

Section 4: Finance

Chapter 20: Limits of Municipal Expenditures

Municipalities are frequently requested to make donations to various worthy private organizations. Such organizations include chambers of commerce; hospitals; museums; veterans' organizations; community funds; Boy Scouts, Red Cross; and other educational, promotional, or benevolent associations. Frequently, it is difficult for the legislative body of a municipality to refuse such requests. However, it appears clear from Michigan law that such donations are questionable expenditures of public funds.

Generally, a municipality's power to spend money is derived from the state through the Michigan Constitution and state laws. In addition to specific grants of power, cities and villages with home rule authority are also able to rely on the applicable provisions in the Constitution and statutes for the power to spend on municipal concerns. Regardless of the authority, it is generally held, however, that municipalities have the power to expend funds only for a public purpose.

One test for determining a public purpose is whether the expenditure confers a direct benefit of reasonably general character to a significant part of the public. It should be noted that the public purpose test has also been limited to the provision of services for which municipalities exist and the powers they have authority to exercise. With respect to the question raised, neither the Michigan Constitution nor state law grants to municipalities the power to spend public money on employee parties, gifts, etc. Nor can a good argument be made that the expenditures are for a public purpose. Absent a grant of spending authority, and

no clear public purpose defined, the expenditure is most likely illegal. Simply put, a municipality cannot give public funds away.

What Is a Public Purpose?

The Michigan Supreme Court has defined the objective of a public purpose:

Generally a public purpose has for its objective the promotion of the public health, safety, morals, general welfare, security, prosperity, and contentment of all the inhabitants or residents within the municipal corporation, the sovereign powers of which are used to promote such public purpose.... The right of the public to receive and enjoy the benefit of the use determines whether the use is public or private. (*Hays v City of Kalamazoo*, 316 Mich 443, 453-454 (1947))

The following questions may be helpful in determining whether an expenditure is appropriate:

1. Is the purpose specifically granted by the Michigan Constitution, by statute, or by court decision?
2. Is the expenditure for a public purpose?
3. Is the municipality contracting for services that the municipality is legally authorized to provide?
4. Is the operation or service under the direct control of the municipality?

If you can answer “yes” to these questions, the expenditure is most likely appropriate.

Michigan Constitution of 1963

The following provisions of the Michigan Constitution are the basis for municipal expenditures:

- Article 7, Sec. 26.
Except as otherwise provided in this constitution, no city or village shall have the power to loan its credit for any private purpose or, except as provided by law, for any public purpose.
- Article 9, Sec. 18.
The credit of the state shall not be granted to, nor in aid of any person, association or corporation, public or private, except as authorized in this constitution. (Note: This applies to all political subdivisions of the state. *Black Marsh Drainage District v Rowe*, 350 Mich 470 (1958)).

Private Purpose Decisions

Expending public funds for a private purpose under Michigan law is illegal. For over a century, the Michigan Supreme Court has considered the limitations on expending public funds and has been consistent in its rulings. Most involve the relationship of a municipality with private businesses.

1. A contract in which the village of Fenton proposed to expend \$1200 to drain a marsh, improve a highway, and construct a dock in order to induce a certain firm to establish a stamemill in the village, was held invalid. *Clee v Sanders*, 74 Mich 692 (1889).
2. Money from a bond issue could not be spent if it appeared that the purpose of the bond issue was actually to provide a fund for paying bonuses to industry for locating in the city. *Bates v Hastings*, 145 Mich 574 (1906).
3. A city-owned building, which was occupied by a manufacturing company,

burned down. The city agreed to pay the insurance proceeds to the manufacturer if it would rebuild the building and occupy it for a term of years.

The rebuilding, however, was not done on the city-owned property. It was held that payment of the \$5,000, even though not raised by tax money, was unlawful. *McManus v Petoskey*, 164 Mich 390 (1911).

Public Purpose—but Outside Municipal Control

Most of the above cases involve a purpose which is worthy, but private in nature. There is another line of cases that involves an additional concern. If the purpose for which the funds are expended is public in nature, *but the operation is not under the control of the city or village which is making the contribution*, it may nonetheless still be an illegal expenditure.

In *Detroit Museum of Art v Engel*, 187 Mich 432 (1915) the Supreme Court ruled that Detroit could not pay the salary of the museum director, even though the city had title to the real estate on which the museum was located and had minority representation on its board of directors. One sentence of the opinion which has been much quoted is:

The object and purpose of relator is a public purpose in the sense that it is being conducted for the public *benefit*, but it is not a public purpose within the meaning of our taxing laws, unless it is managed and controlled by the public.

In more recent cases the *Art Museum* doctrine has been applied on a limited basis. *Hays v City of Kalamazoo*, 316 Mich 443 (1947) involved the validity of the payment of membership fees by Kalamazoo to the Michigan Municipal League. The court distinguished the *Art Museum* case by saying that, contrary to the payment of dues to the League, the transaction with

the Museum did not “involve the right of a municipality to avail itself of, and to pay for, information and services of benefit to the city in its governmental capacity.”

In 1957, the Michigan Supreme Court held that Detroit could properly transfer to Wayne County certain city park land to facilitate the construction of a home for neglected and abandoned children. In sustaining the right of the city to assist the project in the manner indicated, the court noted that two-thirds of the population of the county resided in the city of Detroit, and that the proposed institution would provide care for children from within the city. The court held that the city was aiding in the accomplishment of a purpose that it might itself have accomplished directly under its charter. *Brozowski v City of Detroit*, 351 Mich 10 (1957).

Opinions of the Attorney General

There are numerous opinions by the Attorney General regarding municipal expenditures. The following are offered as examples.

- Money raised under the special tax for advertising can be used to advertise the city's advantage for factory location, but not to buy land to be given for a factory, to build a factory for sale or rent, or to give a bonus for locating a factory in the city (1927-28 AGO p. 672).
- In a park owned by the American Legion which had installed a lighting system and held ball games open to the public, it would be unlawful for a village to assume the cost of the electricity used by the park up to \$100 per year, even though the majority of the village taxpayers had signed a petition requesting such payment (1935-36 AGO p. 5).

Expansion of Public Purpose

The Attorney General has said that a county may not use federal revenue sharing funds to make a grant to a private nonprofit hospital (1973 AGO No. 4851).

The Attorney General concluded that since it could not expend its own funds as contemplated, it could not disburse federal funds for that purpose. The Attorney General suggested that the county might obtain social service and medical service needs by contract. In a later opinion the Attorney General concluded a county could not expend federal revenue sharing funds for loans to private businesses unless the federal statute expressly authorized such expenditure (1987 AGO No. 6427).

Considerable use has been made of the authority to contract with private nonprofit agencies to perform services on behalf of a city or village. 1977 AGO No. 5212 specifically recognized the validity of this procedure. The state legislature subsequently amended section 3 (j) of the Home Rule City Act as follows:

In providing for the public peace, health, and safety, a city may expend funds or enter into contracts with a private organization, the federal or state government, a county, village, township, or another city for services considered necessary by the municipal body vested with legislative power. Public peace, health, and safety services may include, but shall not be limited to, the operation of child guidance and community mental health clinics, the prevention, counseling, and treatment of developmental disabilities, the prevention of drug abuse, and the counseling and treatment of drug abusers. 1978 PA 241.

In addition, there have been other expansions of a municipality's spending power with respect to a downtown development authority, MCL 125.1651 et seq. (1975 PA 195); public economic development corporation, MCL 125.1601 et seq. (1974 PA 338); empowerment zone development corporation, MCL 125.2561 et seq. (1995 PA 75); enterprise community development corporation, MCL 125.2601 et seq. (1995 PA 123); and brownfield redevelopment financing, MCL 125.2651 et seq. (1996 PA 381). Each law allows money and resources to be used for economic growth under the control or oversight of the municipality's governing body.

Statutory Authorizations for Expenditure

Listed below are several specific statutory authorizations for public expenditures:

- Cultural activities (Home Rule City Act). MCL 117.4k.
- Water supply authority. MCL 121.2.
- Public utility. MCL 123.391.
- Exhibition area. MCL 123.651.
- Memorial Day/Independence Day/Centennial celebrations. MCL 123.851.
- Band. MCL 123.861.
- Publicity/Advertising. MCL 123.881.
- Principal shopping district. MCL 125.981.

As a public decision maker, you have a legal duty to make sound financial decisions. Whenever a question arises that does not easily match statutory law, or meet the public purpose analysis, the expenditure is likely improper. Remember, if the question cannot be resolved, your municipal attorney is the best resource for legal advice. You may also wish to consult the state of Michigan Department of Treasury website (www.michigan.gov/treasury) for guidelines.

Chapter by League staff.