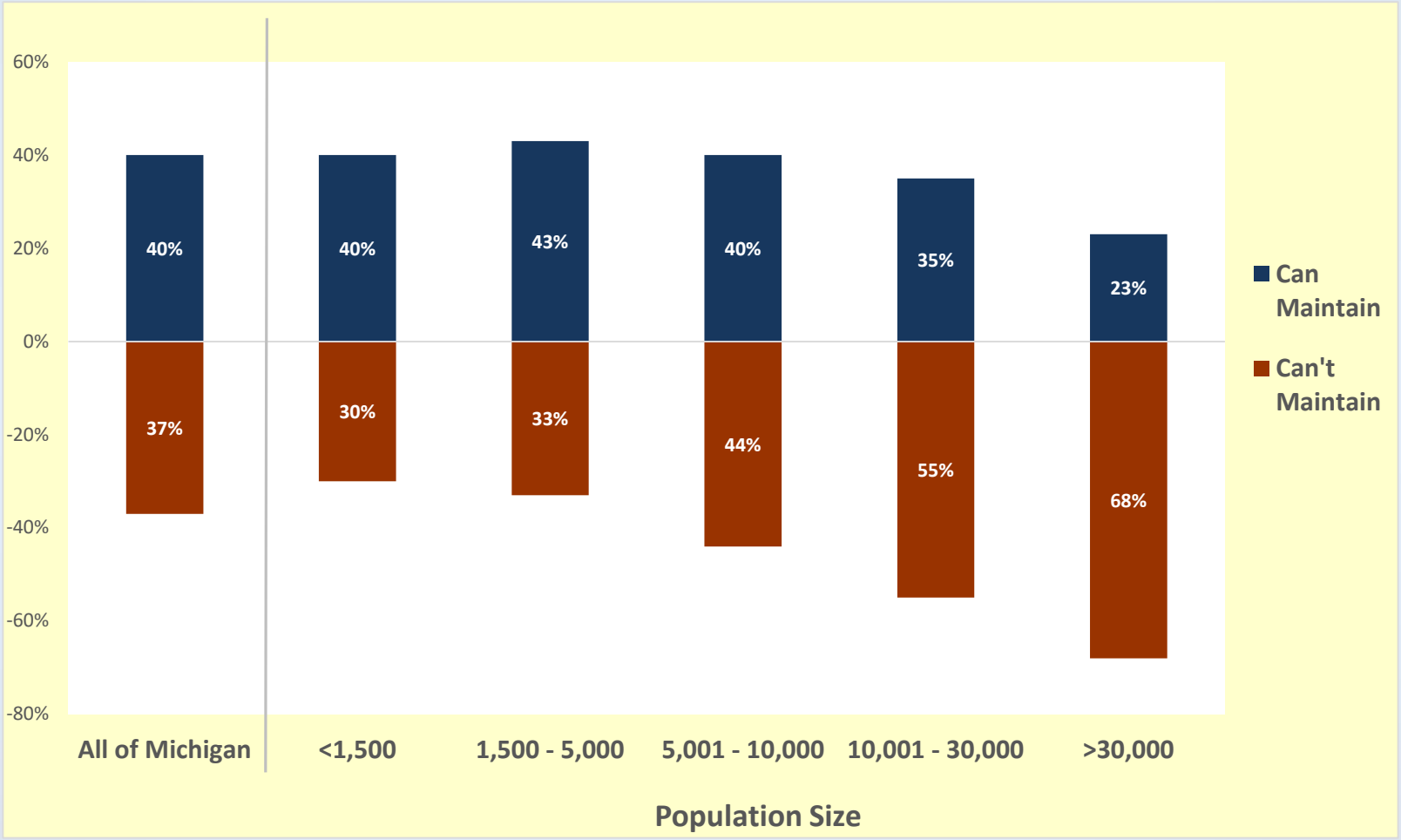
Gerald R. Ford School of Public Policy

Presentation Outline

- Service demands increasing, costs increasing, but revenues not keeping pace?
- Local leaders' views on whether Michigan's system of funding local government is broken
- What local leaders say should be done

Concerns Going Forward

% that can **maintain services** in current system

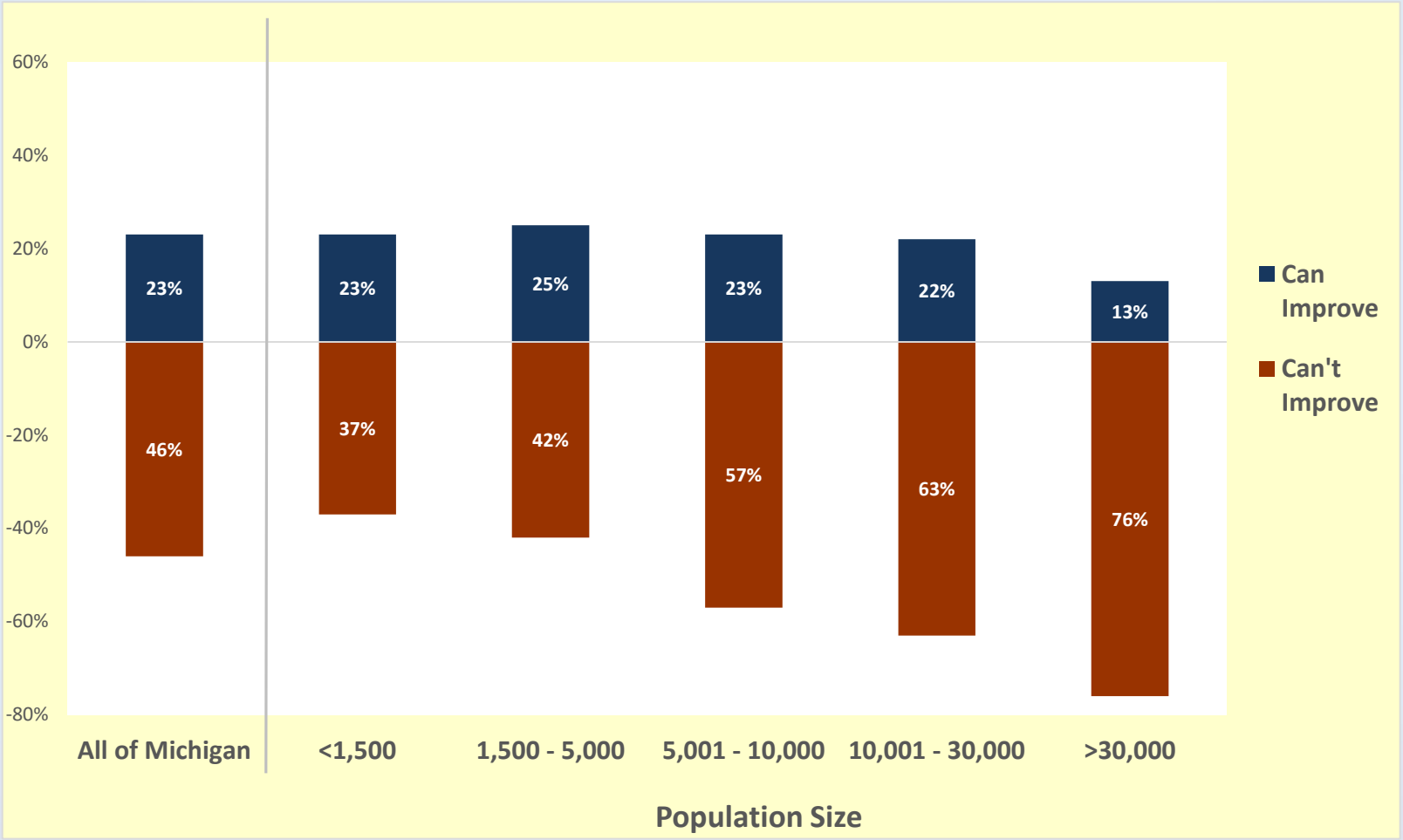


CLOSUP Center for Local, State, and Urban Policy

Gerald R. Ford School of Public Policy

Concerns Going Forward

% that can **improve/add services** in current system

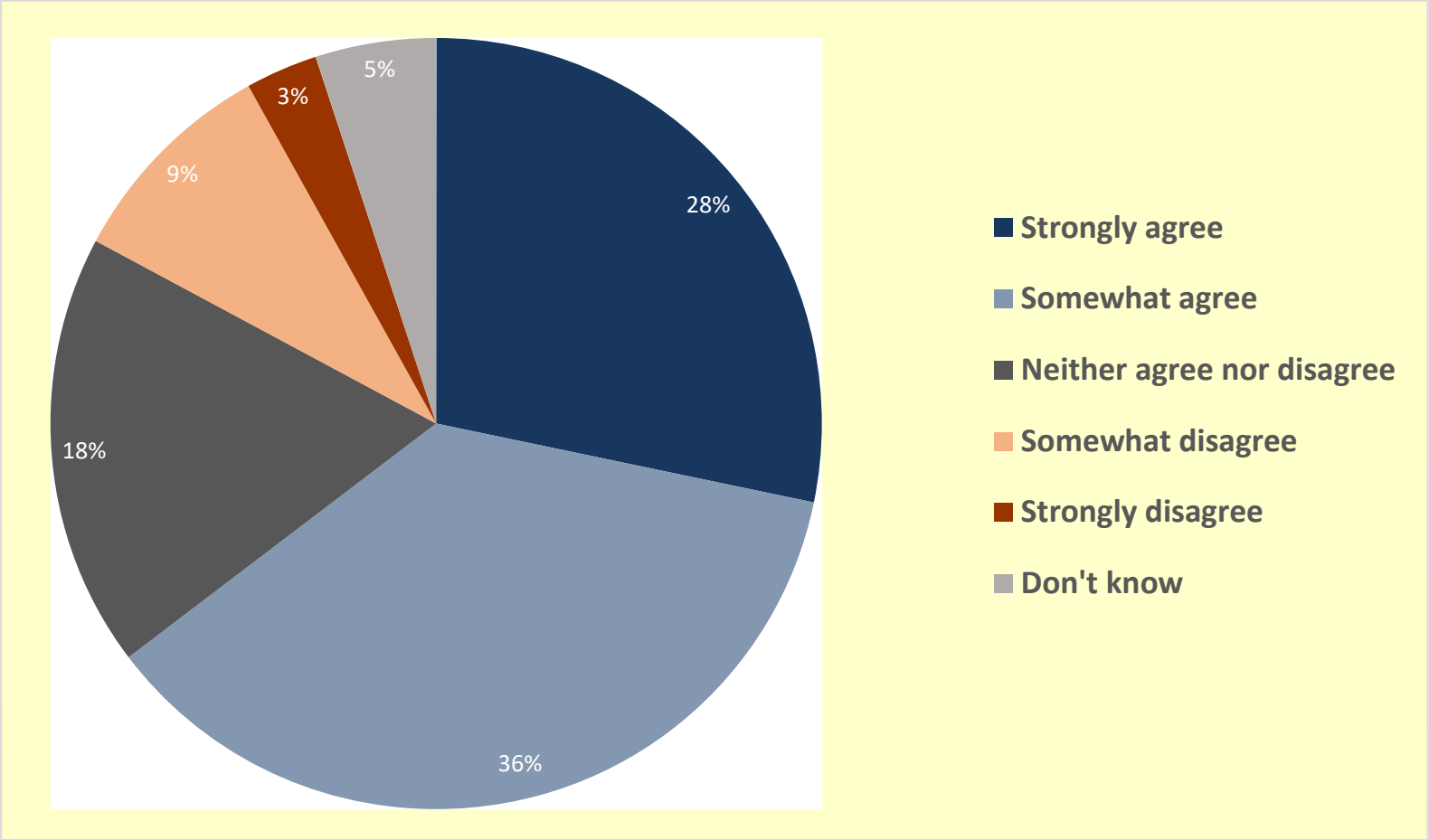


CLOSUP Center for Local, State, and Urban Policy

Gerald R. Ford School of Public Policy

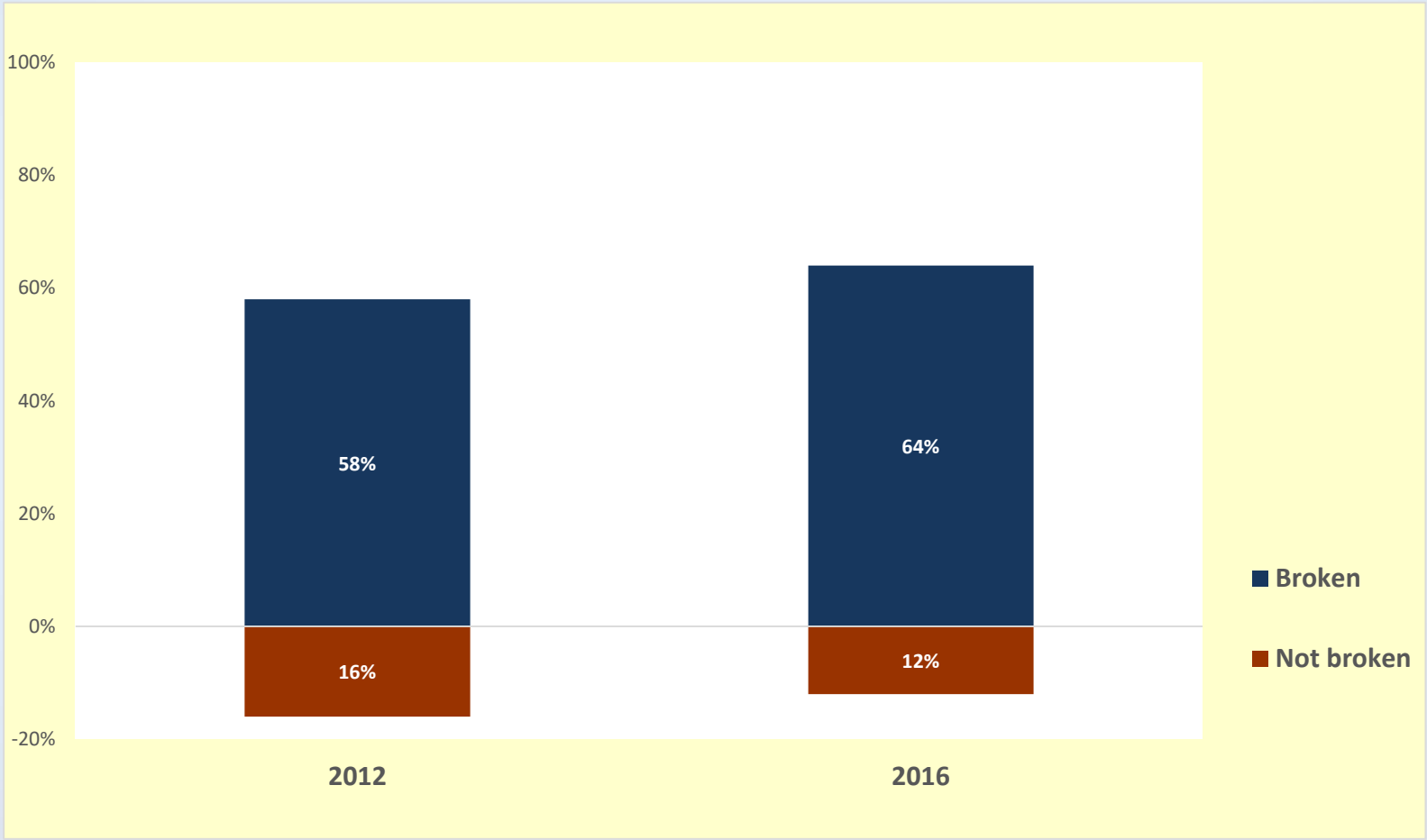
Support for Reforming System

% that believe **system is broken** and needs **significant reform**



Support for Reforming System

% that believe **system is broken** and needs **significant reform**

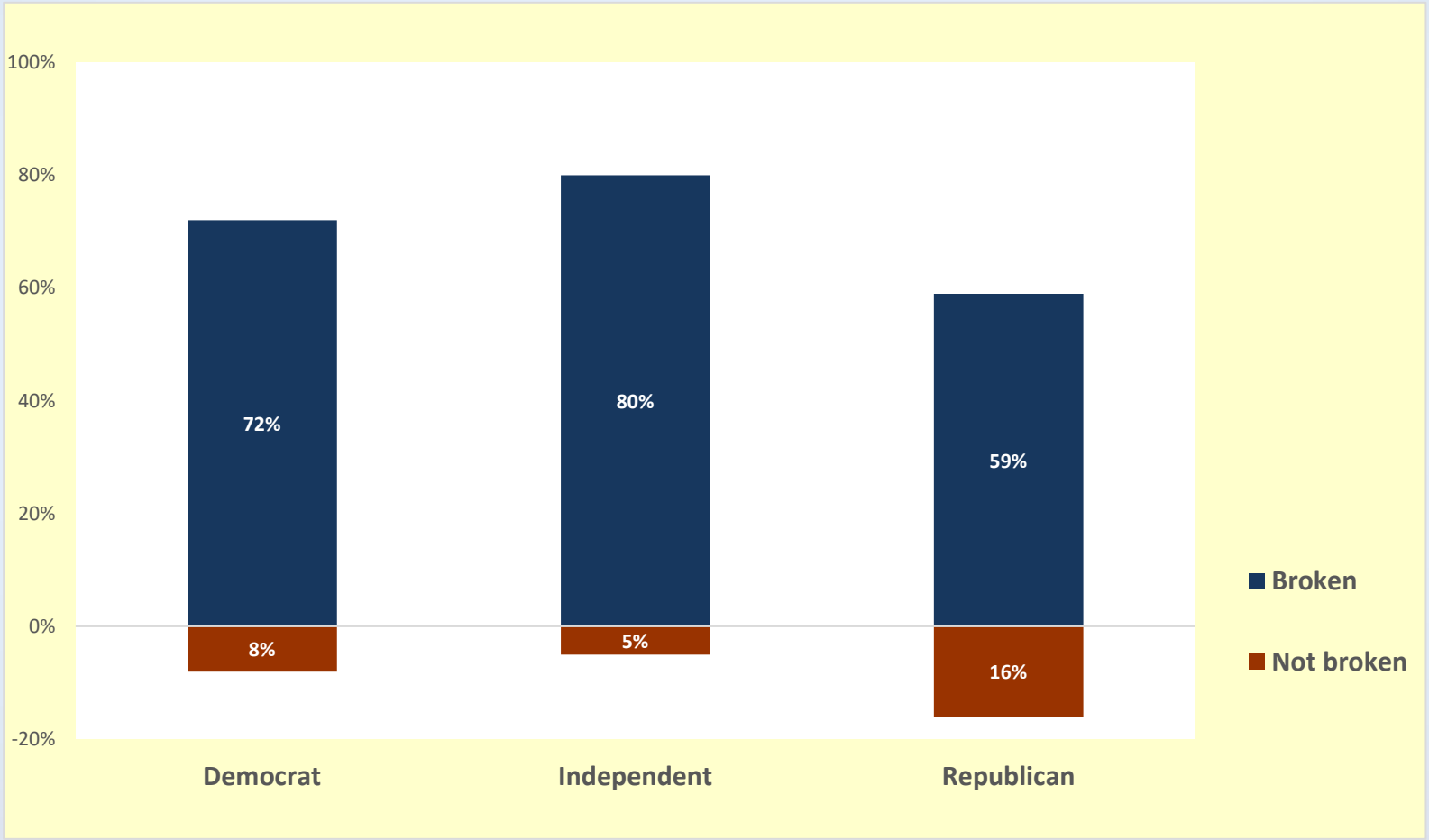


CLOSUP Center for Local, State, and Urban Policy

Gerald R. Ford School of Public Policy

Support for Reforming System

% that believe **system is broken** and needs **significant reform**

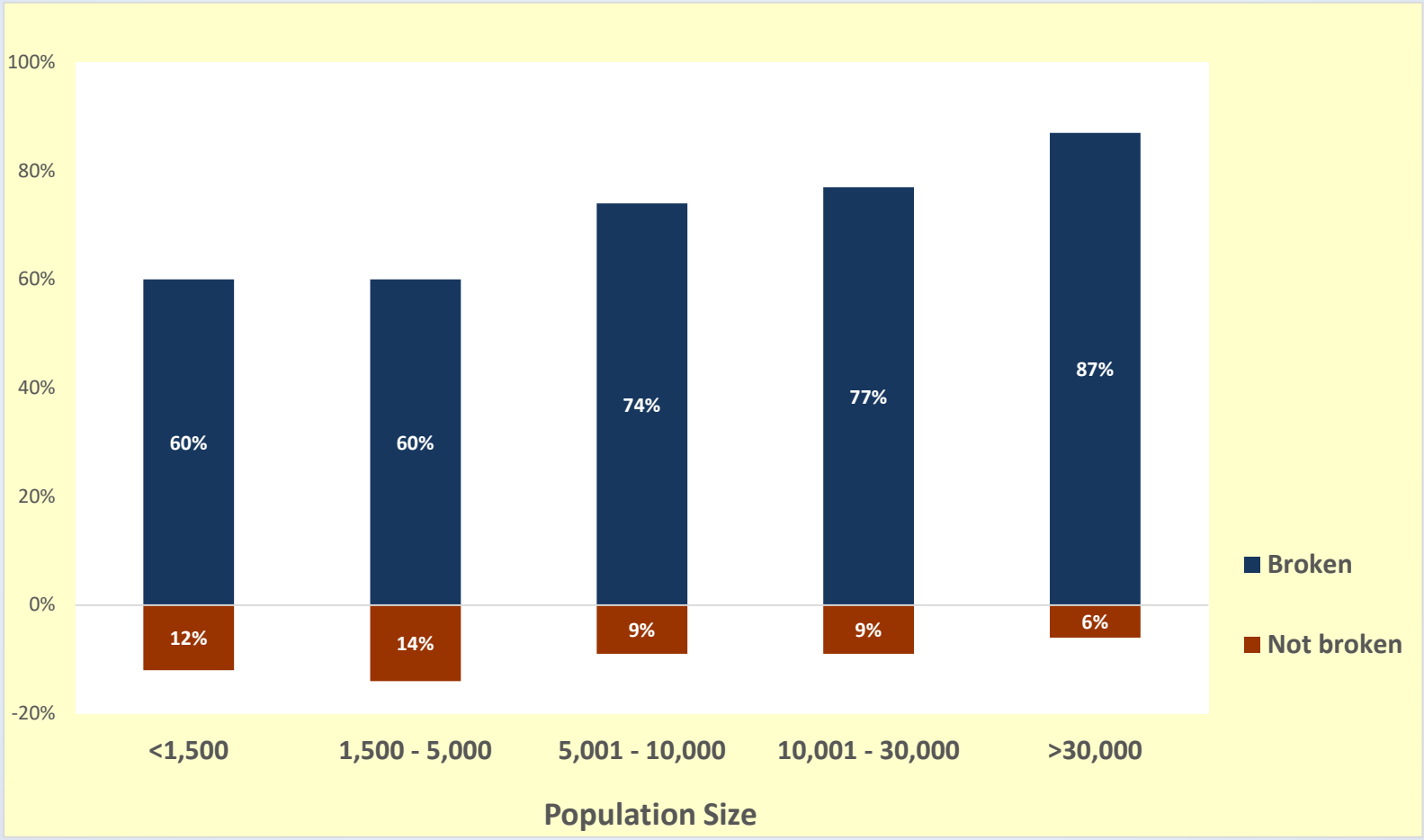


CLOSUP Center for Local, State, and Urban Policy

Gerald R. Ford School of Public Policy

Support for Reforming System

% that believe **system is broken** and needs **significant reform**



CLOSUP Center for Local, State, and Urban Policy

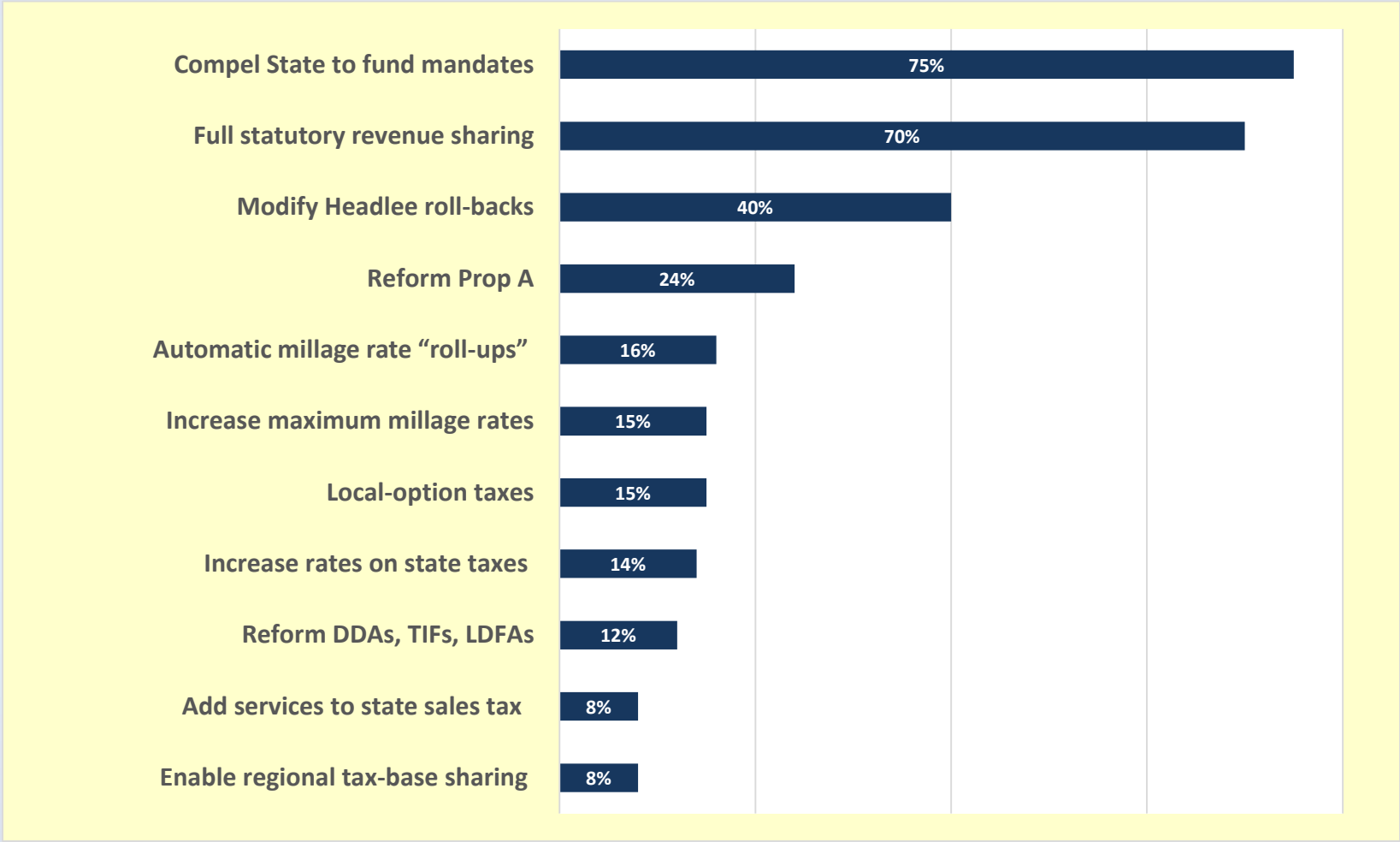
Gerald R. Ford School of Public Policy

Presentation Outline

- Service demands increasing, costs increasing, but revenues not keeping pace?
- Local leaders' views on whether Michigan's system of funding local government is broken
- What local leaders say should be done

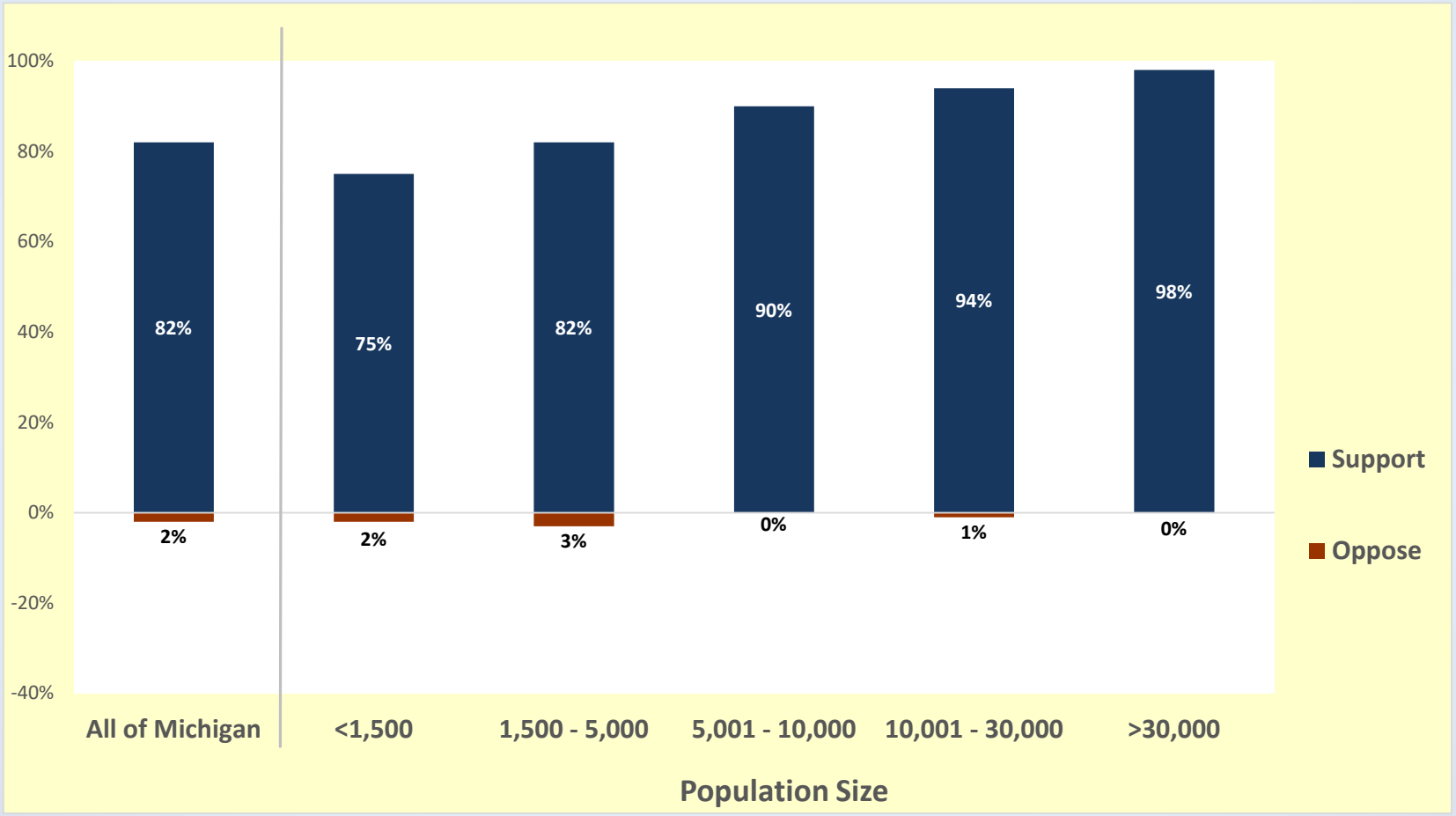
Support for Specific Reforms

% that rank each reform in their **top 3**



Support for Specific Reforms

% that support compelling the State to pay for **"unfunded mandates"**



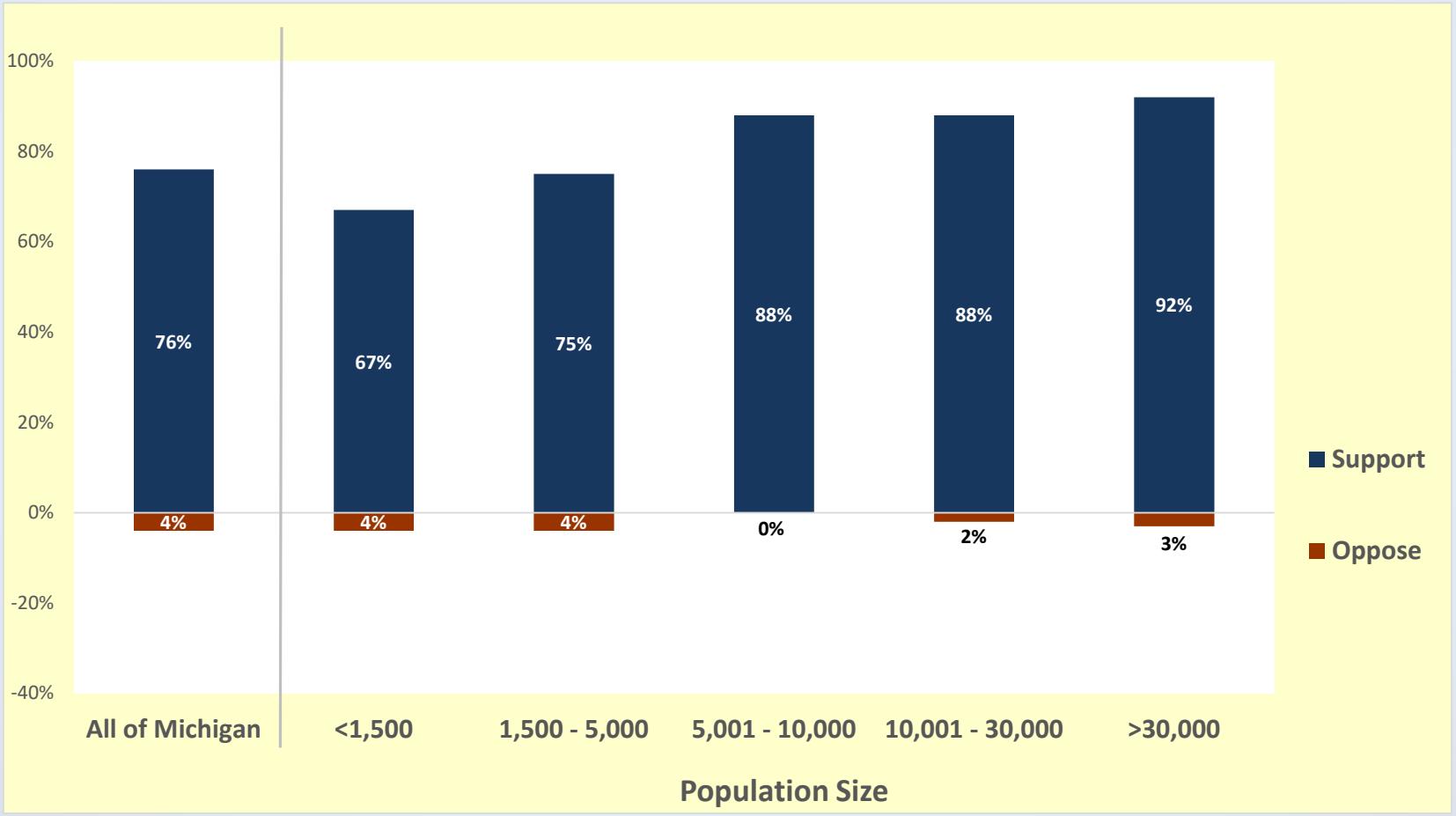
CLOSUP Center for Local, State, and Urban Policy

Gerald R. Ford School of Public Policy

Support for Specific Reforms

% that support restoring

full statutory revenue sharing

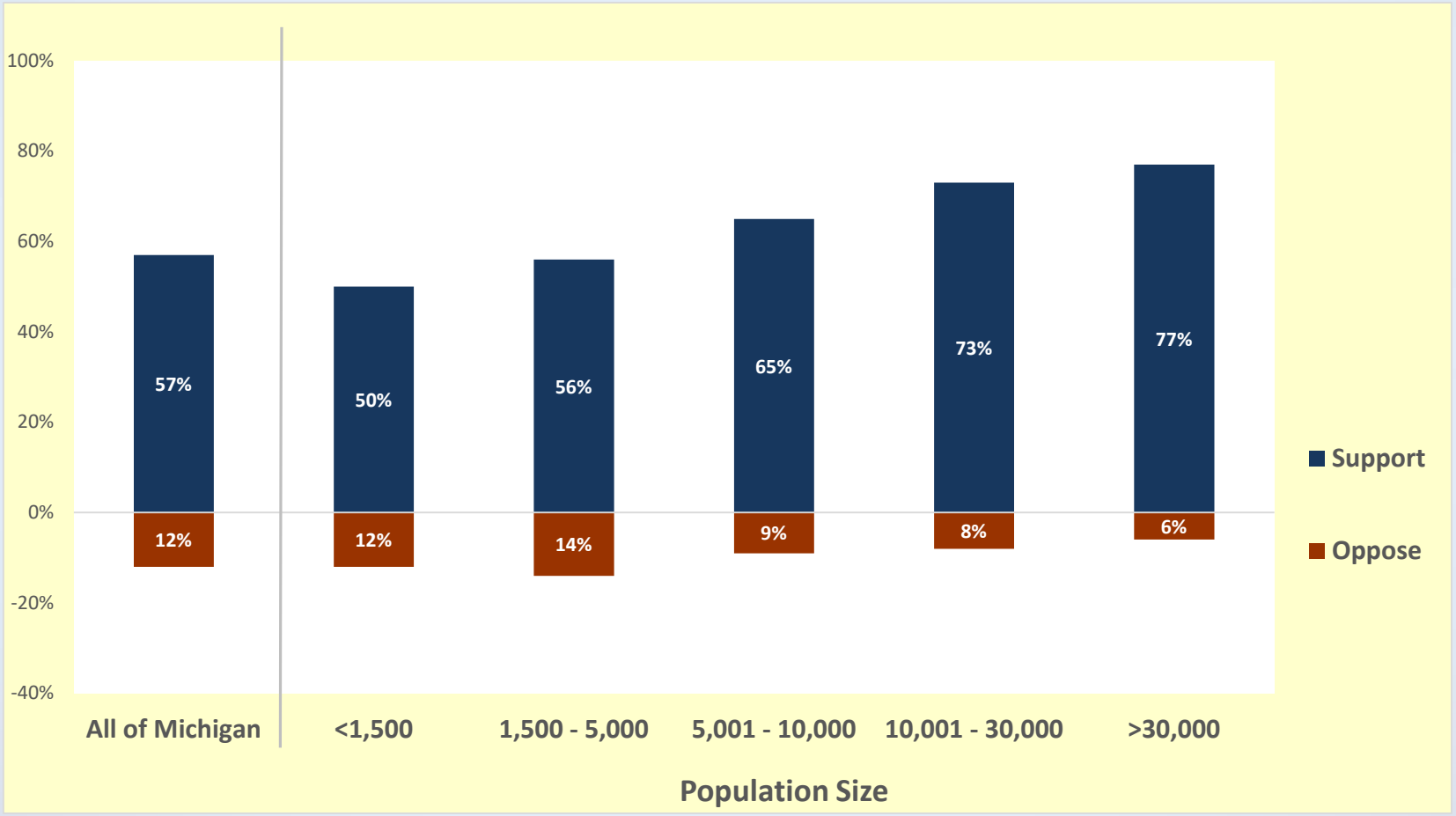


CLOSUP Center for Local, State, and Urban Policy

Gerald R. Ford School of Public Policy

Support for Specific Reforms

% that support reforming Headlee Amendment to eliminate/limit **millage rate roll-backs**



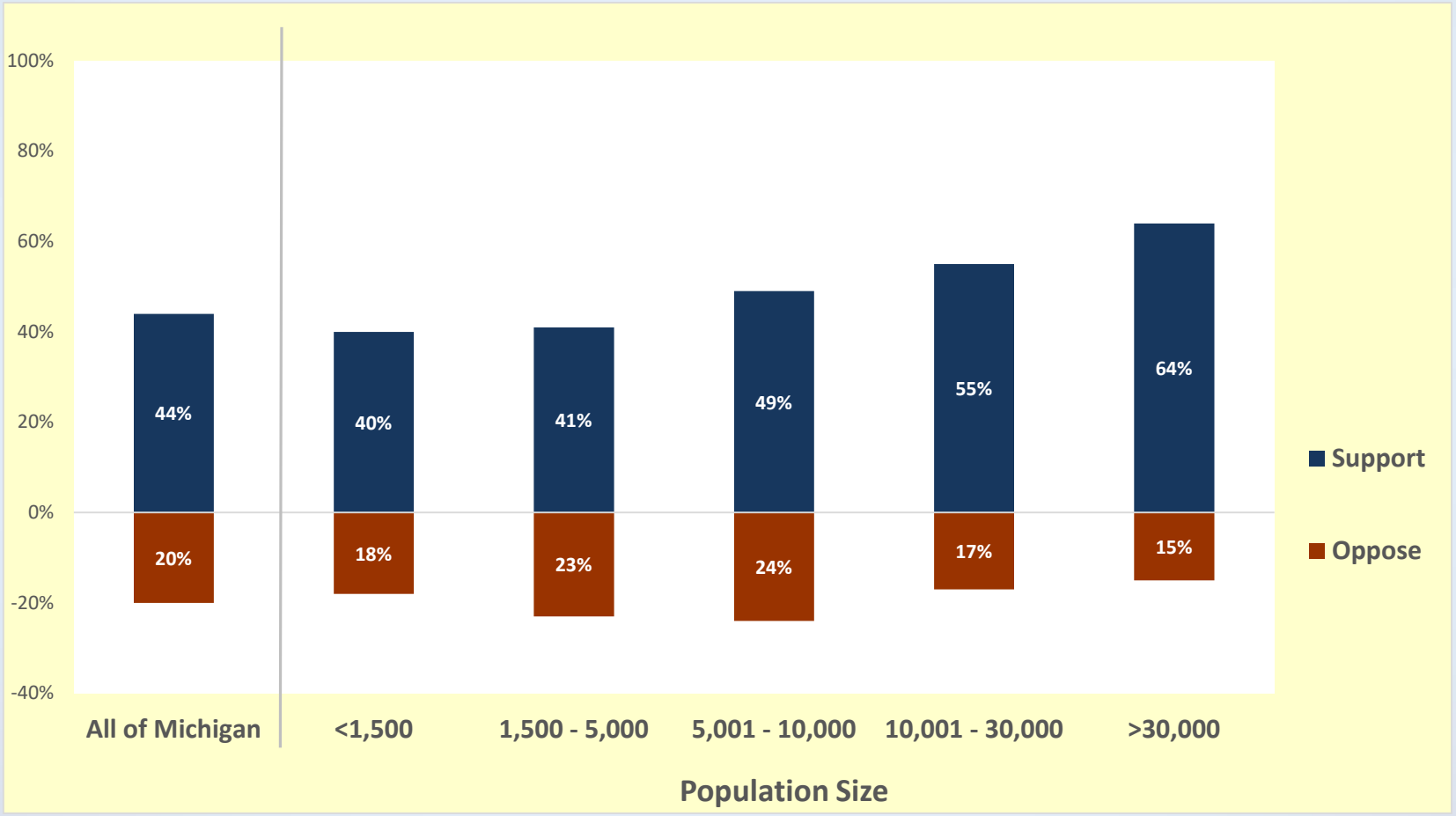
CLOSUP Center for Local, State, and Urban Policy

Gerald R. Ford School of Public Policy

Support for Specific Reforms

% that support establishing automatic

millage rate roll-ups

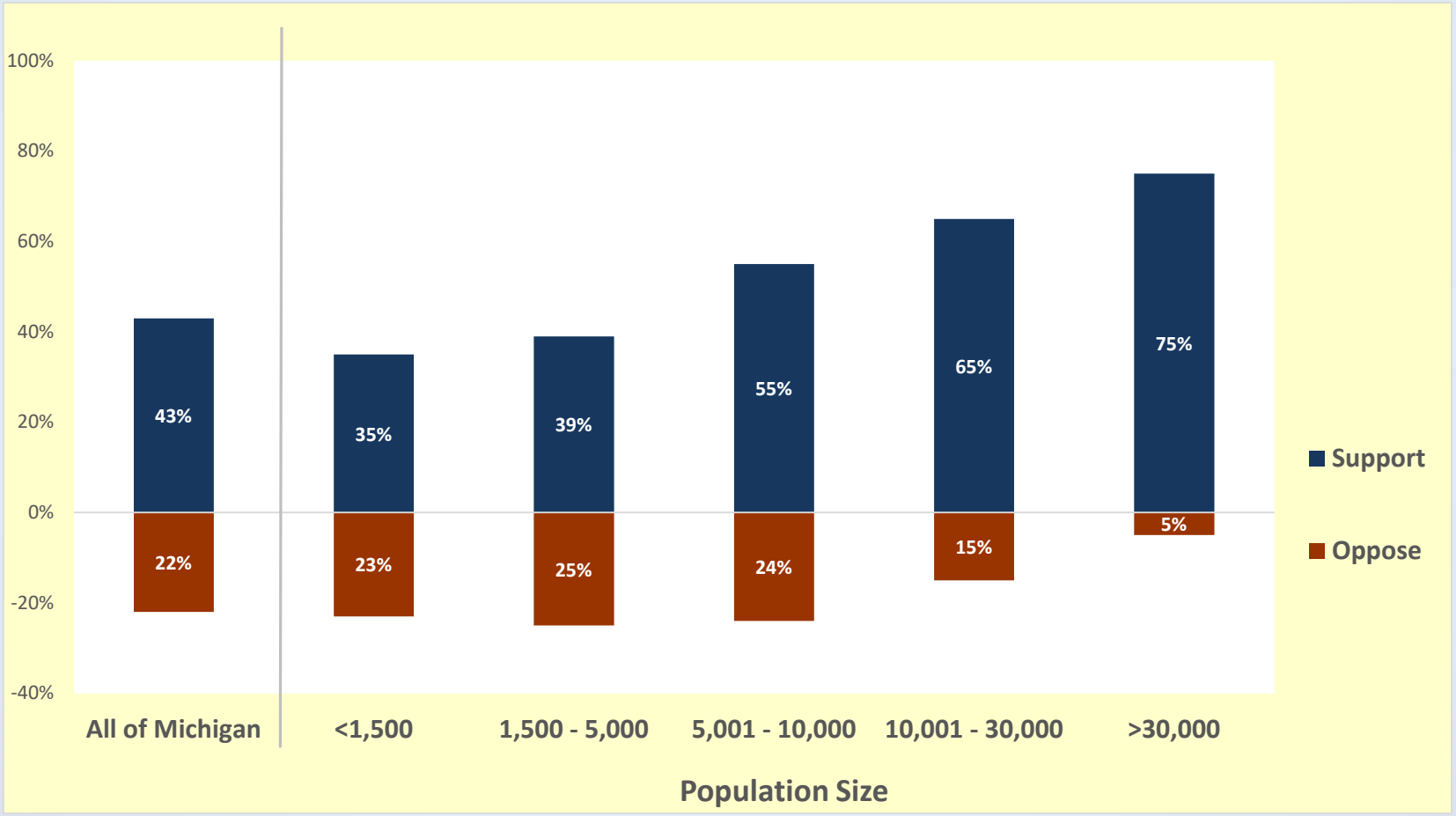


CLOSUP Center for Local, State, and Urban Policy

Gerald R. Ford School of Public Policy

Support for Specific Reforms

% that support reforming **Proposal A** to allow more taxable value growth

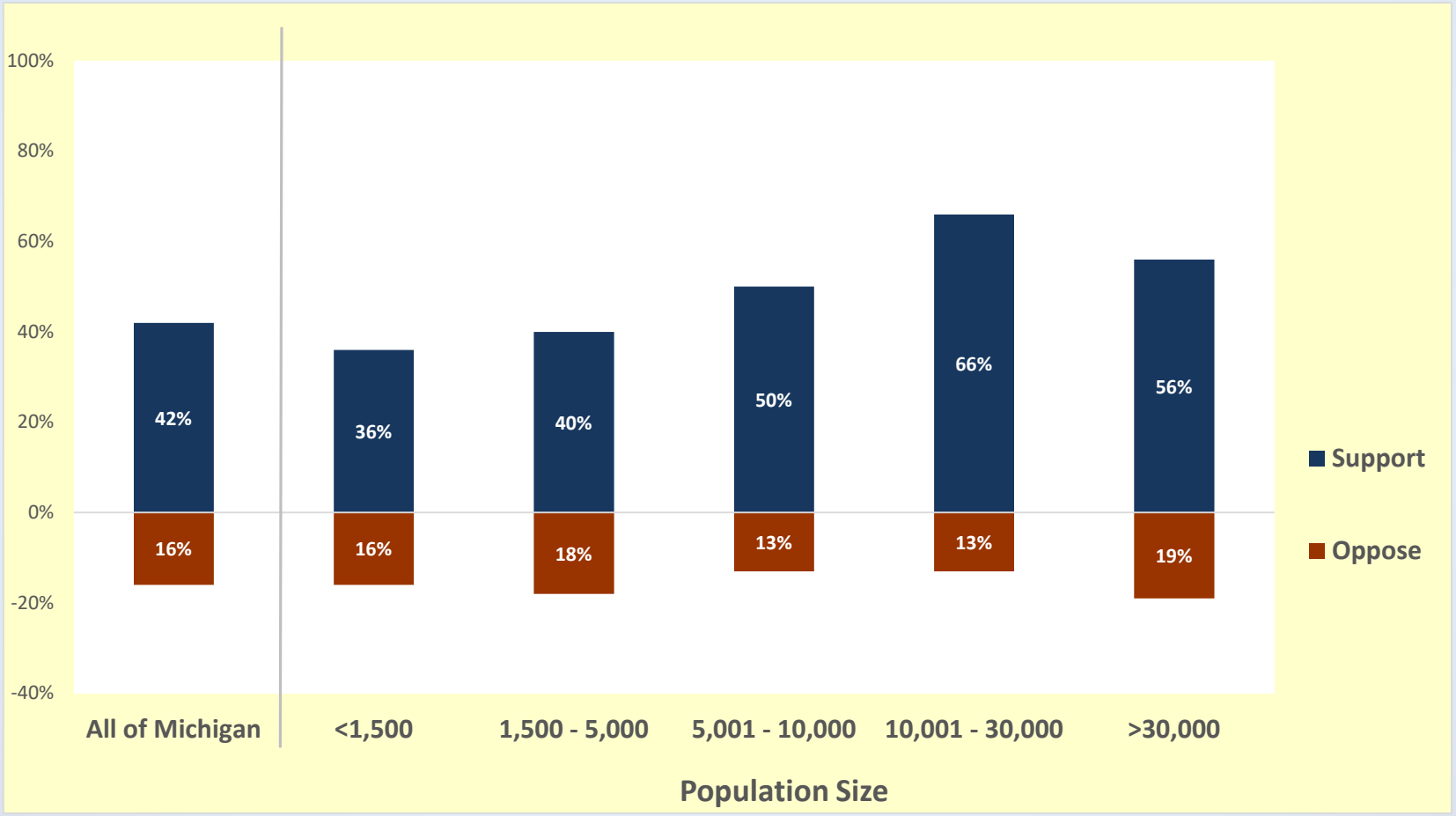


CLOSUP Center for Local, State, and Urban Policy

Gerald R. Ford School of Public Policy

Support for Specific Reforms

% that support increasing **maximum allowable** local millage rates

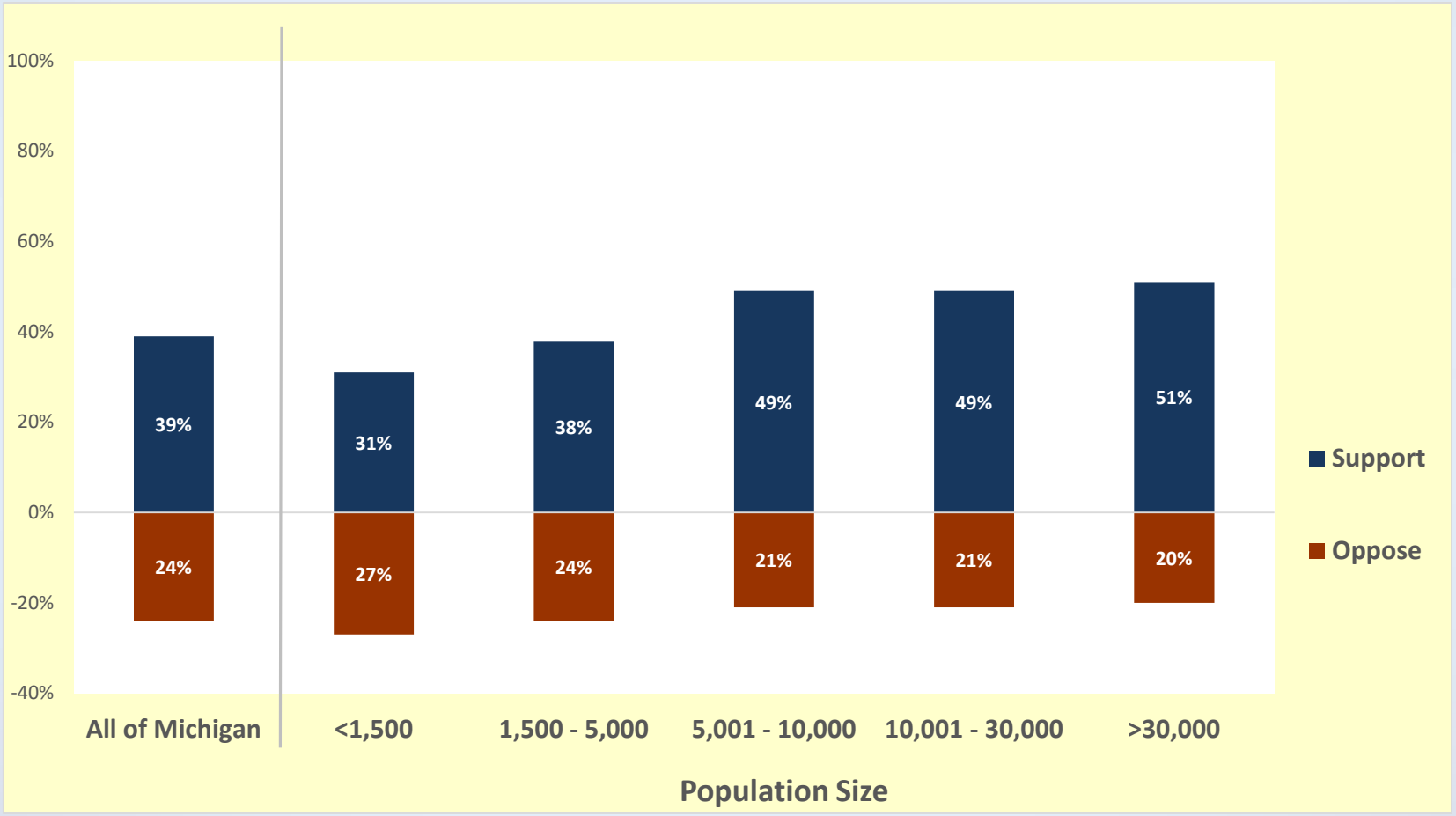


CLOSUP Center for Local, State, and Urban Policy

Gerald R. Ford School of Public Policy

Support for Specific Reforms

% that support **increasing rates on state taxes** with revenue-sharing components

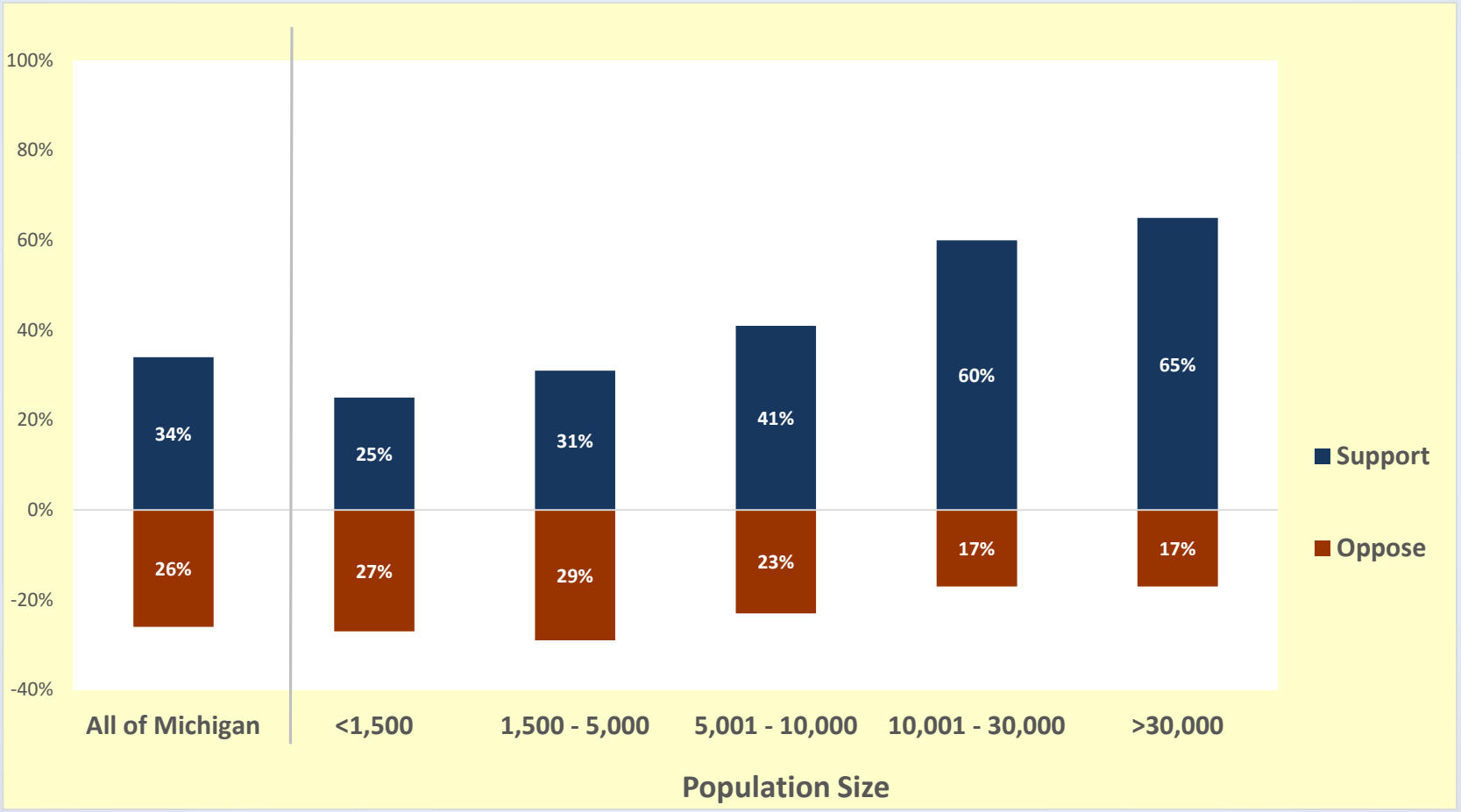


CLOSUP Center for Local, State, and Urban Policy

Gerald R. Ford School of Public Policy

Support for Specific Reforms

% that support allowing local governments to raise revenues through **local-option taxes**

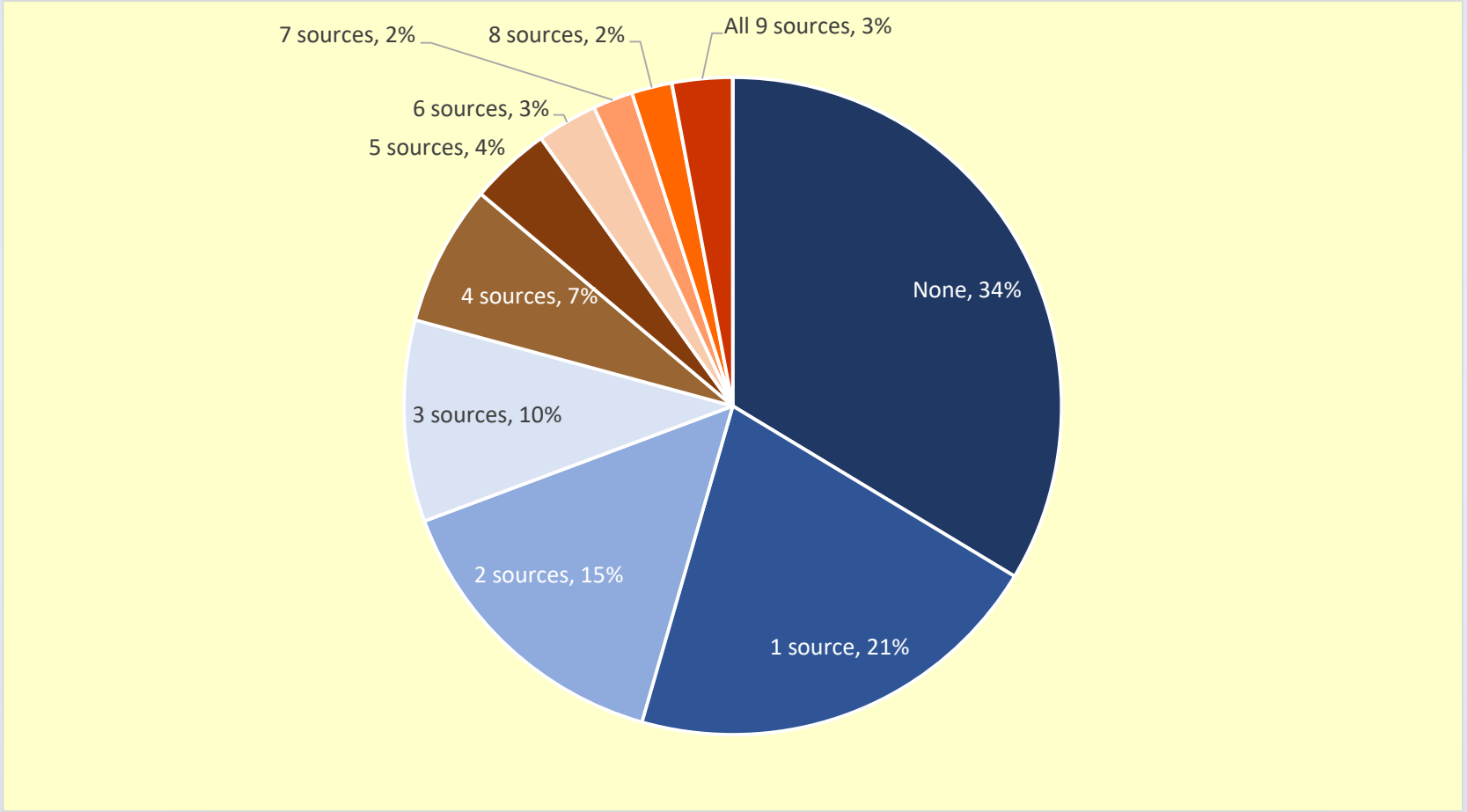


CLOSUP Center for Local, State, and Urban Policy

Gerald R. Ford School of Public Policy

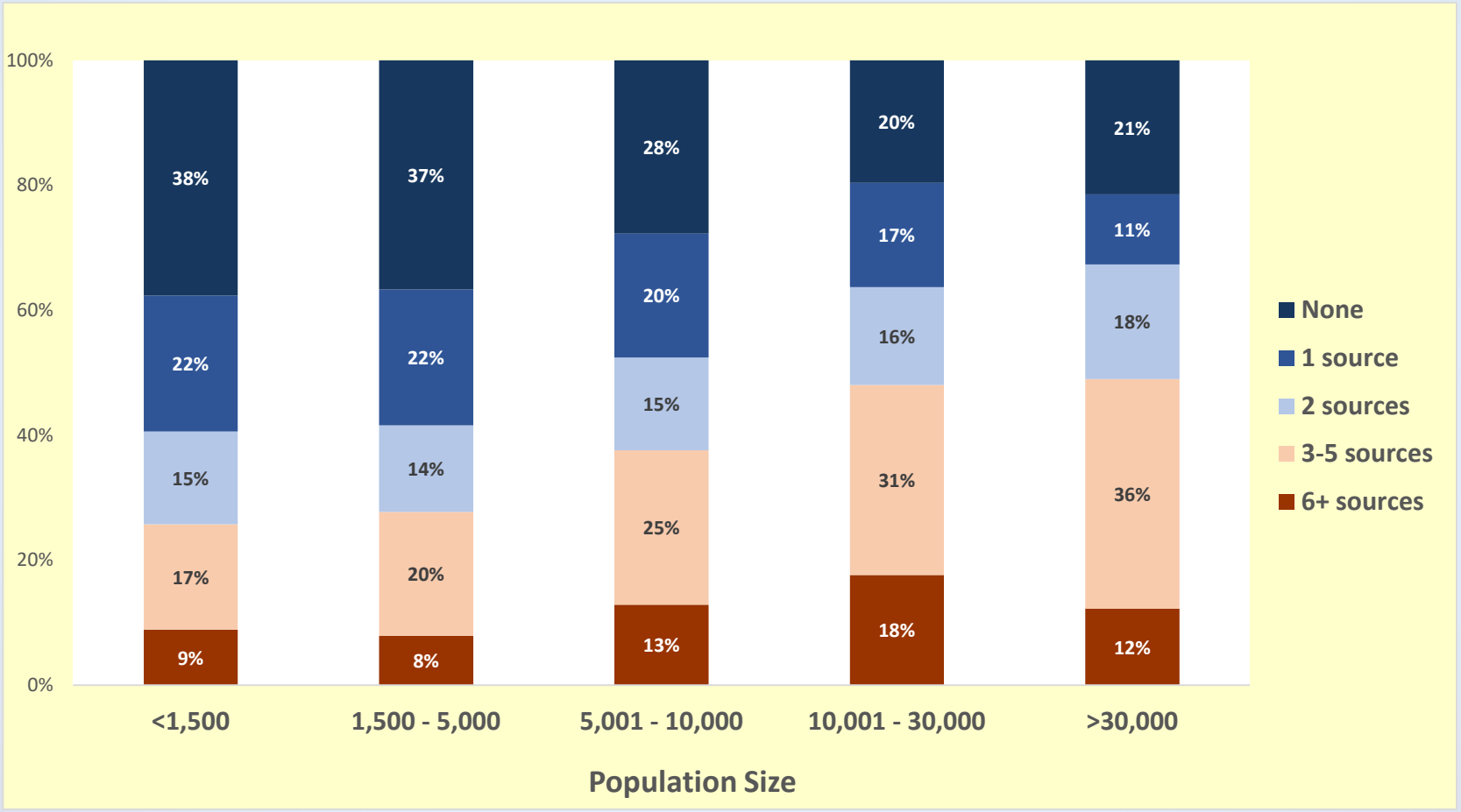
Raising Additional Local Revenue

Number of **local revenue sources** leaders would pursue, if enabled to levy



Raising Additional Local Revenue

Number of **local revenue sources** leaders would pursue, if enabled to levy

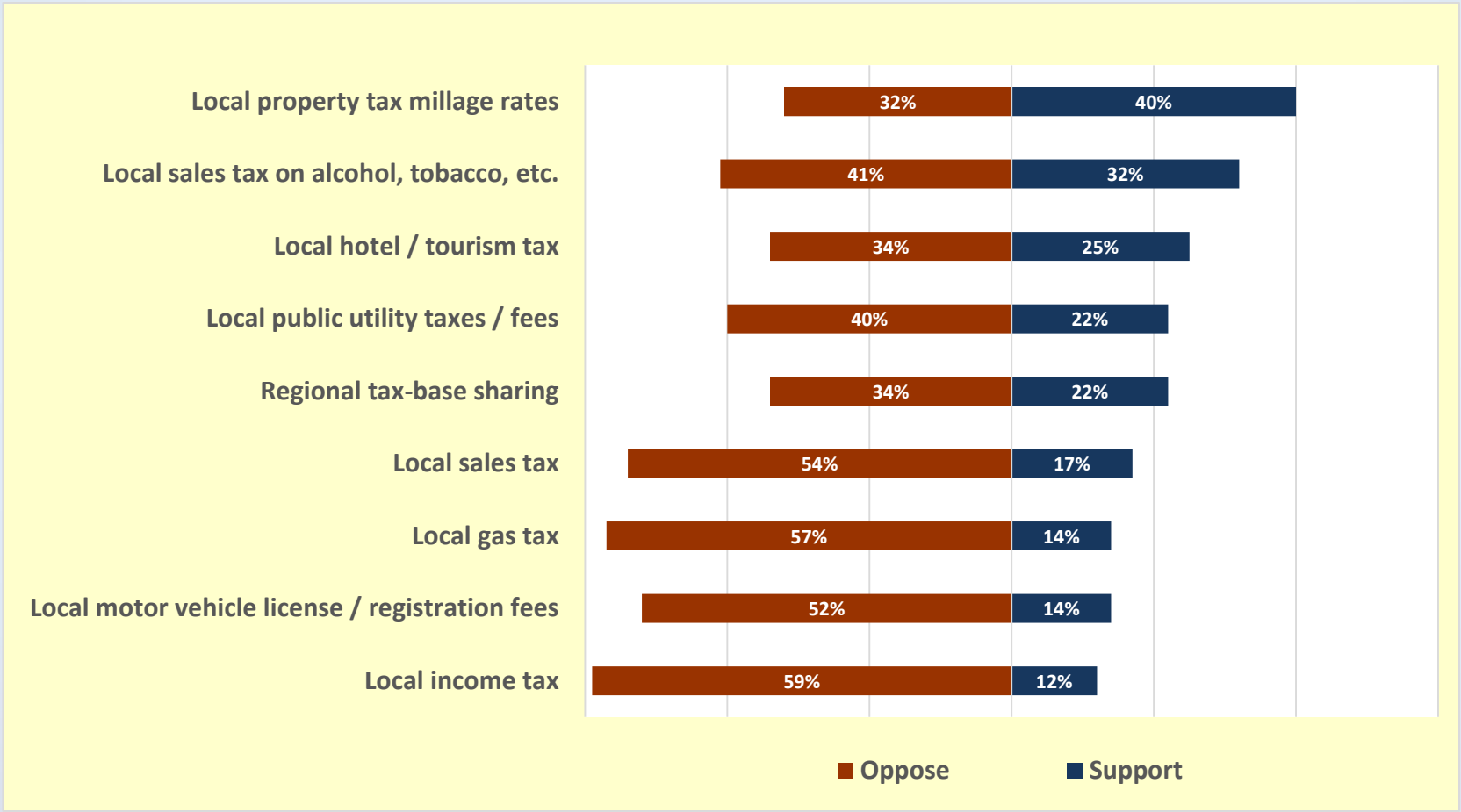


CLOSUP Center for Local, State, and Urban Policy

Gerald R. Ford School of Public Policy

Raising Additional Local Revenue

% that support pursuing each type of **local revenue source**



CLOSUP Center for Local, State, and Urban Policy

Gerald R. Ford School of Public Policy

A Broken Funding System?

key findings

- MPPS fiscal tracking survey shows worst of the Great Recession, gradual trend of improvement, but – now – a reversal in the trend.
- More local leaders now say the system of funding is broken compared to 2012, and fewer say they can maintain or improve services going forward.
- Statewide consensus on 3 reforms:
  - Compel State to fund mandates
  - Restore full statutory revenue sharing
  - Reform Headlee roll-backs
- In largest places, majority support for 9 of 11 reforms.
- 66% of local governments are willing to raise additional local revenues, but no consensus on which options.
- There is no one-size-fits-all solution; more discussion needed.

Alternatives for Reforming Michigan's Local Government Finance System

Citizens Research Council/CLOSUP Webinar
September 13, 2016

Eric W. Lupher, President

Citizens Research Council of Michigan

www.crcmich.org

Reacting to the CLOSUP Survey

What to read into the responses

Greater Preference for State Solutions

Is this

- Long-term memories of promises not fulfilled?

or

- Realization of difficulties of levying local-option taxes?

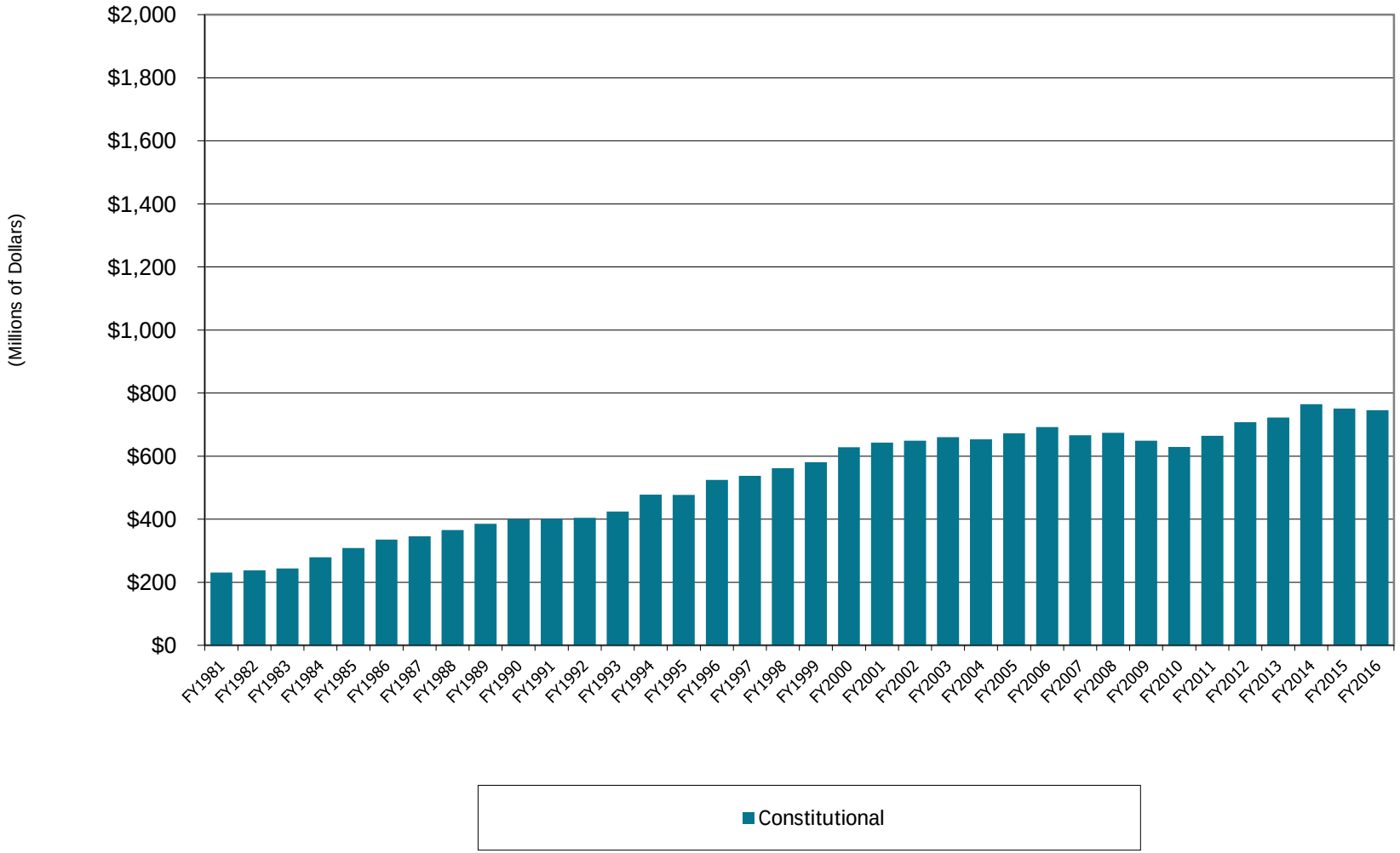
Addressing Promises not Fulfilled

- Unfunded Mandates
- Revenue Sharing
- Headlee Amendment Adjustments

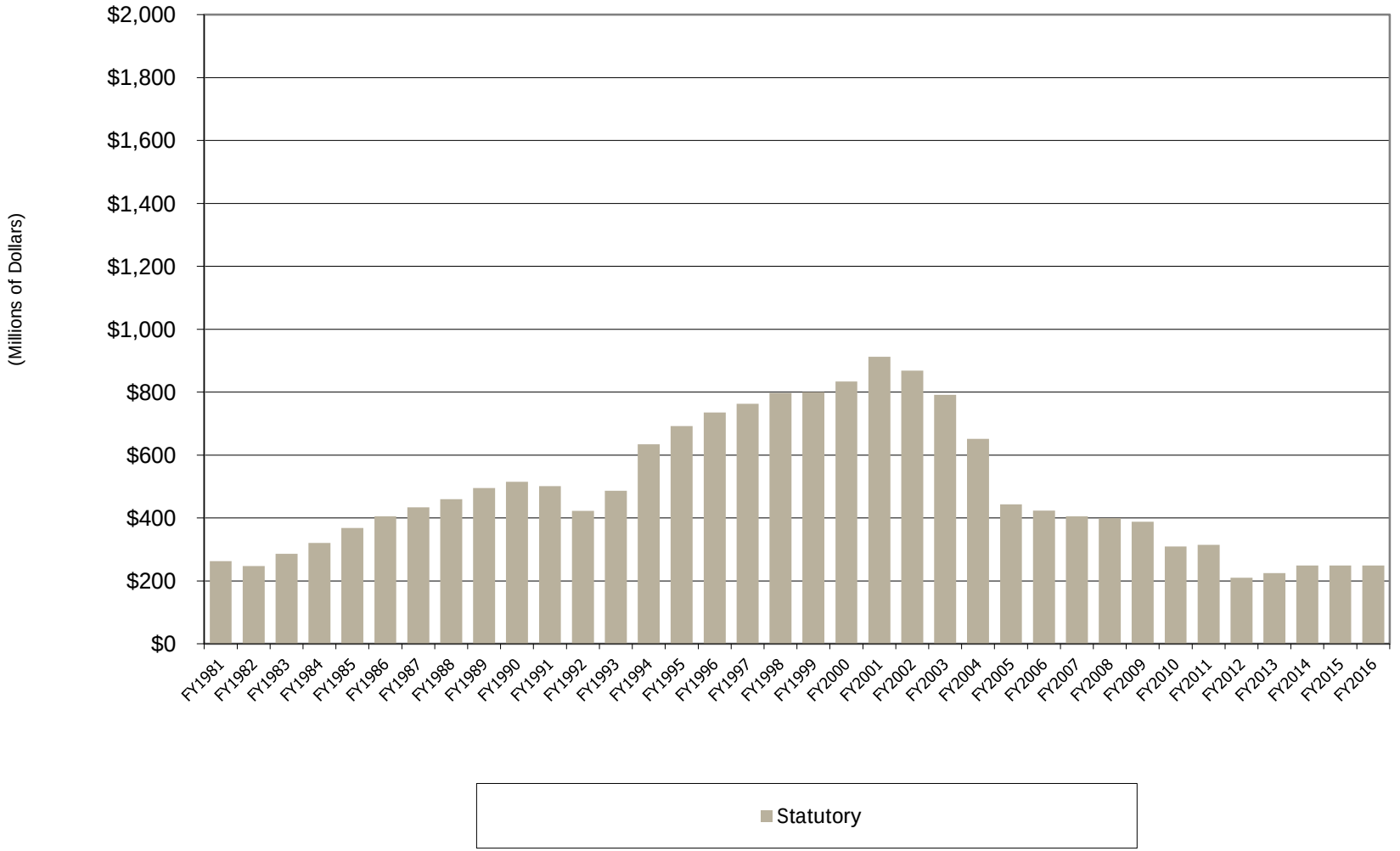
State Revenue Sharing

- 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
  - Revenue generally not returned in relation or origin
  - Social engineering among local governments
  - Generally close to full funding
- Recent history
- Budget realities

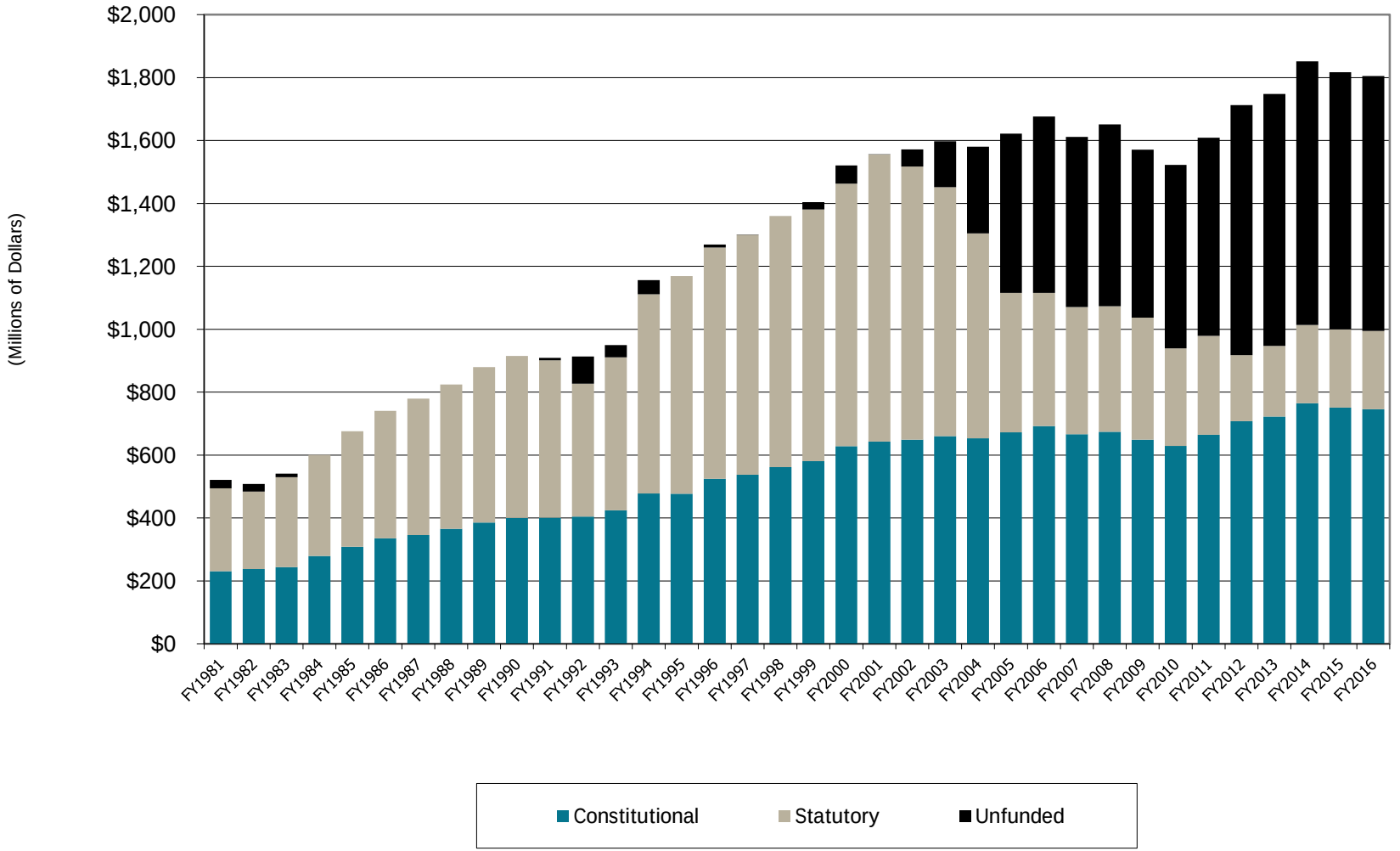
Constitutional State Revenue Sharing



Statutory State Revenue Sharing

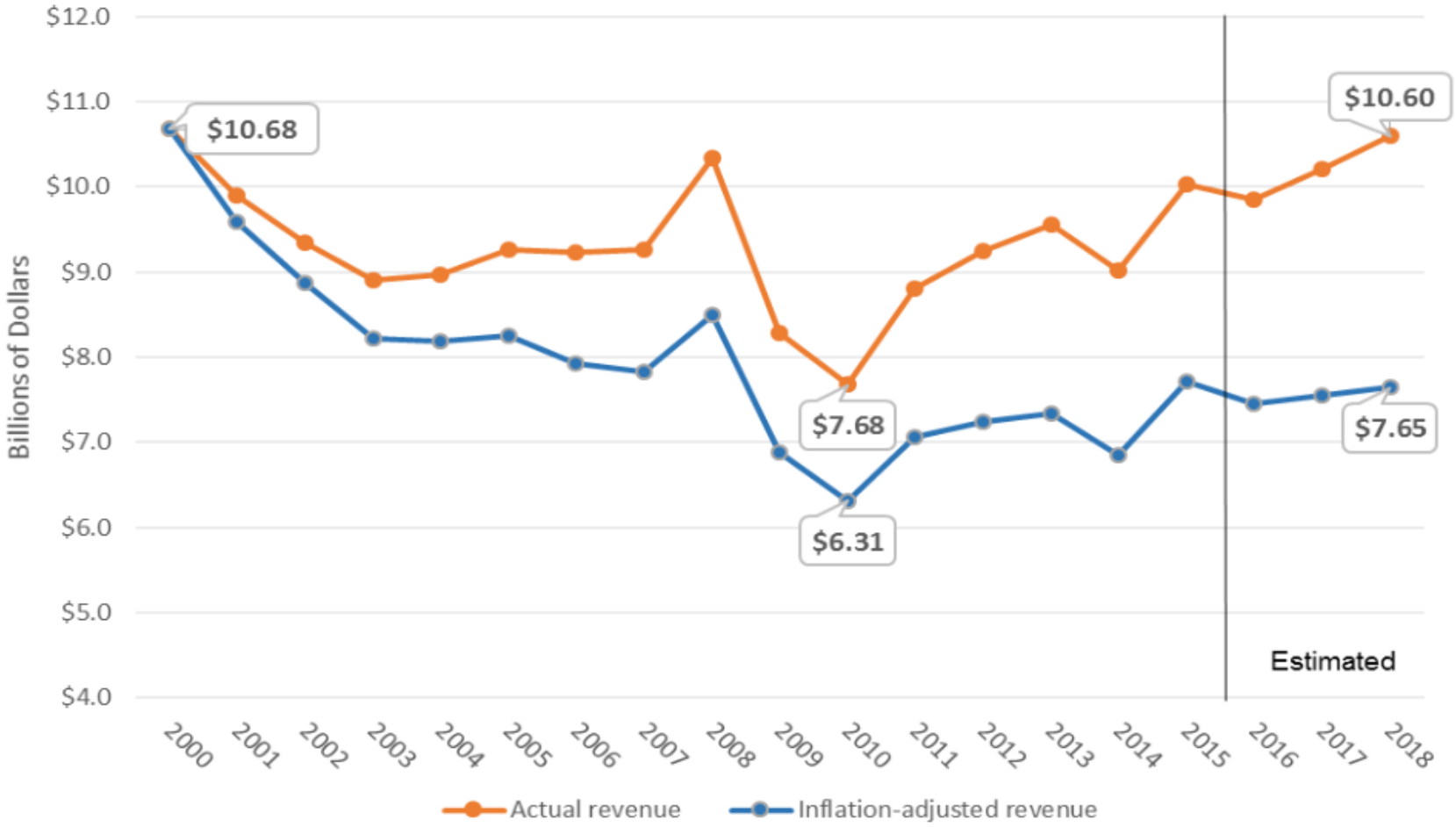


Constitutional, Statutory, and Unfunded State Revenue Sharing



GF/GP Growth since FY2000

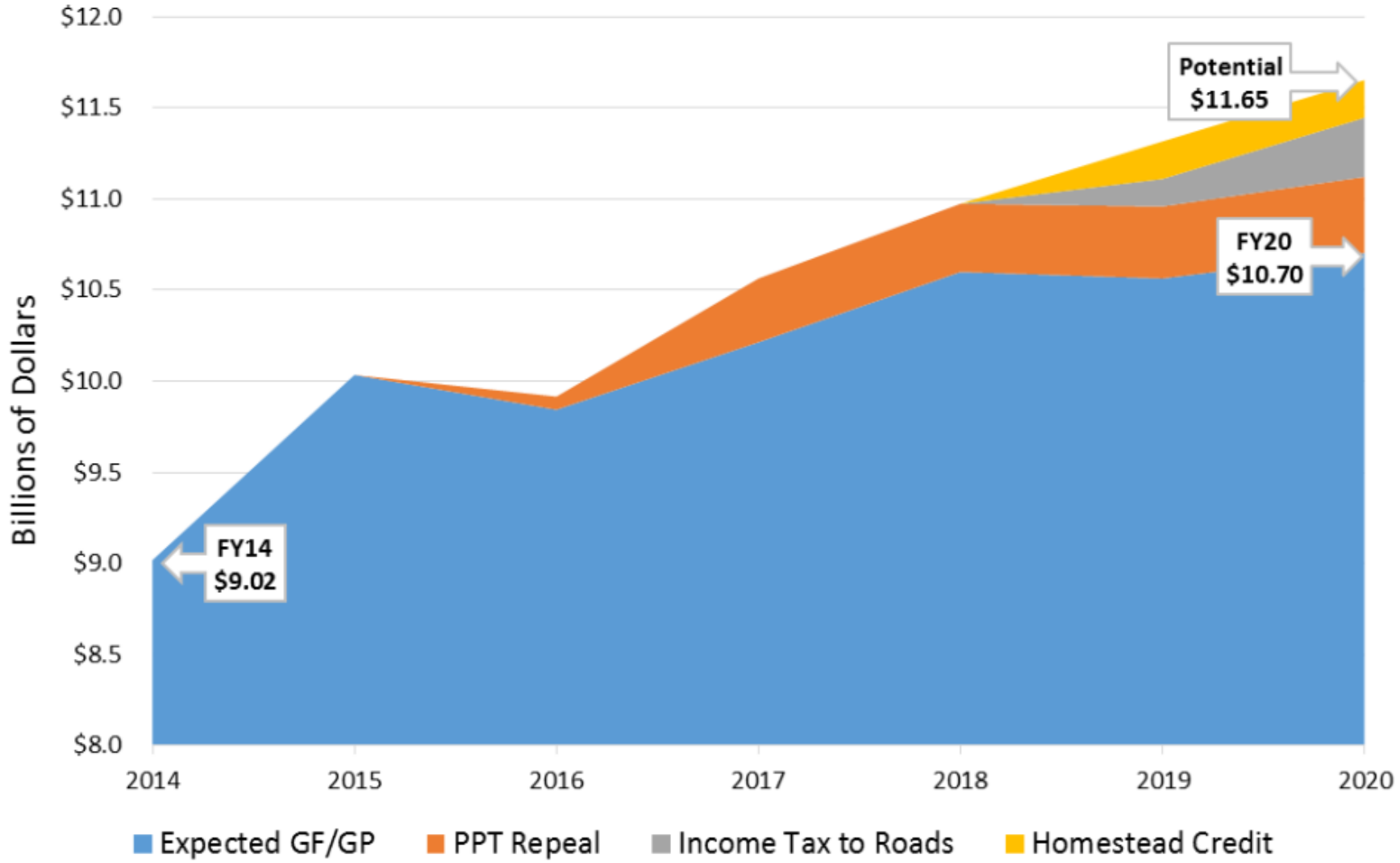
Growth since FY2010, But Still Recovering



Data: Revenue adjusted for inflation using Detroit-area Consumer Price Index.

GF/GP Revenue and Tax Policy Changes

Foregone Revenue Approaches $1B by FY2020



6

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 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…."

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

Would taxpayers notice loss of tax rate rollbacks?

- 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

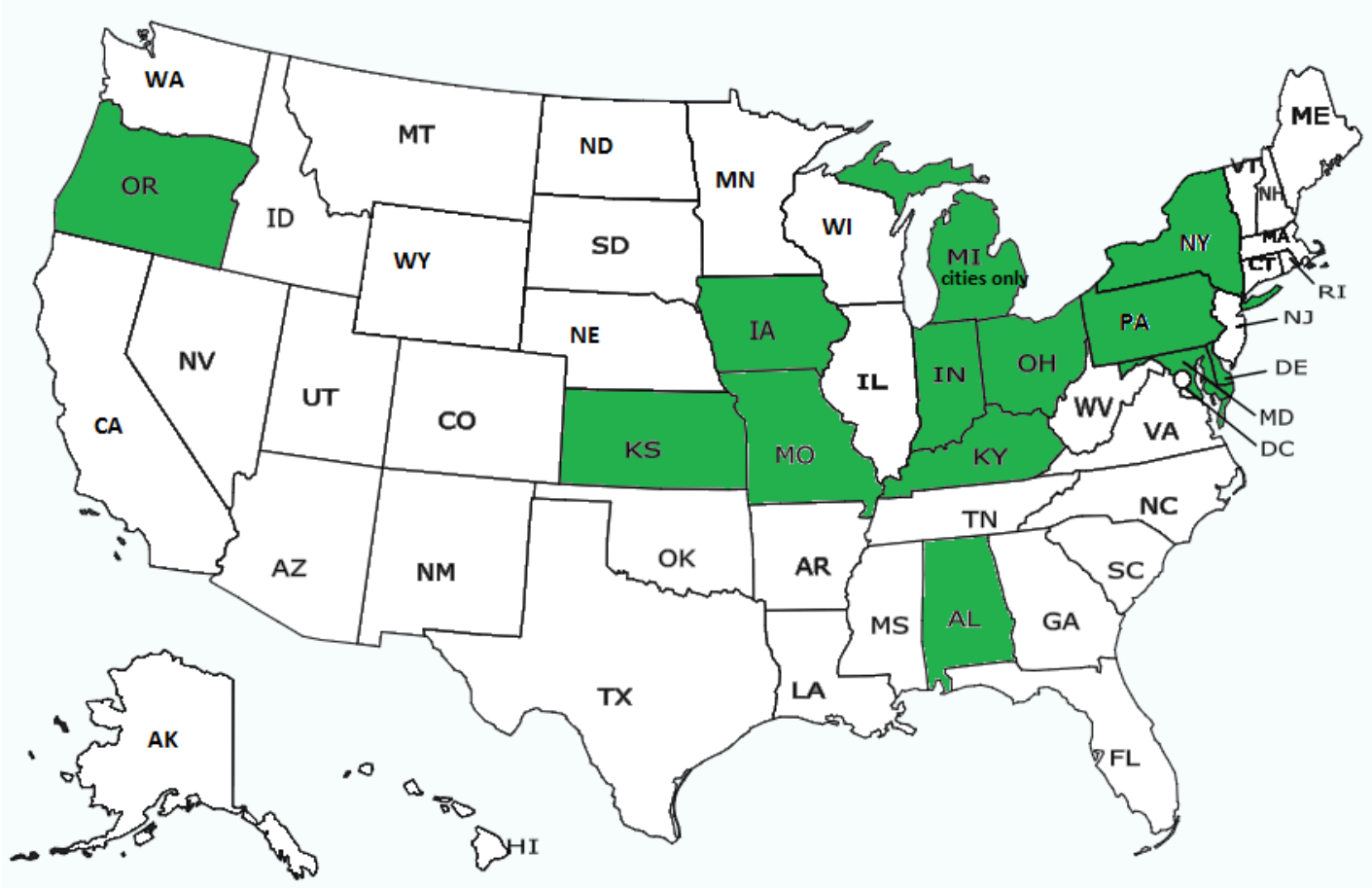
Other Headlee Amendment/Property Tax Reform Ideas

- Recalculate Section 30 ratio
- Reintroduce Tax Rate Rollups
- End Tax Rate Rollbacks associated with “pop ups”
- *WPW vs. City of Troy* and Dark Stores
- Tax Incentives

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



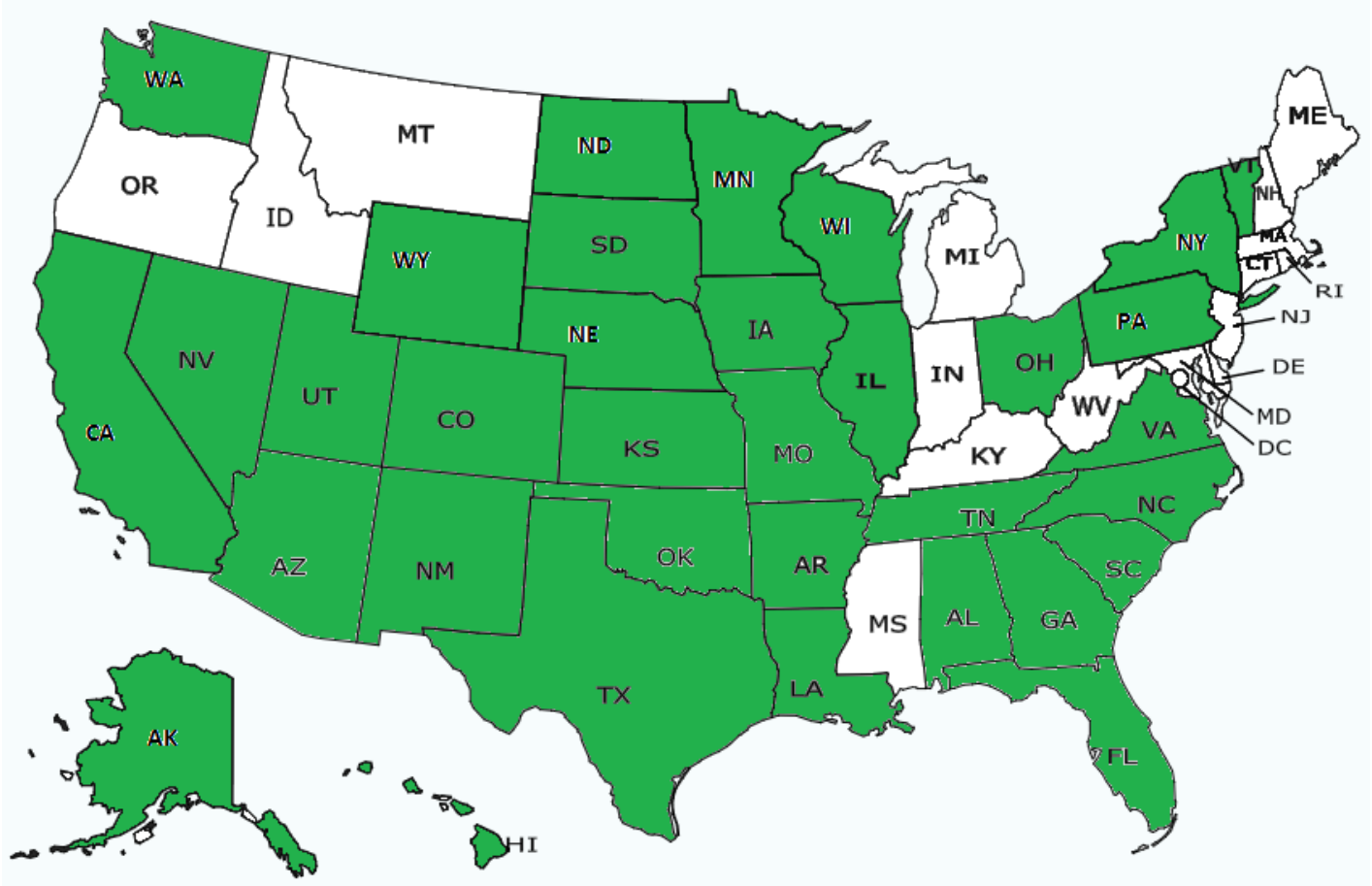
Source: U.S. Census Bureau, 2013 State and Local Government Finance

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

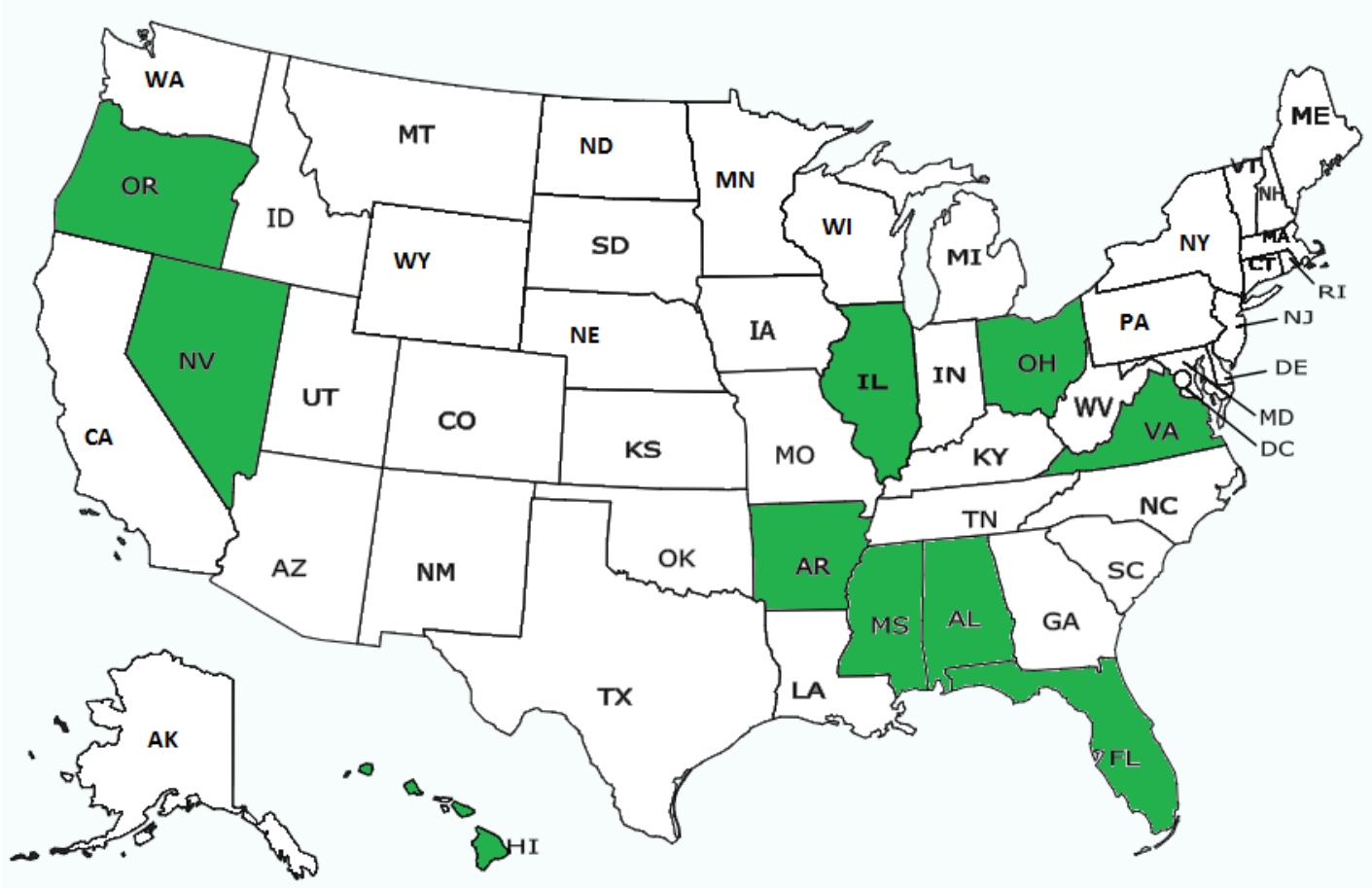
- Even if local governments could levy the tax, they wouldn't get much of the revenues
- Adoption requires constitutional amendment, legislative authorization, and then voter approval

- 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

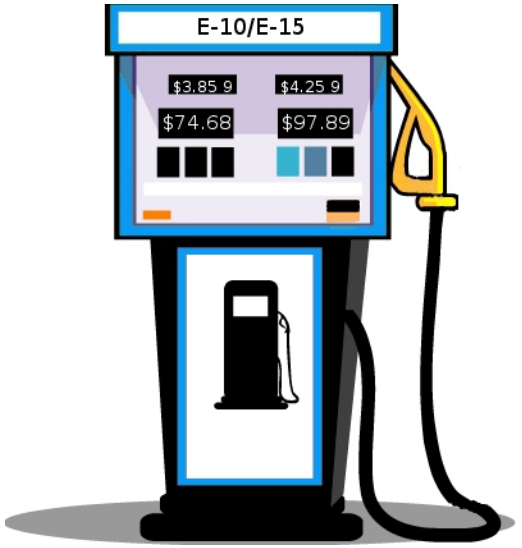
- Public Act 263 of 1974 and 106 of 1985 authorize accommodation taxes
  - PA 263 for counties under 600,000 for financing of the acquisition, construction, improvement, enlargement, repair, or maintenance of convention and entertainment facilities
  - PA 106 in SE MI to fund Cobo Center
- PA 263 selectively 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



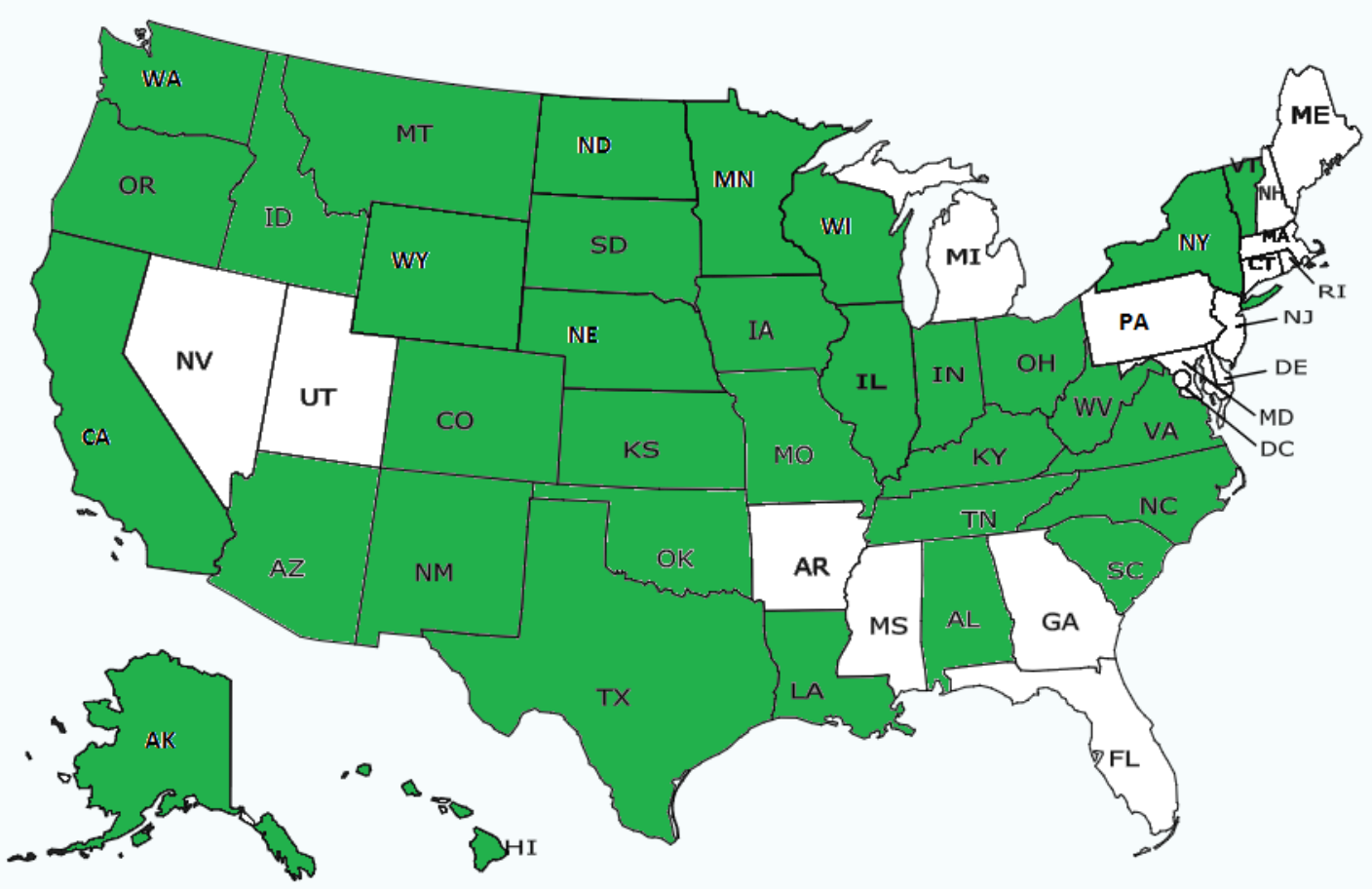
Source: U.S. Census Bureau, 2013 State and Local Government Finance

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
- Adoption requires voter approval

Authorization to Levy Local-Option Motor Vehicle License Taxes

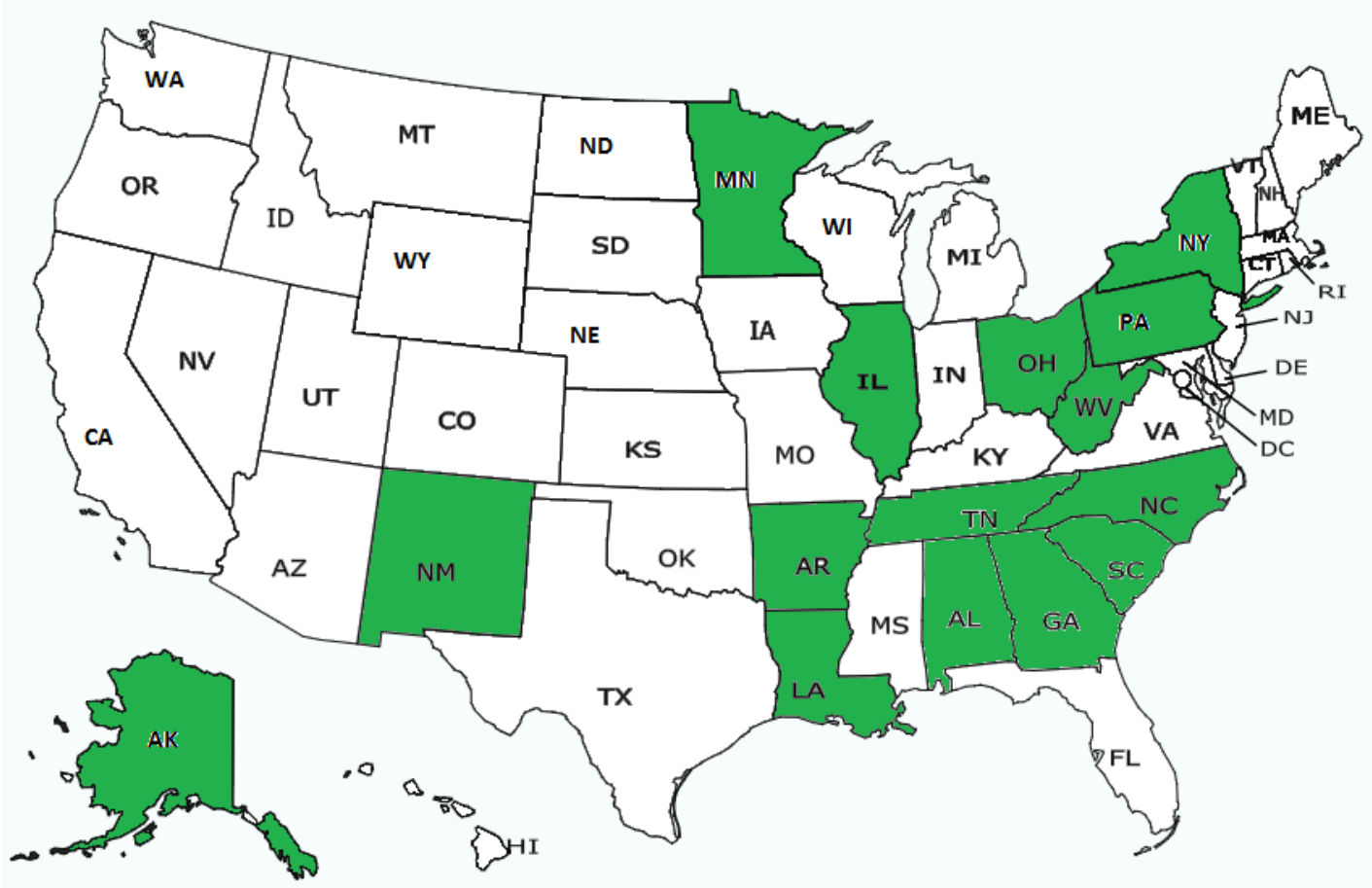


Source: U.S. Census Bureau, 2013 State and Local Government Finance

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

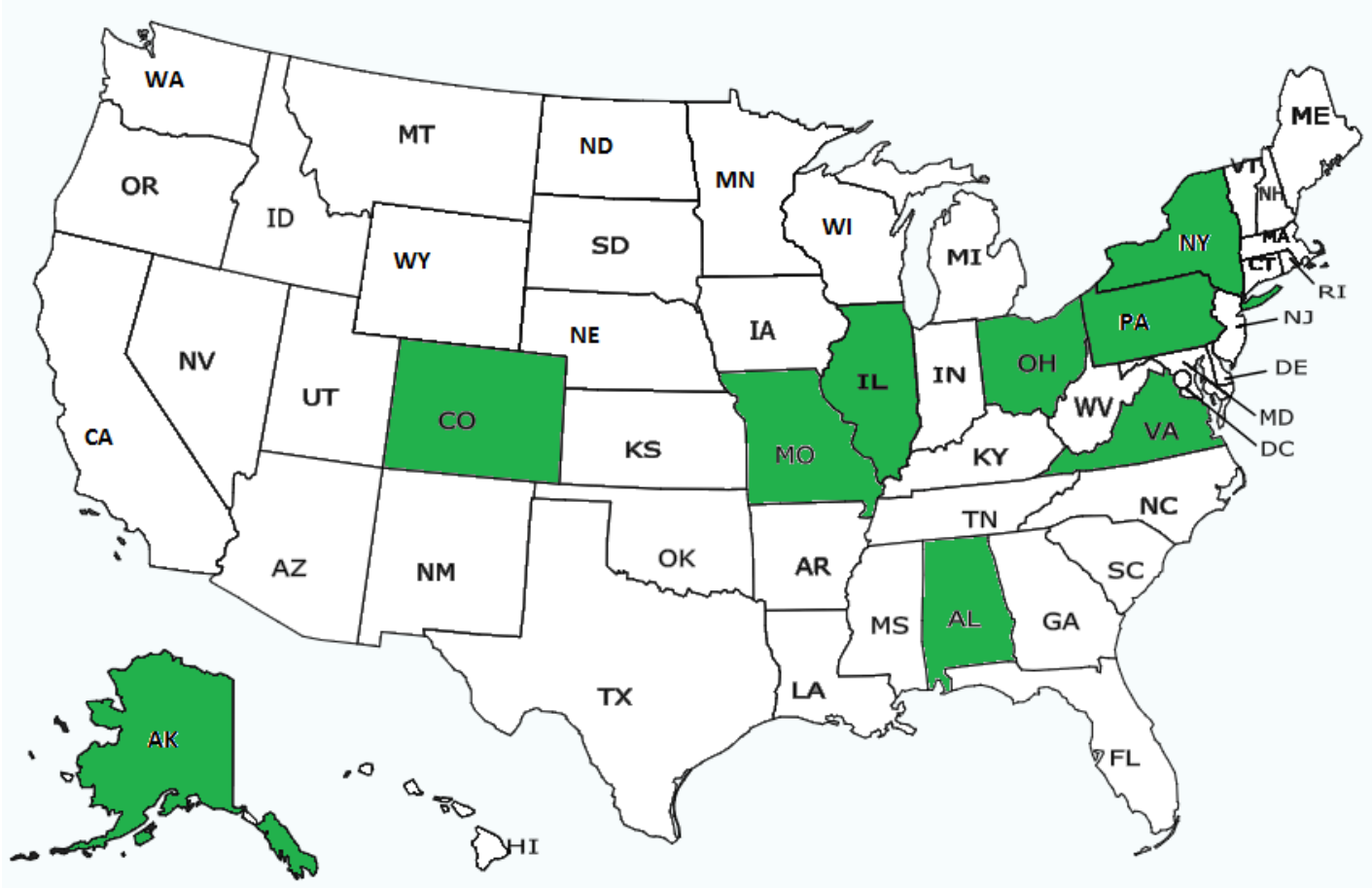


Source: U.S. Census Bureau, 2013 State and Local Government Finance

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
- Adoption requires voter approval

Authorization to Levy Local-Option Tobacco Sales Taxes

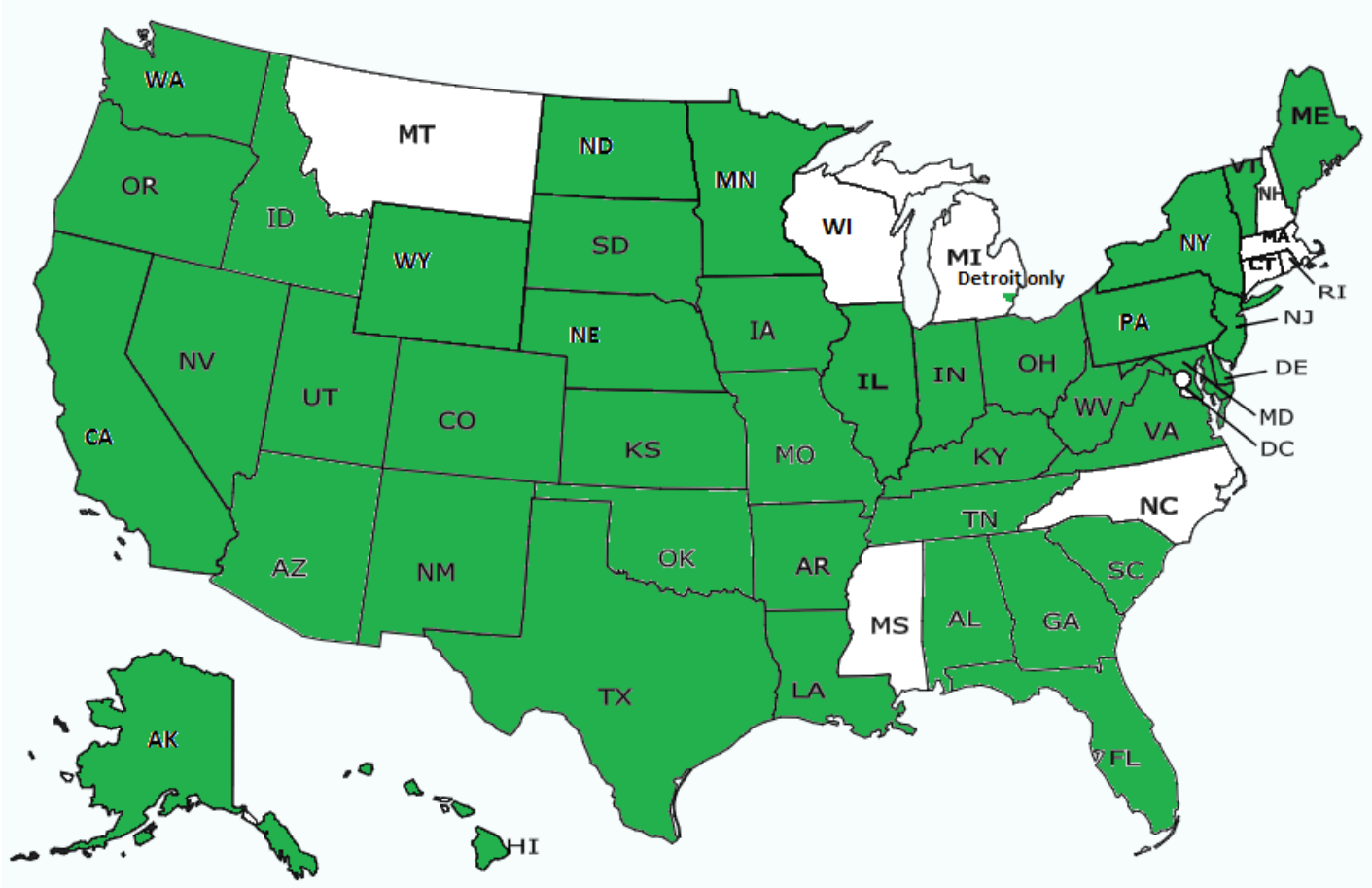


Source: U.S. Census Bureau, 2013 State and Local Government Finance

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
- Adoption requires voter approval

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
- Adoption requires voter approval

Take Aways

- CLOSUP survey results suggest that evidence of a broken municipal finance system is becoming real for more and more local government officials
- 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

CRC publications are available at:

www.crcmich.org

Follow Us on Twitter: @crcmich

Become a Fan on Facebook:

www.facebook.com/crcmich

Providing Independent, Nonpartisan Public Policy Research Since 1916