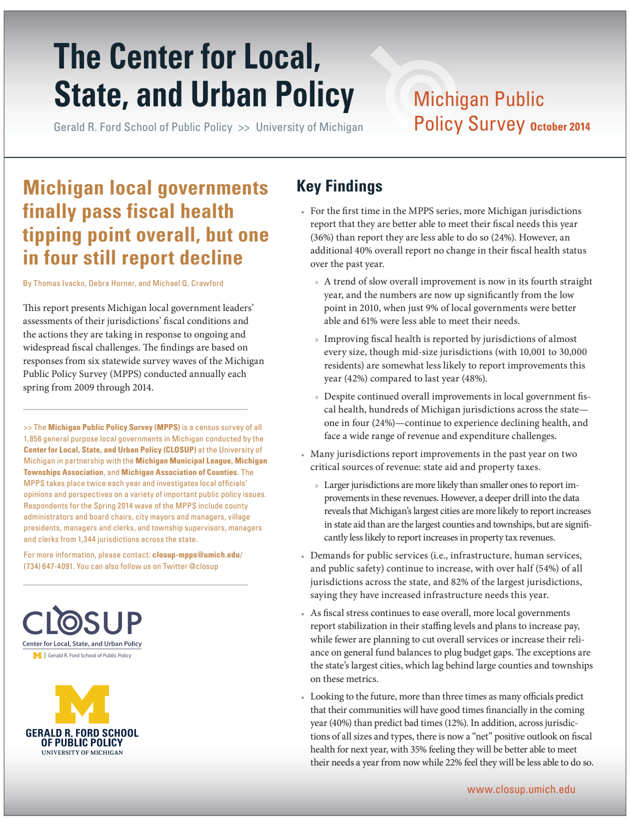
Local Governments Not Sharing in Recovery

By Rick Haglund

Michigan's economy has made a steady recovery from the Great Recession over the past six years. But the state's local governments are far from fully sharing in that recovery.

Scan local newspapers and you'll see stories about communities struggling to keep their finances in the black, even as Michigan is adding jobs and state government revenues are growing.

"In a 2012 University of Michigan survey, most city leaders said they believed Michigan's system of local government finance was broken. It's a view that still echoes today."



The Center for Local, State, and Urban Policy

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Michigan Public Policy Survey **October 2014**

Michigan local governments finally pass fiscal health tipping point overall, but one in four still report decline

By Thomas Ivacko, Debra Horner, and Michael Q. Crawford

This report presents Michigan local government leaders' assessments of their jurisdictions' fiscal conditions and the actions they are taking in response to ongoing and widespread fiscal challenges. The findings are based on responses from six statewide survey waves of the Michigan Public Policy Survey (MPPS) conducted annually each spring from 2009 through 2014.

>> The **Michigan Public Policy Survey (MPPS)** is a census survey of all 1,856 general purpose local governments in Michigan conducted by the **Center for Local, State, and Urban Policy (CLOSUP)** at the University of Michigan in partnership with the **Michigan Municipal League, Michigan Townships Association**, and **Michigan Association of Counties**. The MPPS takes place twice each year and investigates local officials' opinions and perspectives on a variety of important public policy issues. Respondents for the Spring 2014 wave of the MPPS include county administrators and board chairs, city mayors and managers, village presidents, managers and clerks, and township supervisors, managers and clerks from 1,344 jurisdictions across the state.

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Key Findings

- For the first time in the MPPS series, more Michigan jurisdictions report that they are better able to meet their fiscal needs this year (36%) than report they are less able to do so (24%). However, an additional 40% overall report no change in their fiscal health status over the past year.
  - A trend of slow overall improvement is now in its fourth straight year, and the numbers are now up significantly from the low point in 2010, when just 9% of local governments were better able and 61% were less able to meet their needs.
  - Improving fiscal health is reported by jurisdictions of almost every size, though mid-size jurisdictions (with 10,001 to 30,000 residents) are somewhat less likely to report improvements this year (42%) compared to last year (48%).
  - Despite continued overall improvements in local government fiscal health, hundreds of Michigan jurisdictions across the state—one in four (24%)—continue to experience declining health, and face a wide range of revenue and expenditure challenges.
- Many jurisdictions report improvements in the past year on two critical sources of revenue: state aid and property taxes.
  - Larger jurisdictions are more likely than smaller ones to report improvements in these revenues. However, a deeper drill into the data reveals that Michigan's largest cities are more likely to report increases in state aid than are the largest counties and townships, but are significantly less likely to report increases in property tax revenues.
- Demands for public services (i.e., infrastructure, human services, and public safety) continue to increase, with over half (54%) of all jurisdictions across the state, and 82% of the largest jurisdictions, saying they have increased infrastructure needs this year.
- As fiscal stress continues to ease overall, more local governments report stabilization in their staffing levels and plans to increase pay, while fewer are planning to cut overall services or increase their reliance on general fund balances to plug budget gaps. The exceptions are the state's largest cities, which lag behind large counties and townships on these metrics.
- Looking to the future, more than three times as many officials predict that their communities will have good times financially in the coming year (40%) than predict bad times (12%). In addition, across jurisdictions of all sizes and types, there is now a "net" positive outlook on fiscal health for next year, with 35% feeling they will be better able to meet their needs a year from now while 22% feel they will be less able to do so.

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Prosperous Cities Are Hurting, Too

We all know about Detroit's recent bankruptcy—the largest municipal bankruptcy in U.S. history—and the 11 struggling cities in the state that have been either run by emergency managers or faced state intervention in recent years.

But even more prosperous cities, such as Kalamazoo, Grand Rapids, and Marquette, are trying to figure out how to maintain quality city services when rising costs are outrunning revenues that are in part restricted by state actions.

Kalamazoo is considering boosting a variety of fees on parks, building permits and other areas to offset a projected $7 million budget shortfall by 2020.

"We don't have the tools available at this time to make all this work without having to look at further restructurings," Chief Financial Officer Tom Skrobola said in the *Kalamazoo Gazette*.

Grand Rapids, with voters' approval, has enacted a new tax to fund city parks and canceled a scheduled income tax cut to pay for street improvements.

Marquette, the picturesque Upper Peninsula city where the League held its annual conference last year, is like many cities wrestling with an aging infrastructure and underfunded retiree benefit plans.

Oh, and Marquette's largest taxpayer, We Energies, is challenging its $210 million property tax assessment before the Michigan Tax Tribunal. The company is seeking to cut its assessment by nearly half.

"It wouldn't take much for some serious pain to set in," said Gary Simpson, Marquette's chief financial officer.

Vibrant cities are important in making Michigan an attractive state to newcomers and long-time residents alike. People are citizens of states, but they live, work, and educate their children in local communities.

And increasingly, young people want to live in cities that possess a strong sense of place. If our cities can't provide the services and quality of life its residents want, all of Michigan is diminished.

Headlee and Proposal A

Cities have been fighting budget battles for years, with little sympathy from lawmakers in Lansing. In several ways, Michigan's tax structure has made things more difficult for local communities.

The 1978 Headlee Amendment to the state constitution requires communities to reduce their millage rates when annual growth in local property tax revenue exceeds the inflation rate. Millage rates can only be restored through so-called "Headlee override" votes by residents.

Another law, 1994's Proposal A property tax reform, caps annual growth in the taxable value of real property to the rate of inflation and no more than 5 percent.

Those laws were designed in part to protect homeowners from rising property tax bills that were said to be forcing some, especially senior citizens on fixed incomes, from their homes. But something unprecedented happened in the Great Recession. Property values in Michigan plunged, in some areas by more than 50 percent. Local governments are heavily dependent on property tax revenues."In a number of cities, especially in Southeast Michigan, the tax base has fallen so far and the rebound has been restricted to such an extent that they won't recover to 2007 revenue levels for 15 years," said Eric Lupher, president of the Citizens Research Council of Michigan.

And state budget problems have resulted in Lansing shorting local cities some $6 billion in statutory revenue sharing payments over the past 14 years.

"The economy is better, but many of our local governments are not bouncing back," he said. "The system is kind of stacked against them."

Local Officials' Survey Response

It isn't all doom and gloom.

A University of Michigan survey last fall found that more local village, township, city, and county officials said they were better able to meet financial needs in the current fiscal year than in the previous one.

That was the first time in six years that local units reported doing better than in the previous year, according to the U-M Ford School's Center for Local, State and Urban Policy.

But local officials were evenly split on the question, reflecting more difficult economic challenges in municipal governments.

In a 2012 U-M survey, most city leaders said they believed Michigan's system of local government finance was broken. It's a view that still echoes today.

"Those local leaders who think the system is broken think nearly every segment is broken," said Tom Ivacko, administrator of Ford School's Center for Local, State, and Urban Policy.

Many reforms have been proposed. Chief among them is giving local governments relief from revenue restrictions in Proposal A and the Headlee Amendment.

But state government could provide billions more for local governments, if it chose to, by increasing its own revenues.

State Actions

Over the past three decades, the state has tried to cut its way to prosperity, trimming $51 billion in taxes between 1994 and 2012, according to a study by former state Treasury Department official Doug Drake.

Those tax cuts have contributed to the state falling far below its taxing limit under the Headlee Amendment, the same law that is restricting local governments' revenue growth.

The amendment caps state revenues at 9.49 percent of personal income. Michigan could raise $8.5 billion in additional revenue this year before hitting the cap. That's just $1 billion less than the entire general fund budget.

And the gap likely will continue growing. State revenues are expected to be $10.7 billion below the Headlee cap by fiscal 2017, according to the House Fiscal Agency.

Michigan could invest far more to ensure its cities are safe and vibrant if it could find the political will to do so.

To download the U-M study, please visit closup.umich.edu.

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