Michigan's Broken Municipal Finance System:

Issues and Proposed Actions

January 2017

Thriving Communities Drive the State's Economy

Cities, villages, and metropolitan areas drive economic development and job creation in our state. Michigan's metropolitan region house 82 percent of the state's residents, 84 percent of our jobs, and are responsible for 88 percent of our gross domestic product (RW Ventures, 2011).

High quality communities, with strong public services, economic opportunities, and vibrant places, are magnets for young, educated people that bring innovative ideas and highly sought-after talent to a local economy. They are places where people choose to raise families, invest in their communities, and retire. And increasingly, the quality of a community plays a role in attracting and retaining businesses. A recent report by Endeavor Insight noted that America's fastest growing companies often look for quality of life factors such as parks, schools, entertainment, and cultural amenities when deciding where to locate their business (Morris, 2013).

Michigan needs thriving, high quality communities if we are going to be economically competitive with other states.

Michigan's Municipal Finance System is Broken

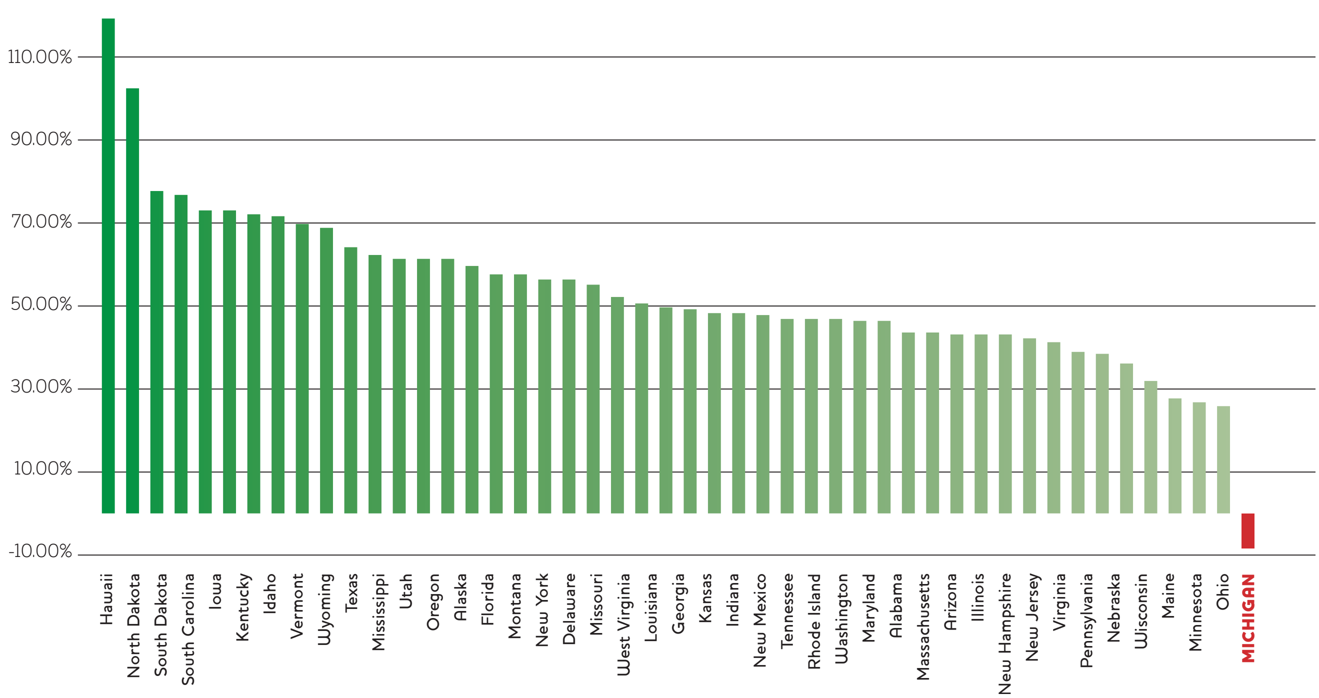
Every day, Michigan residents and business owners' quality of life is impacted by choices local governments are forced to make in providing public safety, street and sidewalk repair, public utilities, recreational and cultural amenities, and other essential investments that create flourishing local economies. People want to be part of vibrant places; local governments fund the services that make these communities possible.

But Michigan's communities are struggling to make the investments they need to be thriving places because state policies have limited local governments' ability to raise adequate revenue, control costs, and address structural changes that would improve efficiencies in service delivery.

The result?

Michigan is increasingly falling behind every other state.

GROWTH IN MUNICIPAL GENERAL REVENUE (2002-2012)



Source: U.S. Census Bureau 2002 & 2012

Michigan is not supporting its communities

In order to create and maintain vibrant communities, cities must invest in a diverse range of services, infrastructure, and amenities. But Michigan's local leaders are struggling to do so because they are operating under a suffocating framework of shrinking funds, rising service costs, and a legacy liability of escalating retiree costs. While the Great Recession worsened municipalities' fiscal hardships, the problems our communities face are structural and pervasive, not the result of short-term economic woes.

What are the issues?

- Michigan's municipal funding doesn't track with the economy
- Michigan's budget priorities have disinvested in communities
- There are not enough municipal finance tools in the toolbox

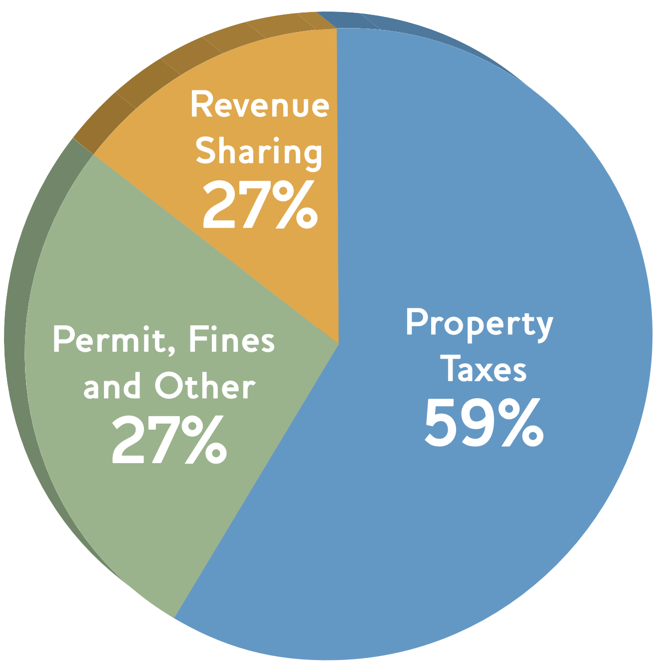
How do we fix this?

- Cost containment
- Improved structure of local government
- More stability and options for local revenue

> **"…cities, towns and rural communities that have appealing and sustainable places, efficient and convenient transportation, walkable main streets, green spaces, thriving shops and cultural amenities. Those are the qualities of Placemaking that are driving demand in today's real estate marketplace."**

~ Gil White, Realtor
(National Association of Realtors, 2015)

MUNICIPAL* GENERAL REVENUE BY SOURCE: 2014



*Does not include Detroit

Source: Scorsone et. al. 2016

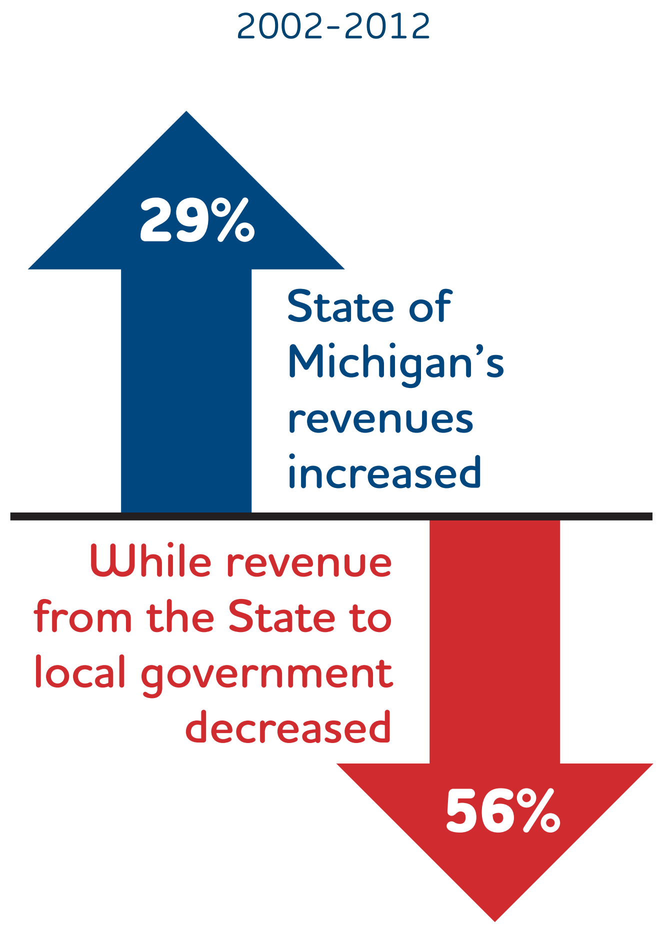
What are the issues?

Michigan's municipal funding doesn't track with the economy

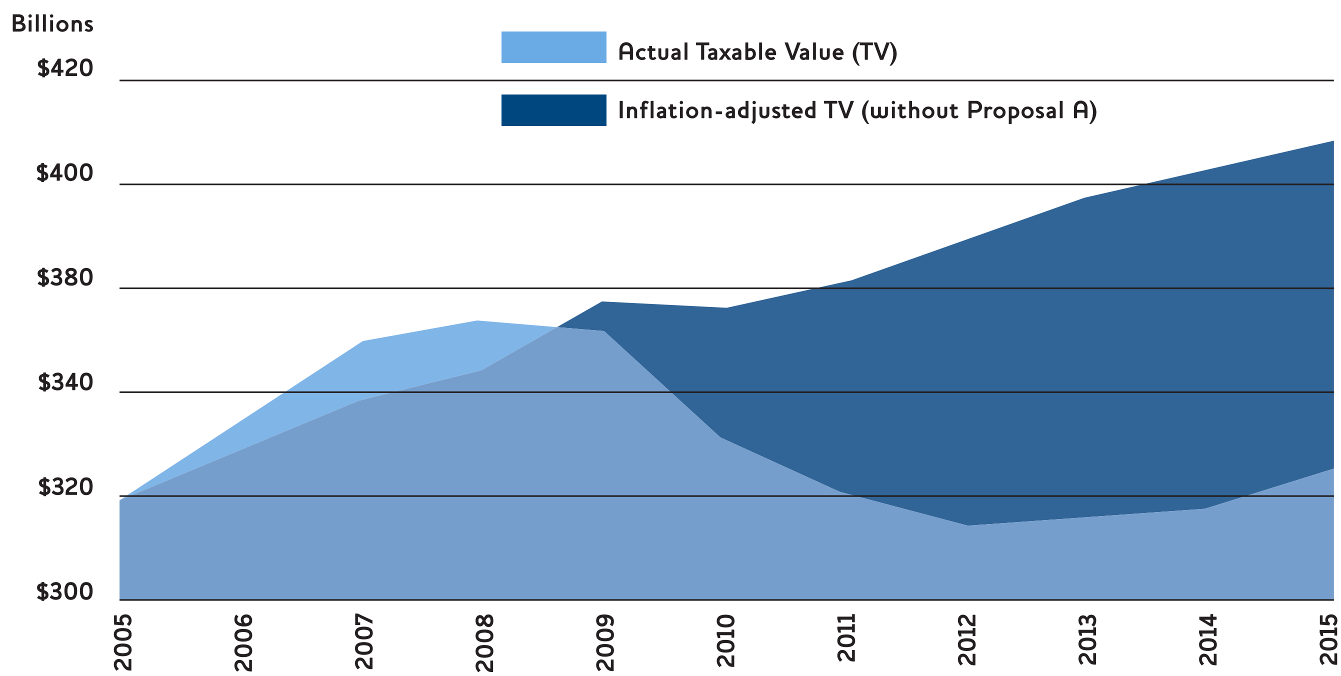
Local revenue options are limited—user fees are restrictive in use, income taxes present economic challenges for most communities, and other taxes such as local sales tax are not allowed. Because of these limitations, local governments depend on property taxes and revenue sharing to cover most of the costs of operating and providing services.

The reliance on these two sources has left communities in a problematic position. Property values dropped considerably during the recent economic recession, but local governments have not been able to recover that taxable value because statutory and constitutional mechanisms (Proposal A and the Headlee Amendment) limit their ability to grow to the rate of inflation or 5 percent, whichever is less. In other words, even as the economy as a whole is recovering, local revenues cannot track with the economy because of these restrictions and communities are facing substantial declines in property tax revenues (CRC, 2014).

As the exhibit below illustrates, property tax values have fallen statewide, and have not been able to rebound at a rate that matches the growth of the economy.



STATEWIDE TAXABLE VALUE (2005-2015)



Source: Adapted from GLEC, 2016

Michigan's Budget Priorities Have Disinvested in Communities

Over the same period property values plummeted, the state chose to cut billions of dollars out of statutory revenue sharing to cover shortfalls in the state budget.

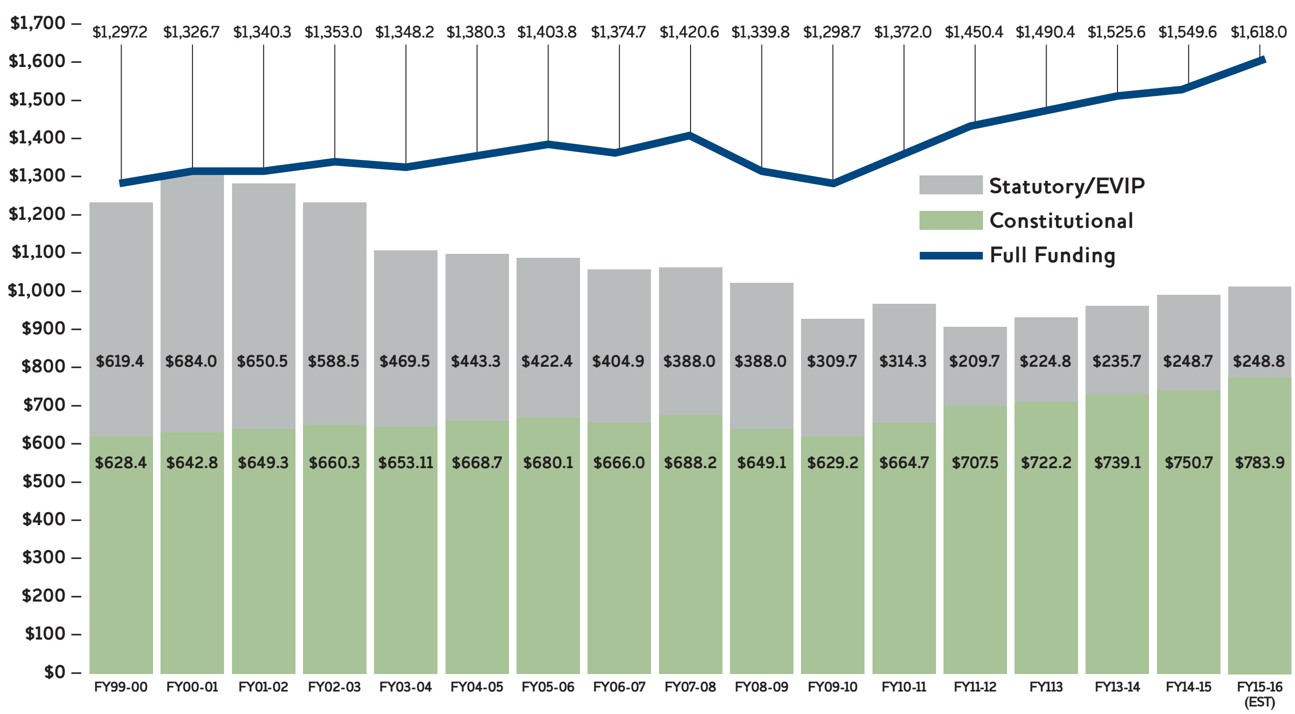
Cities and villages have lost over $7.5 billion in revenue sharing funds from the state since 2002, and in many cases this has been a substantial share of their annual revenue. (Michigan Department of Treasury, Nd.)

Even with modest increases in recent years, revenue sharing to locals is still well below full funding levels, as the exhibit below demonstrates.

While the state and local governments have the same primary drivers of cost—labor and infrastructure—the state has been able to manage cost increases through growth in its revenue. Local governments do not have this same ability. While the state budget has largely recovered from the economic recession, the state-imposed restraints on local revenues left communities behind and forced them to make tough choices that can have serious consequences for their residents.

CITIES AND VILLAGES HAVE LOST OVER $7.5 BILLION IN REVENUE SHARING FUNDS FROM THE STATE SINCE 2002, AND IN MANY CASES THIS HAS BEEN A SUBSTANTIAL SHARE OF THEIR ANNUAL REVENUE.

TOTAL REVENUE SHARING AND EVIP PAYMENTS TO CITIES, VILLAGES, AND TOWNSHIPS



Source: Michigan House Fiscal Agency, 2015

> We evaluate and pursue service sharing arrangements with neighboring municipalities all the time in an effort to save costs, including equipment loaning, shared waste and recycling, and special police efforts.
>
> We have also partnered with fellow communities to address revenue generation. In 2015 we formed the South Macomb Oakland Regional Services Authority with the City of Eastpointe that allows our communities to levy a regional millage to support each of our cities' emergency services.
>
> While these have been effective tools, shared services and regional authorities cannot fully address Michigan's broken municipal finance system...they are only part of the solution.
>
> *~Ed Klobucher,*
> *City Manager, Hazel Park*

Not Enough Tools in the Toolbox

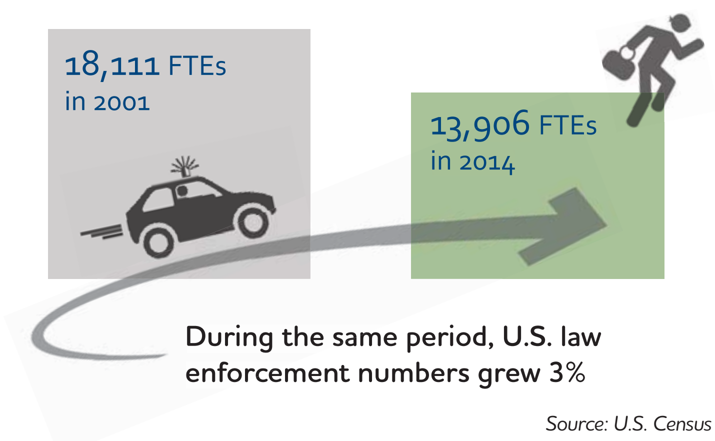
Local governments are responsible for providing some of the most essential and valued services that keep our residents safe and our economy moving. They have overwhelmingly responded to revenue challenges by implementing reforms, cutting costs, and sharing services, but escalating healthcare and infrastructure costs, in particular, have exacerbated budget woes.

Michigan local governments have tightened their belts—making cuts in staffing and reducing local employees' wages and benefits to help control costs.

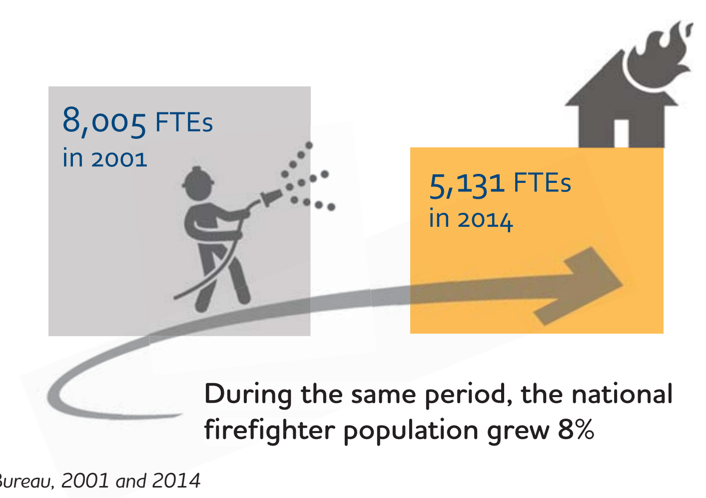
As a state, we now rank dead last in total local employment, including education, and 32nd in per capita state and local wages (BEA, 2015 and U.S. Census Bureau, 2015). Nationally, local government payrolls increased by 34 percent between 2002 and 2012, but in Michigan they grew only 0.3 percent—less than the rate of inflation during that period (Anderson, 2016). And cuts have happened across the board, even in areas that are difficult to cut. For example, Michigan communities have reduced the number of full time police officers by almost 23 percent since 2001 (U.S. Census Bureau, 2001 and 2014).

In an effort to further cut costs and find efficiencies in service provision, communities have also been exploring and pursuing opportunities for shared services and, in some cases, consolidation. These efforts have focused on many different types of services such as recreation, waste management, and public safety, but can be administratively challenging and do not always result in cost savings.

DECLINING REVENUES FORCE MI COMMUNITIES TO SLASH POLICE PROTECTION BY 23%



FIRE PERSONNEL IN MI LOCAL UNITS HAS DROPPED BY 36%



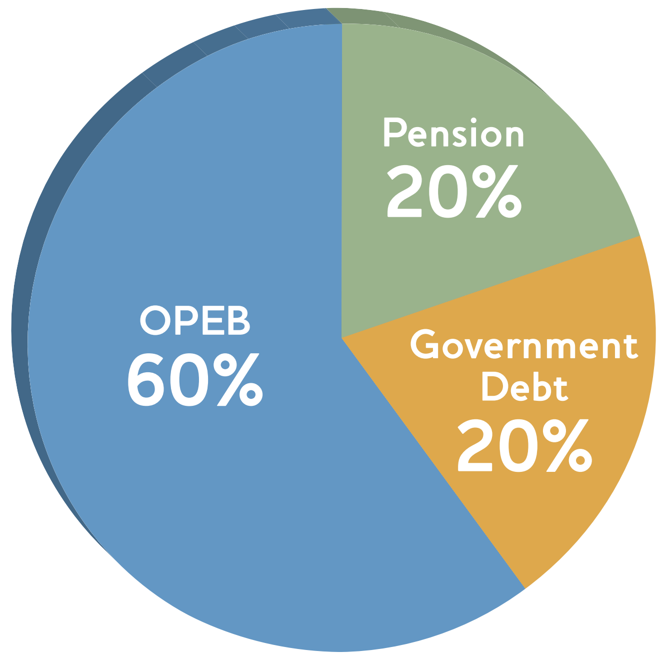
Source: U.S. Census Bureau, 2001 and 2014

While efforts to control salary costs have helped cities manage their budgets, decreased salaries affect our communities' ability to attract the best talent who will help to run our cities efficiently and creatively. And despite these efforts to cut costs and improve efficiency, communities remain in financial crisis.

Local governments are heavily burdened by legacy post-employment health and pension benefit commitments and aging infrastructure that demands a higher investment the longer that maintenance is delayed.

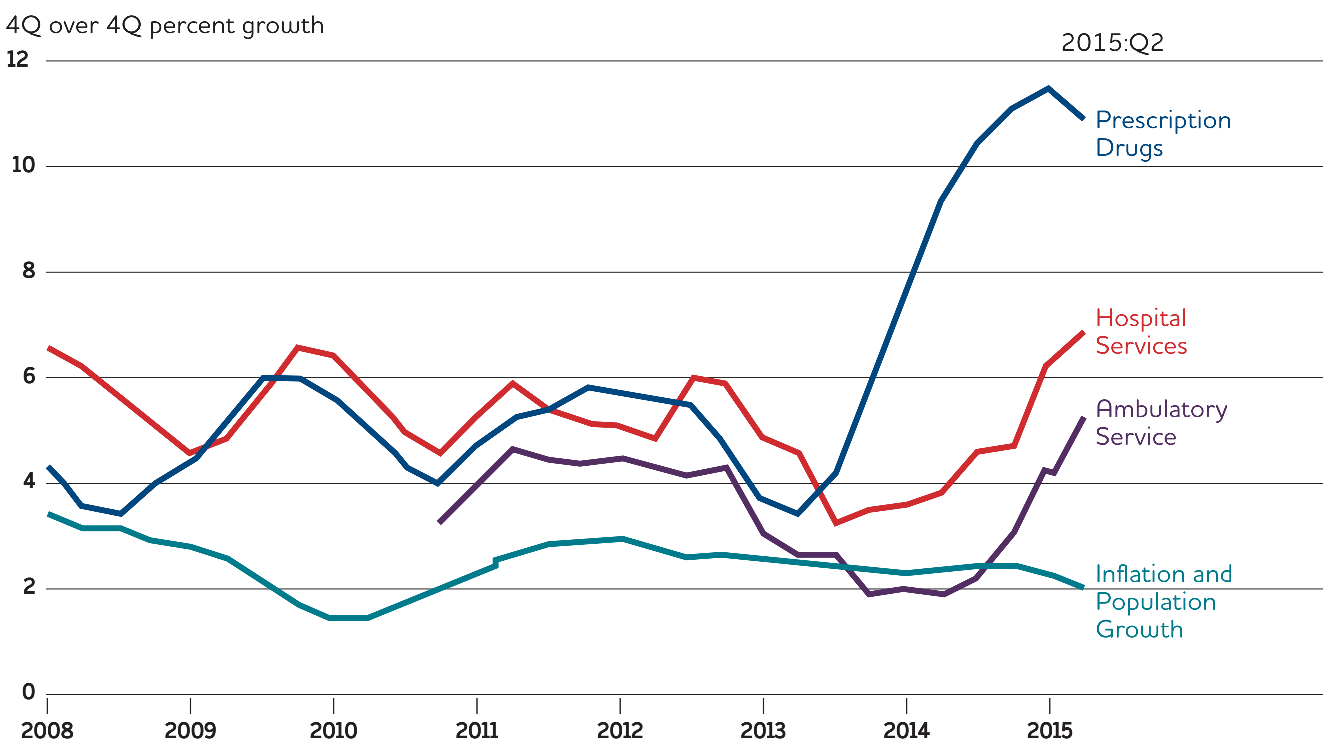
Retirement health care costs, in particular, have grown dramatically and unexpectedly over the last 20 years, as shown below, and revenues have not kept up. When communities agreed to cover those costs many years ago, they were much lower because actuarial calculations were based on people dying younger, and pharmaceutical and prosthetic costs have skyrocketed. Local governments do not have enough tools to address these legacy costs.

TOTAL LIABILITIES



Source: Scorsone et. al., 2016

GROWTH IN HEALTH CARE SPENDING



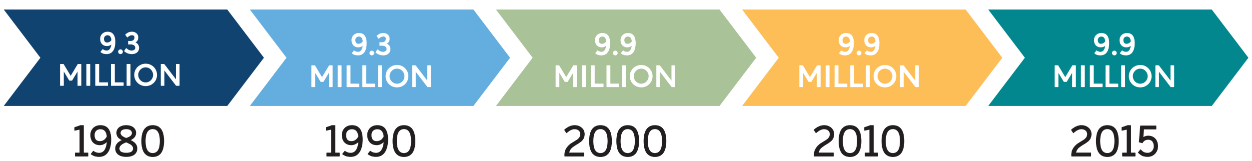
Source: Cornerstone Municipal, 2016

ENCOURAGING NEW INFRASTRUCTURE OVER UPGRADING OR SHARING EXISTING SYSTEMS LEADS TO INEFFICIENT SERVICE DELIVERY AND OVERBUILDING. THIS IS UNSUSTAINABLE.

Infrastructure cost burden is growing

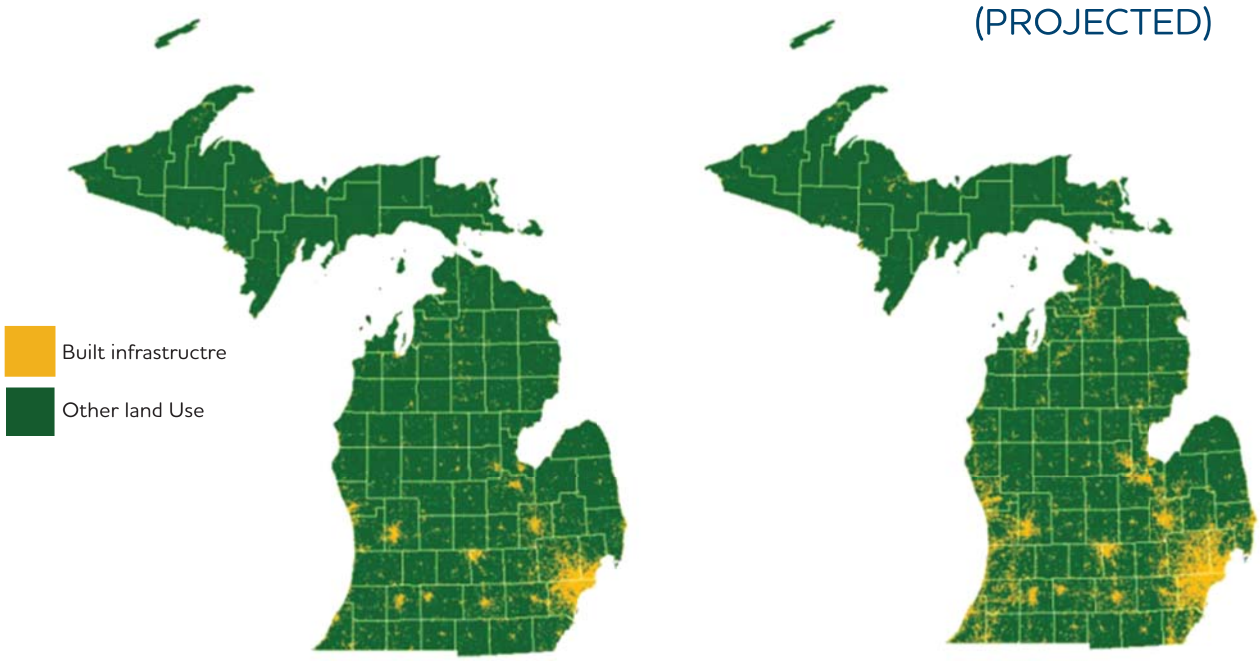
The systems we use to allocate state and local road and water infrastructure funding often encourages new infrastructure construction over upgrading and expanding existing systems or sharing infrastructure across communities. This not only leads to inefficient service delivery; it can also result in overbuilding infrastructure to a level that is unnecessary to meet the needs of our population. As the exhibits below illustrate, Michigan's population has remained flat over the last 35 years, but we have had a substantial increase in built infrastructure over that time. This creates an unsustainable system where the same number of people are responsible for maintaining an ever-growing infrastructure system.

GROWTH IN MICHIGAN POPULATION



LAND USE 1980

LAND USE 2020 (PROJECTED)



Source: Public Sector Consultants. 2001.

How do we fix this?

In the face of mounting structural costs and limitations, communities will continue to struggle making investments that are so critical to attracting the talent and business which will drive Michigan's economic growth. So how do we fix this problem? The state, in partnership with local governments, must address three major issues: costs, structure, and revenue.

Cost Containment Measures

Michigan's communities are burdened by a variety of significant cost pressures, including aging infrastructure and a large level of debt from retiree health care obligations (OPEB), among others. These costs are diverting money from current operations and service delivery.

In order to sustain modern health benefits, we need modern health care system design. We must move to a service delivery model that provides reasonable and sustainable benefits without burdening future budgets. If done correctly, we can stabilize city finances and reduce OPEB liabilities. Unfortunately, local governments cannot do this independently. State legislative changes are the only way we can achieve the goal we all share: to control these costs while ensuring that retirees have access to medical care.

Structure of Local Government

Historically, we have evaluated the efficiency or necessity of any infrastructure improvement within the limited context of a political boundary. This has led to methods of service distribution in Michigan that are fragmented, duplicative, and inefficient, and investment in sometimes unnecessary new infrastructure. We should maximize investment in existing infrastructure rather than building new systems. This means allocating resources and making infrastructure investments that focus on maintaining and upgrading existing systems. It also requires utilizing shared infrastructure across communities, including water treatment, transportation, emergency services, and other facilities, as communities grow.

Expanded service sharing can also offer opportunities for improving local finances, but we need shared service models that result in true economic efficiencies and do not diminish the quality of services. We must also recognize that some types of local services are better suited for functional consolidation than others. The value that different communities place on very public-facing amenities (such as parks, emergency services, road maintenance) may not lend themselves to sharing with neighboring communities. But some programs, such as assessing and election activity, might offer better opportunities for consolidation among municipalities.

"We are now well past optimizing efficiencies; cuts have, and will continue to impact the quantity and quality of services delivered. And this creates a further spiral. As we make more and more impactful cuts, we further reduce quality of life and make it more challenging to attract talent and businesses."

~ Anthony Minghine,
Mchigan Municipal League 2016

"The State of Michigan has failed our cities... We have a dysfunctional system of local government organization and financing. The entire system needs to be overhauled. We cannot have a strong state without strong communities."

~ Robert Kleine,
former state treasurer. (GLEC, 2016)

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OUR MUNICIPAL FINANCE
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More stability and options for local revenue

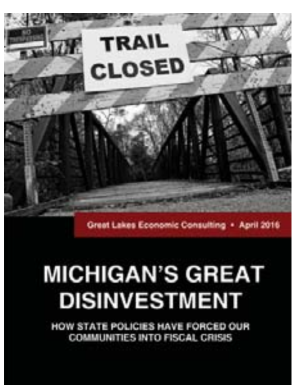
If we truly want a great Michigan, our municipal finance system must track with the economy. We must commit to a strategy of investing where we will achieve the greatest return on our investment: our communities. Creating great communities that attract and retain talent and job providers, while at the same time sustainably investing in necessary transportation, water, energy, and other public infrastructure, is virtually impossible under our current finance model. Efforts to reform municipal finance need to provide funding levels and flexibility that will enable local governments to address needs that are not being met.

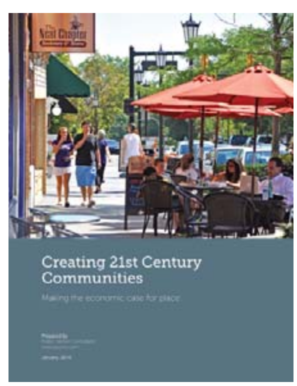
We can work to correct this deficiency by addressing the unforeseen interactions between Proposal A and the Headlee amendment that result in less than inflationary growth for our communities. Solutions must allow for currently excluded growth from property sale "pop ups" and enable communities to recover following market drops in value. Additionally, the state needs to recommit to investments in revenue sharing and expand the authority for municipalities to utilize special assessments and other locally-originated revenue tools, especially those aimed at infrastructure and investments in "place."

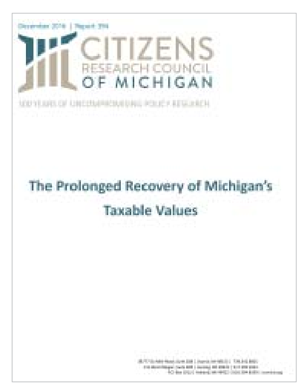
For more information, see the following resources by visiting www.savemicity.com:

Save MI City

www.saveMIcity.org
#saveMIcity







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michigan municipal league

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