The Task Force on Local Government Services and Fiscal Stability

Final Report to the Governor

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EXECUTIVE SUMMARY

Fiscally sound local governments, capable of creating safe, clean communities, are essential to a thriving Michigan economy. Despite the critical role that local government plays in attracting residents and businesses, many units of local government have already declared themselves unable to ride out the economic downturn that affected the United States in general and continues to affect Michigan in particular. Others warn that they are becoming increasingly unable to forestall their own slide into the same condition.

Governmental operations are labor intensive, and as such, the cost of providing services to residents has risen dramatically with recent increases in labor costs. Unfortunately, local governments in Michigan have become increasingly restricted as to how they raise revenues to cover these costs. Despite a long history of voter control over the levy of taxes, policy decisions have continually eroded the manner and method in which local officials can request necessary increases from voters. Additionally, many communities in Michigan have maximized their revenue generating capabilities, and are still struggling to provide the necessary services. With two Michigan cities currently in emergency financial management, and one recently coming out of emergency financial management, and dozens of others facing fiscal distress, the structure of municipal finance must be re-evaluated.

Public discourse often raises the question, “Why doesn’t the public sector operate like the private sector to gain efficiencies and lower the tax price of government to citizens?” One distinguishing characteristic between the two sectors is the ability of the private sector to select consumers and alter the demand for a service or product through market forces, advertising and marketing. The public sector does not have the luxury to choose its customers. Constitutions, enabling state statutes, court and administrative orders determine whom government serves. Often the imposed rules ignore price and capacity constraints. Unlike the private sector, which can adjust consumer demand through pricing, as well as cross-subsidizing services, government is left to accommodate new service demands within a fixed revenue stream. The demand for public or community services generally rises during a period when tax revenues are most constrained, such as during a recession, leaving governmental leaders caught between increased demand, especially for safety net programs, and declining ability to fund the services.

It is becoming increasingly evident that many local governments have experienced an increase in demand for services while revenues have not kept pace. In fact, income taxes and State Shared Revenues have fallen dramatically at the local level.

For these reasons, Governor Jennifer M. Granholm charged the Task Force on Local Government Services and Fiscal Stability to evaluate existing State statutes and policies hindering local units of government from carrying out their mission and to recommend new statutes or policies that will enable them to continue to deliver essential services in good economic times and bad.

The following summarizes the key findings and recommendations of the Task Force:

Key Findings

- Many local units of government have experienced flat or declining revenue. Revenue losses are the result of reductions in State Shared Revenue and the interaction of the Headlee Amendment and Proposal A. Fully developed and urban core cities have been the most adversely impacted.

- While revenues have been restricted, many expenditures are increasing beyond the control of local government.[1] 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.

- 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, to meet ongoing increases in operating expenditures, has left many local governments with 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.

[1] **This point is further illustrated by an MSUE/MACAO study, which estimates that Michigan's counties alone are mandated by state law to perform over $1 billion in services annually, and the state only provides approximately $550 million toward that end.**

Key Recommendations

- A permanent State supported institution is necessary 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 with incentives and mandates regional cooperation among local units of government and eliminate regulatory obstacles at the local and state level to consolidating services.

- 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.

- Consider policy mandates to assure local governments have a long-term financial plan to adequately fund post retirement benefits. 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.

- The recommendations of the Final Report of the Michigan Land Use Leadership Council must be the basis of State development and growth policies.

INTRODUCTION

The Governor's Task Force on Local Government Services and Fiscal Stability was a fifteen member body chaired by the Michigan State Treasurer. For purposes of this Task Force, local government was defined as cities, counties, townships, and villages. The members represented all levels of local municipal government. The Task Force held meetings throughout the latter half of 2005, early 2006, and heard reports from representatives of the Citizens Research Council of Michigan (CRC), Michigan State University, and a number of experts on the topic of legacy costs and other policies that impact local government budgets. Executive Order 2005-7 and other Task Force documentation can be found in Appendix A and B respectively.

The recommendations of the Task Force were developed with both a long- and short-term perspective. The existing structure of the municipal finance system is no longer viable for many communities in Michigan, and may become damaging to more local units of government in the near future. Changes have been recommended to alleviate current problems caused by this system, but also to create a process by which future problems may be addressed.

A significant finding made by the Task Force was the lack of relevant data available to State leaders regarding the operations and financial condition of local units of government. This lack of information caused the Task Force to adopt the following approach to the data included in this Report:

- The Task Force concluded that data is only useful if it is not so general as to mask the differences among types and sizes of local governmental units.
- The Task Force accepted data presented by recognized, reliable sources and has documented those sources throughout the Report.
- Where relevant data from these sources was not available, the Task Force has included specific information collected from local units of government, including those represented by Task Force members.

The Task Force members were energized by the opportunity to have public policy dialogue that identified common concerns and issues among counties, cities, and townships and villages. The multitude of topics as well as the length of discussion exemplifies the genuine need for a permanent forum for intergovernmental discussion on state-level policies.

THE LANDSCAPE OF LOCAL GOVERNMENT

The precarious landscape of local government in Michigan today is troubling. The Fiscal Year 2007 Executive Budget reports that revenues in Michigan have increasingly fallen below the limit set by the Headlee Amendment in 1978. Current revenues are $5.8 billion below that limit. Traditionally, the state has transferred significant revenues to local governments to support services. Although, the State has repeatedly balanced the budget, the lack of sufficient revenues inhibits local government's ability to meet the rising demands for services that often occur during economic decline. Compounding this problem, increases in the costs of delivering essential services have outpaced increases in revenues received for payment for those services. Residents are moving out of older cities and crowding into what used to be rural communities. Businesses are closing and moving out of Michigan, despite seven straight years of reduced taxes.[2]

The Task Force heard presentations from many experts, all of whom reported on the landscape of local government in Michigan today. These presentations are summarized below.

Michigan State University's Department of Agricultural Economics, State & Local Government Program delivered a summary of much of the literature to the Task Force at its first meeting.[3] The primary conclusions demonstrated the following:

- Michigan's loss of employment has impacted local units of government unequally, as did the addition of jobs in some areas.
- Michigan's recovery since 2003 has not matched nationwide economic recovery, exacerbating the unequal impact on local units of government.
- State policy changes and budget reductions often shift financial burdens to local units of government. The shift produces greater strain on an already overburdened and inequitable property tax system. Examples of such shifts include State reductions of mental health services and facilities resulting in many displaced persons becoming incarcerated or homeless. Further, grossly inadequate Public Act 51 road funding that places a greater burden on property taxes to maintain and rebuild streets and bridges.
- The gap between local government-mandated expenditures and associated revenues has widened significantly.
- State policies and statutes have reduced or restrained own-source revenues (property tax, fees, etc.) for units of local government. Meanwhile, state revenue

[2] Michigan's Land, Michigan's Future: Final Report of the Michigan Land Use Leadership Council, August 15, 2003.
[3] Summary of Issues. Provided by Michigan State University to the Task Force members in September 2005.

sharing has been suspended for counties and held constant or even reduced for other local governments.

- Political and social hurdles can prevent local units of government from working together or even discussing the possibility of collaboration, even when economic factors would ordinarily drive collaborative efforts to deliver services.

In addition, the Task Force heard presentations regarding the impact of post-employment benefits on local government expenditures, in which the presenters agreed to the following:

- Some units of local government have already demonstrated that they will not be able to afford the post-retirement benefits already promised to retirees and to vested employees.
- The use of techniques such as pattern bargaining for like groups of employees, has led many local units of government to anticipate that they will be unable to meet future promises from existing revenues.

Finally, the Task Force read and agreed with the following findings in the Final Report of the Michigan Land Use Leadership Council:[4]

- The state's development patterns, which exemplify both America's and Michigan's historic frontier mentality – the yearning by many to leave congested areas and conquer wilderness – pervade every aspect of our lives.
- On average, the state of Michigan develops its land eight times faster than its population grows.
- When investment shifts from cities to the suburbs and beyond, (1) city property values decline; (2) city population dwindles, leaving behind a concentration of older, minority, and/or low-income populations who often cannot afford to move out; (3) the city's tax base shrinks; and (4) the city's roads, sewers, buildings, police and fire services, and public institutions deteriorate.
- The developers of new suburban land uses should be required to fund the costs of new public infrastructure concurrently with their developments when property with available utilities and roads exists in the urban area.

[4] Michigan's Land, Michigan's Future: Final Report of the Michigan Land Use Leadership Council, August 15, 2003.

- Federal, State and local funds should be prioritized for the maintenance and reinvestment of existing infrastructure.

This landscape has unevenly impacted local government, and has undermined the ability of local officials to encourage economic development efforts. Michigan's economic performance is integrally tied to the fiscal health of local government. To correct flaws in the existing municipal finance structure, it is necessary to first understand this link.

State Economy Impacts Local Units of Government Unevenly

State leaders recognize that the State's economy is doing poorly as compared to the rest of the nation. Although they disagree on the nature of action to be taken, leaders in both political parties have warned that action is necessary to address the State's economy.

- In her 2006 State of the State speech, Governor Jennifer Granholm warned that "many fear that good life is slipping away in Michigan as our economy faces unprecedented challenges".
- Senate Leader Ken Sikkema has stated "it's very clear that if we are going to bring Michigan out of this economic slump we have to take action. The biggest risk of all is to just sit here and watch this state hemorrhage jobs as employers look elsewhere to invest."[5]
- House Speaker Craig DeRoche put it this way: "Michigan is at the bottom of too many lists. Our unemployment rate is stuck near last in the nation, and as other states have enjoyed recovery and robust growth, Michigan's economy remains stuck in neutral. This is a position we cannot afford to remain in if we hope to maintain the quality of life we have enjoyed here in Michigan for generations."[6]

The statistics show that Michigan is facing the most challenging economic environment of the last thirty years.[7] The state has lost nearly one third of its manufacturing jobs between 2000 and 2005. The unemployment rate is a full percentage point higher than the national average according the Michigan Senate Fiscal Agency (2006). The Agency further estimates that 2006 and 2007 will see no economic relief.[8] The State's fiscal stress will likely translate into minimal increases or even cuts to local government revenue sharing and other programs.

The overall State picture, however, is not reflected evenly throughout all the units of local government in the State. The restless out migration of residents from the State's inner cities to its suburbs and rural communities has masked the overall impact of the State's economy on its local units of government. For example, personal income trends are significantly different in non-metropolitan or rural Michigan, where personal income growth was 88% (the same as national personal income growth); while metropolitan Michigan's personal income grew only at 78%.[9] Furthermore, 27 Michigan counties

[5] Senator Sikkema, press release dated October 25, 2005.
[6] Representative De Roche quoted in press release dated February 6, 2006.
[7] Citizens' Research Council of Michigan presentation, Michigan Financial Crisis and the Outlook for School Funding, September 2005
[8] Senate Fiscal Agency, Michigan Economic Indicators, December 2005
[9] Summary of Issues. Provided by Michigan State University to the Task Force members in September 2005

have consistently outperformed the national average employment growth since 1970. These 27 counties are a diverse group ranging from Oakland County in southeast Michigan to Alcona County in northeast Michigan. On the other hand, 16 Michigan counties have under performed national employment growth.[10]

Units of Local Government Are Critical to the State's Economic Development

Economic challenges have emerged as Michigan has become part of the global economy. Thomas L. Freidman of the New York Times has written that "the world is flat" in the 21st century.[11] Competition for business and people takes place on a global scale and the winners in this new world must be able to compete not only with their next door neighbors but with cities, towns and regions around the world.

However, this idea may be somewhat misleading. In fact, according to Professor Richard Florida of George Mason University, author of The Creative Class, globalization has created substantial inequalities among communities.[12] While global competition is worldwide, only some places will experience economic prosperity, while others will fall into the economic valleys.

Although there are many factors that determine if a region or state will become an economic peak or valley, quality of life factors play a major role in attracting "new economy" businesses and workers (Florida, 2000). Research shows that quality of life factors that attract a highly educated and competent workforce are integral to taking advantage of the current economic climate. [13] Businesses and individuals act in their rational self-interest: why remain in or move to a community with aging roads, parks, and other facilities, no visible reinvestment, reduction of essential services, and high local taxes? Capital is mobile and will move where it can be matched with an attractive workforce and public infrastructure in order to generate high rates of productivity and an acceptable return on investment. A high return on investment is the basis for providing high quality compensation packages for this "creative class" workforce. For Michigan to succeed economically in the 21st century, it must invest in the types of services that will attract and retain the "new economy" workforce

Quality of life factors are partially determined by local government service provision in items such as transportation systems, health care and food safety, parks and recreational opportunities and public safety. Businesses' and residents' bottom lines are affected by the delivery of public services as well as by tax rates. A review of the relevant economic research published by Ronald Fisher, Professor of Economics at Michigan State University, demonstrates a link between the provision of public services

[10] Id.l
[11] Thomas L. Friedman. The World is Flat.
[12] Richard Florida. The Rise of the Creative Class. 2002.
[13] Id.

such as public safety and transportation and economic development.[14] Research also shows that this link exists even after factoring in tax rates.[15] Therefore, local communities and governments must strike a balance between providing a reasonable portfolio of services while maintaining reasonable tax levels. An imbalance in either direction will be potentially damaging.

[14] Ronald C. Fisher. The Effects of State and Local Public Services on Economic Development. March 1997.
[15] Id.

LOCAL DELIVERY OF ESSENTIAL SERVICES

Local units of government have existed in Michigan since before the State was admitted to the Union.[16] As early as 1850, the State Legislature began requiring units of local government to provide essential services. Among the required services were construction of roads, bridges and culverts by counties and townships.[17] The 1850 constitution contemplated the county delivery of sheriff patrol services, a county clerk, county treasurer, register of deeds and prosecuting attorney.[18] It also required townships to have a supervisor, clerk, commissioner of highways, treasurer, school inspector, up to 4 constables, and an overseer of highways for each highway district.[19] The 1850 constitution left the method of establishment and the delineation of powers and responsibilities of cities and villages up to the State legislature.[20]

A recent survey by the Citizens Research Council of Michigan listed 26 different categories including over 100 specific types of public services delivered by local units of government.[21] The authors of the Memorandum concluded that the menu of services provided by different units is broad and the methods to provide those services equally diverse. The following list details some of the essential services identified in the survey.

- *Democracy*: Some of the essential services provided are those that sustain the State's democracy. These include setting election schedules for inclusion of candidate and ballots, approving petitions, publishing notices of election, registering voters, maintaining active files of qualified voters, and canvassing votes.
- *Public Safety:* Public safety is one of the most essential services that local units of government provide. Police and fire protection are critical to the well-being of a community. Among other public safety programs, local governments house prisoners of the state and pay for the costs of keeping courts open for both civil and criminal actions. They inspect buildings for safety, enforce health and environmental codes, and provide animal control services.
- *Health:* County governments in Michigan provide community, public and mental health services that ensure the continued health of residents. These services include activities such as immunizations, public water testing, and communicable disease control.

[16] 1835 Constitution of Michigan included elections in local districts, counties or townships, and referred to the City of Detroit as the location for the Constitutional Convention as well as the original seat of government.
[17] 1850 Constitution of Michigan, article 4, section 49.
[18] Id, article 10.
[19] Id, article 11.
[20] Id, article 15, section 13.
[21] CRC Memorandum, "Catalog of Local Government Services in Michigan", September 2005.

- *Quality of Life Services:* Local leaders respond to State demands for the delivery of community and economic development services to attract businesses and residents to the State. Aging populations are creating increased demand for senior services and facilities. Local units of government also provide clean and safe streets, sufficient parking, and public transit to enable citizens to get to work and visit businesses, parks, and other recreational and cultural facilities. They also are responsible for developing and maintaining a Master plan and enforcing zoning ordinances.
- *Property Tax Administration:* Other services assure the proper and uniform assessment of property for taxation and the billing, collection, and distribution of property taxes raised by all levels of government, including the State.
- *Environment:* Local units of government collect garbage and provide places to put the garbage safely away from water sources and resident and business locations. In areas where septic systems and wells are insufficient to assure all residents clean water and healthy surroundings, units of local government provide water distribution, water treatment, sewage collection, sewage treatment, and storm water management under increasingly strict federal and state environmental guidelines.

Given the importance of these services, local officials must find means by which to generate funding. As the following section will demonstrate, this has become increasingly difficult as costs have rapidly increased, and further restrictions have been placed on revenue generating capabilities.

LOCAL FUNDING OF ESSENTIAL SERVICES

Although economic decline has had severe effects at both the state and local level, State policy decisions have worsened the situation and created accelerated fiscal stress for even some of the best-managed communities in the State. A healthy fiscal balance between revenues and expenditures is necessary to the provision of local public services, without which economic development efforts will falter. While data is sparse, the experience of local leaders and available statistical analyses will demonstrate several representative cases of local governmental fiscal imbalance and stress. It must be emphasized that this local governmental fiscal imbalance is partly due to economic factors, but more importantly due to the restrictive legal structure of Michigan's public finance system, and State policy decisions that have reduced State taxes resulting in reduced financial support for local government.

Michigan has a strong historic connection to voter control of the levy of taxes at the local level. Other than taxes already authorized by the electors of the State in the Michigan Constitution of 1963 (county, general law townships and school property tax), all local taxes require approval of the local electorate. Home rule cities, all villages, special taxing districts such as community parks and district libraries, and charter townships, above 5 operating mills, must all seek voter authorization either of their general operating millage or of special millage for specific purposes.

Local units of government responding to various inquiries and surveys conducted by their representative organizations and by Michigan State University have consistently reported that they have experienced three phenomena simultaneously:

- The cost of providing essential services has risen at a rate greater than the CPI (the measure used to restrain growth in government revenues).
- Local units lack sufficient opportunity to obtain sufficient revenue from willing local electors who demand essential services.
- The State has either held constant or reduced the amount of money distributed by the State to units of local government. Since 2001, local units have received $1.5 billion less in revenue sharing payments when compared to the full amount outlined in the Michigan Constitution and state statute.

1. Increased Cost of Services

Government expenditures associated with basic and vital operations, such as public safety, have increased at levels exceeding general inflation. This problem is exacerbated by the high cost of providing health insurance and retirement benefits to employees. The largest component of local government labor costs are for police and fire protection, yet these costs are often outside of the control of local elected officials. Arbitrators appointed under provisions of Public Act 312 of 1969 determine a vast number of wages and benefits for police officers and firefighters. The arbitrator's decisions have additional roll-up costs by setting a pattern for wages and benefits of other unions and non-union employees. Government operations are labor intensive compared to the private sector, and as the cost of funding the labor force has risen, so has the price of government.

Given these trends and growing responsibilities passed down to local governments, it is not surprising to see direct expenditures by local governments have grown 46 percent during the ten-year period 1992 and 2002. Comparing the growth rates in revenues to that of expenditures during this same ten-year time period; reveals that expenditure growth has outpaced revenues by over two percent.[22] While this may seem manageable for any one individual unit, when aggregated across all local governments it signals a troubling fiscal imbalance.

There is a wide disparity in the compensation levels of various communities. Each community must assess whether the compensation paid is in line with the surrounding communities, comparable communities, and the private sector. Further exacerbating the situation is the out migration from the State's inner cities to its suburbs and rural communities. This has left the inner cities with increased demand for services and diminished revenues. Once an organization is confident that its level of wage and benefit compensation is appropriate, the only solutions remaining available are either to eliminate services or increase revenue.

Prices for health care related goods and services have grown faster than general price inflation (CPI) between 1990 and 2004. The Citizens Research Council of Michigan states that rising health care expenditures account for roughly one-third of the of the State's budgetary increases between FY 2001 and FY 2004. The audited financial statements for fiscal year 2004 of the City of Highland Park show that expenditures for retiree and employee health benefits equal half of its total general operating budget. According to information submitted to Michigan State University, employee and retiree health insurance costs increased over 18 percent between 2001 and 2004. Communities with aging populations face the added challenge of funding health care for an increasing number of retired employees. Hazel Park spends 50 percent of its $2 million health care budget on retirees. In October 2005 city officials in Royal Oak predicted a $6.4 million deficit in the $35 million general fund budget for the fiscal year 2005-06, in large part due to employee and retiree health costs[23].

[22] Calculation completed by Michigan State University's State and Local Government Program, January 2006
[23] Detroit News. *Royal Oak manager hosts town hall meeting on deficit*. 10/17/2005

In large measure, the rising cost of local government is driven by state and federal mandates and other factors beyond the control of local officials. The rising cost of basic government operations poses a significant long-term threat to local government financial stability, and Michigan's legislative decisions about local public finance have worsened the problem.

2. Restrictions on Revenue Generating Capability

A major factor contributing to fiscal imbalance is the limited revenue flexibility and constraints due to constitutional and statutory limitations. Municipalities rely primarily on property taxes and intergovernmental revenue to finance essential public services. In recent years, revenue from these sources has failed to keep pace with the rising cost of public services. Structural constraints, such as the interaction of the Headlee Amendment and Proposal A, have limited the collection of taxes on existing properties; while statutory revenue sharing payments, as well as various State grants to local units of government, have been cut as the State reduces its payments towards its statutory obligations under pressure from the stress of Michigan's ill-performing economy.

The Task Force values the role of the local elector in making local tax decisions. Legislative constraints, however, prohibit local governments from asking local electors tax related questions. This chokes the ability of local governments to develop new and innovative ways of paying for the vital services necessary for economic development. Furthermore, revenue constraints are particularly problematic for older, built out communities in Michigan. These areas must continue to provide services at the expected levels, while being severely constrained as to their revenue generating capabilities. As more rural communities experience growth, the Task Force foresees a similar impact on those local units in the future. This has been validated by the Michigan Metropatterns Study.[24]

Own-source revenues include taxes, charges/fees, fines/forfeits, and other miscellaneous revenues. These revenues serve as a gauge to measure the inherent revenue generating capability of Michigan's local government finance system. While these sources provide a degree of control to local governments in that the revenue is largely discretionary, they remain subject to State rate limitations, which may not reflect local government revenue requirements. Revenues from outside funding sources, such as state aid and grants, become subject to political forces and availability of funds. Unless protected, such as through a Constitutional earmark, these revenues are the first to disappear during poor economic conditions or the changing of priorities, as witnessed by recent cuts to statutorily promised revenue sharing.

[24] Michigan Metropatterns: A Regional Agenda for Community and Prosperity in Michigan, April 2003, Ameregis Metropolitan Area Research Corporation

▲ *Structural Limitations in Property Tax Collection* ▲

Throughout Michigan's history, the Michigan Constitutions have preserved to the local electors strong local control over the level of taxation and the purposes of taxation. The reaction of the State Legislature has been to limit that power each time it is granted. For example, Article 7, section 21 of the Michigan Constitution of 1963 granted cities and villages the power to levy a wide array of taxes in addition to property taxes "subject to limitations and prohibitions provided by this constitution or by law".[25] Within one year of ratification of the 1963 Constitution, the Legislature reversed this broad local control by providing that no city may levy a tax except as expressly permitted by law. "Except as otherwise provided by law and notwithstanding any provision of its charter, a city or village shall not impose, levy or collect a tax, other than an ad valorem property tax, on any subject of taxation, unless the tax was being imposed by the city or village on January 1, 1964." MCL 141.91.

In 1978, Michigan voters approved a Constitutional amendment commonly referred to as the "Headlee Amendment" that simultaneously gave local electors stronger power over the decision to incur additional taxes for debt *and* reduced their power by imposing a recalculation of voter approved millage to account for inflation. The accompanying legislation and later legislation took the decision-making power away from the local officials without providing for lasting, predictable financial support from the state.

The Headlee Amendment addressed local government finance in three ways:

- Limited the growth of local government property tax revenues by providing millage rollbacks whenever revenue from existing property grows by more than the rate of inflation, unless voters override the rollback.
- Required voter approval for any new local taxes or increases in a tax rate not authorized at the time the amendment was adopted.
- Required that the state provide reimbursement for any additional costs resulting from new requirements mandated by state law.

Although the Headlee amendment did limit revenue, it was not very visible to average citizens, who voiced continued dissatisfaction over rising assessments. As a result, Proposal A was adopted in 1994; it included a limitation on assessment increases for individual parcels of property, excluding new construction on the property, to the lesser of 5% or the rate of inflation.

Importantly, there are many ways in which the statutory environment related to these provisions is actually less favorable to local governments than the State Constitution requires or permits. Statutory limits include:

- In 1964 the Legislature prohibited local governments from levying any tax not authorized by State law.

[25] 1963 Constitution, Article 7, section 21

- While the Headlee Amendment permits cities to impose an income tax without voter approval, since 1995 the legislature has required that cities seeking to impose an income tax for the first time receive voter approval.

- Although initial implementing legislation for the Headlee Amendment permitted rolled back millages to be adjusted upward when property tax values increased by less than the rate of inflation, the Legislature eliminated any millage rate recovery for this situation following the passage of Proposal A.

- The mandated cost provision of the Headlee Amendment has proven to provide virtually no protection for local government because "it excludes any activity or service that is not required of a local unit of government….but that is provided at the option of the local unit of government." Virtually all local government services including police and fire protection; roads; water and sewer service; sanitation, solid waste and landfills; parks and recreation; zoning and building regulations; libraries and numerous essential services are legally defined as "optional." Therefore the State has continued to mandate costly regulations contrary to the intent of the Headlee Amendment and the financial capability of local units.

- The legislature chose to include increases in assessments due to Proposal A "uncapping" as part of the calculation of the Headlee millage rollback. Arguably the legislature could have chosen to treat the difference between the capped value and the state equalized value as "exempt property", in which case the increase due to removing the cap would have been excluded from the Headlee millage calculation. This provision has reduced property tax revenue to local units and mandates millage roll back calculations which restrict property tax revenue growth to a rate considerably less than the rate of inflation. The Legislative statute has also accelerated Headlee millage roll back requirements thereby reducing local government's property tax capacity.

3. State Revenue Sharing Reduction and Freeze

The state revenue sharing program is a redistribution of tax dollars collected at the State level to local units of government, provided at least in part to recognize their reduced local taxing authority. This funding helps supports the cost of local delivery of essential services such as police and fire safety, infrastructure maintenance, capital projects, and snow/trash removal. Funding communities through revenue sharing was done under the philosophy that it would create efficiency in tax collections, as well as provide for a basic service level throughout communities. Further, revenue sharing monies replace tax dollars in areas of high service delivery need and low fiscal capacity. When the state reduces revenue sharing payments, often times in the middle of local budget cycles, local communities must reduce or eliminate essential services to the community.

The Task Force reviewed the history of revenue sharing in the state and concluded that current state decision makers will best make future revenue sharing decisions if they are aware of the historic legislative promises imbedded in the state revenue sharing program. A useful discussion of the history of revenue sharing is found in the Citizens Research Council of Michigan 2000 publication entitled Michigan's Unrestricted Revenue Sharing Program: Retrospect and Prospect. With CRC's permission the Task Force offers this brief historical outline.

Table 1: Milestones in Michigan's Unrestricted Revenue Sharing Program*

Year	Event
1933	Unrestricted revenue sharing begins with liquor-license tax collections.
1939	State exempts intangible personal property from local property taxes. In exchange, the State returned 2/3 of the State intangible tax collections to local governments.
1946	Constitutional amendment passes. State begins sharing one-half cent of Sales Tax with cities, villages, and townships.
1963	The new state constitution requires that 15% of state sales taxes, then at 4%, be returned to local governments on a per capita basis.
1967	When the State passed an income tax, it passed a statute which returned 11.5% of the revenue to local governments (1/2 to counties and 1/2 to cities, villages, and townships).
1972	Distribution of city, village, and township Income Tax payments based on relative tax effort (RTE).
1975	The State passed a single business tax replacing several local business taxes. As a replacement for local government's right to levy local taxes, the State passed a statute to return a portion of the new single business tax to local governments on a relative tax effort basis.
1991	The State discontinues intangibles tax distribution to municipalities.
1996	State consolidates income tax and single business tax shared revenues into an expanded percentage of the sales tax. Past revenue reductions in statutory allocations made permanent through lower sales tax percentage.
1997	At the beginning of FY1998, growth in the statutory payment allocation is made on a per capita basis. A legislative task force is charged with recommending changes in the statutory formula.
1998	Although the state constitutional requirement to return 15% of original 4% State sales tax base remained *, the State eliminated returning State income taxes and single business taxes to local government and in return passed a statute which required sharing 21.3% of the 4% sales tax with local governments.
2000	After one year under the new formula, the State broke their pledge to return State sales taxes to local government and retained them for State purposes.
2001 to 2005	State continues to cut revenue sharing to balance its budget and temporarily suspends county revenue sharing in exchange for collecting property taxes early. In every State budget since the change to the State Revenue Sharing formula, the State has not fully returned State sales taxes as required by State statute.

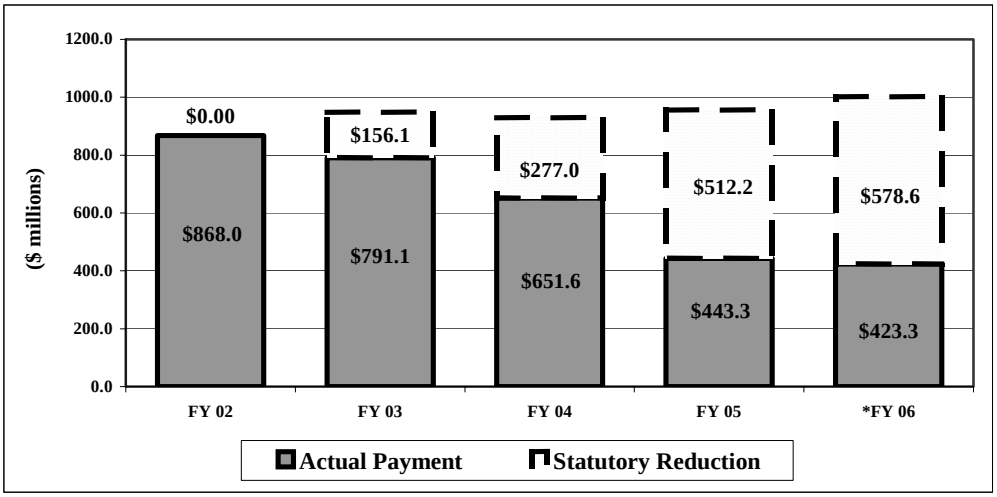
* In 1994 the State increased the sales tax from 4% to 6%, decreased other state taxes, and passes prohibitions on local governments to raise local taxes. The additional revenue from the 2% is dedicated to school funding.

Source: Adapted from the Citizens Research Council Michigan's report: Unrestricted Revenue Sharing Program: Retrospect and Prospect.

Statutory Revenue Sharing reductions have a very inequitable impact on local units of government. The components of the formula consider the type of local unit and local tax capacity. In other words, other things being equal, a community with a low property tax base per capita is receiving more revenue sharing funding per capita than a wealthier, high tax base community. Because Statutory Revenue Sharing is the only state resource that has traditionally been designed to reduce disparities between low and high tax base local units, reductions impact poorer communities to a much greater extent and exacerbate the inequities. Statutory Revenue Sharing reductions, effectively, have produced a growing gap between the "haves" and "have nots."

Even during the robust 1990's statutory revenue sharing was rarely fully funded. In fact, the revenue sharing formula has only been fully funded three times in the last fifteen years. When economic factors reduced the revenues of the state in 2000, revenue sharing was hit the hardest by cutbacks in state funding. Since 2001, local communities have lost over $1.5 billion in revenue sharing payments, when compared to the amount that would had been distributed had both the Constitutional and statutory formula been fully funded. The constitutional portion of revenue sharing payments have only grown by 6.65% from $649.3 million to $692.5 million between 2002-2006, which is less than the rate of inflation during that time. Statutory revenue sharing reductions, on the other hand, have totaled 58% and accounted for 38% of the state's $4.2 billion GF/GP spending cuts (see Figure 2 below).

Figure 1: **Statutory Revenue Sharing, Actual and Statutory Reduction.**



Source: State Budget Office, and the Citizens Research Council of Michigan.

The amount of state revenue sharing reduction shown above for FY 05 and 06 includes the $186.3 million (FY05) and $192.4 million (FY 06) in county revenue sharing payments. These payments have been temporarily replaced with withdrawals from individual revenue sharing reserve funds, which derive funding from the advancement of the levy of county allocated millages from December to July over a three year period.[26]

[26] See Appendix C for the schedule of county re-entrance into the state revenue sharing program

More recent reductions and budgetary decisions to fund state revenue sharing at prior year levels have caused larger communities to bear a greater burden. With a majority of townships removed from the statutory program, each round of cuts has had to be spread across a smaller pool of communities. A constitutional requirement to fund the per capita distribution, which grows with sales tax revenue, when coupled with the legislative decision to hold total distributions level, requires further reductions in the statutory distribution. Each round of cuts digs deeper and deeper into already constrained municipal budgets and has caused many municipalities to drastically cut or eliminate services.

There is an apparent difference in perception between state elected officials and local leaders. Many state legislators perceive revenue sharing as a line item among competing needs within the appropriations process. Local officials perceive the state's actions as a broken promise that has hamstrung local units of government and caused them to reduce police, fire, and other essential services that produce the quality of life necessary for communities of a vibrant state.

LOCAL GOVERNMENT OPTIONS

As outlined above, local governments in Michigan are operating in a weakened fiscal environment. Periods of sustained and/or potential revenue shortfalls leave local government officials with three options to continue providing services in accordance with citizen demands and state and federal mandates. They can:

- Reduce expenditures
- Deliver services in alternative ways
- Seek to increase revenue

All three options have been used throughout the State in various ways.

1. Reduce Expenditures

To achieve a reduction in expenditures local units may directly cut service levels such as police, fire service, economic development, parks and recreation, infrastructure development and maintenance, library, and emergency medical services. Local officials often reserve these cuts as a last option, because they are the most essential to citizens. However, the quality of these services is undermined as administrative and support services are reduced. Elimination of what may appear to be an optional service, such as economic development, injures local government's ability to entice new businesses and residents to communities and a state that needs them very badly. For county government, these services are not optional and are often constitutionally mandated such as the office of the clerk, treasurer, sheriff and prosecutor.

Other budgetary reductions such as delaying capital projects have long-term implications for the fiscal stability and quality of life in a municipality. Municipalities with deteriorating infrastructure become less attractive to new businesses and residents.

2. Intergovernmental Cooperation

Local officials often seek to reduce costs and maintain service levels by exploring new methods of service delivery. This can be achieved using some degree of privatization, or through cooperation with another unit of government. A recent survey by Citizens Research Council (2005) catalogued local services and found that privatization is most often found in solid waste collection, road maintenance, and janitorial services. Cooperation between governments is also common in provision of fire, ambulance/EMS, and sewer and water services. Elsewhere local governments may share libraries, senior centers, parks, and public transportation.

3. Revenue Enhancement

Local governments may find it necessary to increase revenues when citizens oppose service reductions, and hence expenditure cuts and alternative delivery methods do not present themselves. But as previously noted above, when communities have reached their maximum rates, there are few additional options for them to raise revenues. Local governments have resorted to using fund balance, selling property, or turned to other one time funding sources. However to address structural revenue shortfalls, non-depleting revenue sources are needed. Generally, these reoccurring revenues are sought through increases in fees or charges for local services, which are passed on to community residents. Additionally, local governments draw on their tax base for additional revenue. Although rare in the 1980's and 1990's, initiatives seeking voter approval for additional millage rate or Headlee override authorizations are becoming increasingly common.

▲ *Case Studies* ▲

As mentioned earlier, data collection has been a recurring problem for the Task Force. Accurate information pertaining to local government fiscal stress across the state is not readily available, nor is it reliable. At best, this makes discussion relating to intergovernmental concerns difficult, and at worst it creates policy that is based on incorrect assumptions about local government finance.

In light of this problem, the members of the Task Force elected to include examples from their own communities and others around the state to highlight how they have utilized the above 3 options: Reducing Expenditure, Finding Alternative Delivery Methods, and Increasing Revenues.[27] The members represent communities from various regions of the State, and their stories illustrate how the current structure of finance is failing to help them provide necessary state mandated and citizen demanded services.

In response to revenue shortfalls, local government leaders usually turn to expenditure cuts. Although the members of the Governor's Task Force on Local Government Services and Fiscal Stability recognize this as an important component of government operations in times of slow economic growth, they are generally only a short-term solution. Cooperative efforts and reliable revenue streams are imperative to the continued economic and fiscal health of Michigan communities.

[27] Examples were collected through a Michigan State University survey submitted to Task Force members, information collected by the Michigan Municipal League and Michigan Association of Counties, as well as various other documents submitted by Task Force members.

Southeastern Michigan



Macomb County

- The Michigan Supreme Court has recommended that Macomb County add 3 additional Circuit Judges in order to keep up with increasing caseloads. Due to fiscal constraints, the Board of Commissioners has agreed to budget one additional Circuit Judge in 2007, but only with the understanding that the bench would increase discretionary court fees in an amount sufficient to cover the additional cost of the new judgeship.
- The Board of Commissioners has set a goal of reducing the 2006 adopted budget by $6 million dollars. To date the County has reduced the Budget by $4.7 million including the elimination of 11 budgeted positions and continues to work toward its goal of $6 million in savings for the 2006 fiscal year.
- Health Care concessions totaling $2.5 million per year have been negotiated with our major union groups.
- The County Jail has been at capacity for over one year, but the County is not moving forward with expansion plans due to funding concerns. We have taken the following actions to avoid a jail crisis:
    - Increased reliance on Community Corrections
    - The County Judiciary has adopted the "Kent County" plan which allocates a limited number of jail cells to each Judge
- Sheriff has proposed eliminating 9 positions from road patrol.

City of Detroit

- Over the past four years, have eliminated 5,500 jobs from city government equaling 25.9 percent of its overall workforce.
- Has reduced by $48 million the General Fund subsidies to city enterprise agencies such as the People Mover, the Detroit Zoo, the Detroit Historical Museum, the City Airport, and the Parking Department.
- Has an estimated current General Fund deficit of $50 million.

City of Warren

- Cut 87 positions or 10 percent of municipal workforce in FY 2005; in last several years has cut 1 in 5 city positions.
- Cut services like libraries, parks and police equipment.

City of Livonia

- 89 vacant city jobs will remain open due to budget deficit.
- Increased fees and closed the Sheldon Road Senior Center.
- General fund capital expenditures are $2.5 million lower in 2006 as compared to 1998.

City of Dearborn

- Facing a $4.1 million deficit in 2006; city is considering eliminating 100 positions on top of 116 positions eliminated in 2003 and 2004.

City of Pontiac

- Ended the 05 Fiscal Year with a General Fund deficit of $31.8 million and the deficit for all funds totaling $53 million.
- Expenditures exceeded revenues in the 05 Fiscal Year by $10.9 million.

City of Ann Arbor

- Hiring freeze in place since 2002.
- City has consolidated 14 departments into 4 broad service areas.
- Staff and services reductions, most notably in public safety.
- In 2006, $2 million in personnel and operating costs will be eliminated.

City of Huntington Woods

- Revenues declined or remained flat in 4 of 5 years since FY 2000.
- City utilized Fund Equity for 4 consecutive budget years to cope with revenue reductions.
- Voters approved structured Headlee Override in November, 2003 to allow City Revenue to increase with inflation.
- Implemented major changes in employee health care and pensions.
- Consolidated Public Safety dispatch and jail services with a neighboring City.

Charter Township of Saginaw

- FY 2006 projected general fund deficit of $526,000 equaling 8% of general fund.
- Cuts and postponements for many items including equipment purchases, vehicle replacement, library, road improvements.

Southwestern Michigan



Kalamazoo County

- Between fiscal year 2003 and 2006 the county has eliminated over $9 million from the budget.
- Between 2003 and 2006 the County has eliminated 64 positions:
    - 38 positions from the Courts, Sheriff and Prosecutor
    - 15 positions from County Human Service Department
    - 5 positions from General Services Departments
    - 6 positions from Administrative Services
- Program Reductions and Eliminations:
    - Eliminated Justice Council Coordinator
    - Eliminated Justice Information Technology Coordinator
    - Eliminated County Recycling Coordinator
    - Eliminated one of two Corporate Counsel positions
    - Reduced funding for economic development activities by 50%
    - Reduced Parks budget by 25%
    - Reduced MSU Extension budget by over 25%
    - 4.9% total employee wage increase over 4 years
    - Increased employee health premium cost sharing
    - Increased employee health insurance deductibles and co-insurance costs
    - Eliminated longevity for new employees
    - Reduced eligibility for retiree health insurance
    - Increase retiree health insurance deductibles and co-pays

Central Michigan



Bay County

- Health insurance expenditures, including retiree health insurance, increased by 26% between 2002-2003.
- Despite cuts made between 2003-2004, health insurance expenditures for the county again increased by 22% between 2004-2005.

City of Grand Rapids

- In 2003 and 2004, the City used over $11 million from its reserves.
- Since 2002, the City's expenditures have exceeded its revenues.
- The City significantly reduced its expenditures to solve $50 million in budget shortfalls over the past five years. The City has employed Lean Thinking, adapted from the manufacturing industry, to eliminate waste.
- City employees pay more for their benefits, and the City has raised user fees, extended the life of its motor vehicle fleet, and privatized services.
- The City has reduced its General Operating Fund workforce by 214 positions, or about 17% of that workforce. This included the elimination of 40 sworn police officers, 12 firefighters, and other vital positions. For the City's core functions such as property tax assessing, tax collection, accounts payable, and vehicle maintenance, staff reductions have become so severe that the remaining staff is more and more often unable to complete legal requirements.
- The Fire Department has eliminated its Training Division and Emergency Medical Coordination.
- By 2010, the City will only be able to afford police and fire services if nothing is done.
- The City closed three swimming pools in 2005 and they are not budgeted to open in 2006. Four playgrounds were closed, five wading pools were closed, adult athletic programs were eliminated, and special events were eliminated.
- Over 200 seasonal employees will not be hired in 2006 and thereafter. The budget of the Parks and Recreation department was slashed by 33%. Loss of all these services will hurt the quality of life in the city.

Upper Peninsula of Michigan



Township of Wakefield

- Road repairs can no longer be included in the budget.
- Health insurance for board members has been cut substantially.
- Residents must help cover the cost of the garbage collection.
- Can not offer any recreation to our residents and children other than the City Park.

City of Wakefield

- Contract with Sheriff for patrol services has been reduced 50 percent.
- Deputy Clerk position has been unfilled leading to increased workloads.

RECOMMENDATIONS: Achieving Major Systemic Reform

ISSUE 1

FORUM FOR INTERGOVERNMENTAL DISCUSSION

There is a need in Michigan for a permanent, state-level forum to address the long-term fiscal stability of Michigan local governments and State/local relations.

During the course of its deliberations, it became evident to the Task Force that addressing the issues and problems critical to the future fiscal stability of local governments in Michigan will require and institutionalized body that is capable of in-depth and sustained analysis. The members of the Task Force were not capable of such analysis in the time allotted. However, the experience and knowledge of the Task Force members combined with the limited data provided illustrated that a major restructuring in the Michigan local government funding system may be necessary to avoid increased fiscal insolvencies in the near future. The Task Force believes that a major systemic reform proposal can only be researched, defined and presented for serious consideration by the public and legislature if the following recommendations are immediately implemented.

Recommendations:

I. Create and fund a State Commission on Local Government Sustainability and Intergovernmental Cooperation.

- **a.** The Commission would be comprised of elected and appointed local governmental officials, as well as state officials from the executive and legislative branch.
- **b.** The Commission would allow parties to discuss potential or existing problems, have a review role for administrative, regulatory, and legislative changes that affect local government, and provide access to reliable information relating to governmental operations.
- **c.** The proposed Commission and the corresponding Center on Intergovernmental Cooperation can serve to coordinate research efforts across the state.
- **d.** Of first priority, the Task Force recommends the examination of the following issues:
  - o A review of boundary adjustment issues
  - o A review of the delivery and funding of public safety among and between levels of government
  - o An analysis of the state of local public infrastructure, such as water and sewer, roads, buildings, parks, etc.
  - o An analysis of how technology can be utilized by local governments to give notice to electors, taxpayers and ratepayers

e. The Task Force also recommends that the Commission carry out the following responsibilities on an annual basis:
- A periodic review of State authorized or mandated fees and charges
- An annual review of State mandated expenditures at the local level and any changes to those expenditures
- Make annual recommendations to the Legislature to repeal/update laws on local government
- The Commission would be responsible for creating a critique/scorecard of how local governments are performing using specific benchmarks
- The Commission should analyze the impact that the Intergovernmental Transfer of Responsibilities Act, as well as local issues (e.g. charter), can impede to local government cooperation and consolidation.
- The Commission should be charged with creating an incentive program to encourage local government cooperation and consolidation

II. Create a Center for Intergovernmental Cooperation.

a. The Center for Intergovernmental Cooperation would serve as staffing/research arm for the Commission. The Center would be created in cooperation with several Universities and other interested organizations.

III. Require a comprehensive, uniform annual financial report to be filed by all local governments with the Michigan Department of Treasury.

a. Municipal finance reporting to Michigan Department of Treasury should be revised to provide uniform, comprehensive data that supports policy research and effective state monitoring.

b. Fund the costs necessary to institute intergovernmental technological advances.

c. Electronic collection of information should be encouraged whenever possible, i.e. an improved Local Unit Fiscal Report (F-65) form.

d. Revise requirements for retention of governmental information, and require appropriate alternative disaster recovery methods.

These recommendations are critical to the future stability of local governments in Michigan. As creatures of state government, cities, villages, counties, and townships are regularly impacted by and dependent upon changing state policies, statutes, regulations and funding. Yet there is no single, official state entity that is charged with the responsibility to analyze the impact of these changes on local service delivery, and place “front and center” the issues and concerns affecting Michigan local units of government.

The effectiveness of the proposed Local Government Commission is only as good as the staff that supports it and the data it relies upon for its analyses. The proposed Center for Intergovernmental Cooperation could provide more than just routine administrative support to the Commission. As a university-based program, it could be a nimble, expert cadre of researchers whose intellectual passion could stimulate ideas as well as sound advice.

Finally, the Task Force believes that the collection and availability of good data on local government finances, services, and programs is in serious need of improvement. In order for the Michigan Department of Treasury and the Legislature to achieve this higher level of information, clearer, more comprehensive reporting requirements including definitions, explanations, and examples must be established and then compiled and easily made available for researchers/policymakers through the use of technology.

ISSUE 2:

LOSS OF LEGISLATIVE HISTORICAL CONTEXT

The loss of institutional memory that comes from Michigan's term limited legislature presents major challenges to the reform of the local government finance system. Newly elected officials would benefit from the historical perspective of colleagues in legislative bodies to recognize and solve problems that arise as a result of past policies. For example, recent treatment of the state revenue sharing program demonstrates the vulnerability of legislation that is left orphaned by the forced retirement of its authors. At the local level, frequent turnover diminishes the ability to establish lines of communication and a full understanding of what is at stake. Term limits are obstacles to careful legislation and effective oversight.

Recommendations:

I. State leaders should give serious reconsideration to repealing or significantly increasing legislative term limits for the Governor, Secretary of State, Attorney General, and members of both the House of Representatives and Senate.

ISSUE 3:

INTERGOVERNMENTAL COOPERATION

Local governmental officials recognize intergovernmental cooperation as one of the tools available to cope with fiscal stress. The Task Force recommends that the state implements the following changes to facilitate cooperation.

One area of cooperation identified as critical by Task Force members was the assessment and equalization of property taxes. There are three steps in Michigan's equalization process. (1) local assessment, (2) county equalization, and (3) state equalization. At each level, staff reviews deeds and land contracts, compiling sales information and preparing sales studies that compare sale price to assessed value. At each level again, staff prepare appraisals, however, at the county and state level, appraisals are performed on small samples of properties. This duplication represents a cost for local government. Moving assessing responsibilities to the county level and equalization to the state level would have the following advantages.

- Better customer service with centralized property and tax data (possibly available via internet)
- Improved valuations with centralized county tax maps
- Reduced the amount of time the state must dedicate to auditing/correction
- Increased professionalism with full-time staff personnel
- If funded by an administrative fee, cities and townships could potentially save money

Recommendations:

I. Transfer assessment of property values to the county level, and all equalization responsibilities to the State.[28]

II. Create incentives to encourage consolidation of other services/units
- **a.** State grants should be established to assist local units of government with the initial costs associated with consolidation of services or units. These grants could offset the cost for feasibility studies.
- **b.** Current state law requiring that employees be held harmless when consolidation occurs should be reevaluated.
- **c.** A simple process for villages to incorporate or dis-incorporate should be established. Villages should be given an opportunity to opt out of automatic incorporation into a new class of city or dissolve into the township.

[28] Minority Report included in Appendix F

ISSUE 4:

LEGACY COSTS

The Task Force heard testimony that demonstrated that the biggest debt owed by local units of government is a debt no voter has approved, i.e., the debt owed for post-employment benefits to retirees when they retire.

The Task Force values the importance of a strong local public safety system in Michigan. This system and those employees protect our homes, places of work and schools, and provide the hometown security everyone feels is critical. Local public safety is a vital public service that encourages economic development efforts for local communities and the state.

The costs of these police and fire services represent a significant part of the budget of many local units, often to the detriment of other service cost centers. Many cities, villages, townships and counties provide benefits for their retirees. Article 9, Section 24 of the Michigan Constitution of 1963 addresses pensions, defining pension benefits as an "accrued financial benefit" and providing that "financial benefits arising on the amount of service rendered in each fiscal year shall be funded during that year…"

Local governments also provide an array of other benefits to their retirees including things like health care, vision, dental and other benefits, collectively referred to as Other Post Employment Benefits (OPEB). The largest component of OPEB is retiree health care. According to the Government Finance Officers Association (GFOA) 1998 publication Prefunding Retiree Health Benefits, 74 percent of state governments and 57 percent of local governments provide health benefits to retirees over age 65. Approximately the same percent provide health benefits to retirees under age 65. In 2002, a study by the Municipal Employees' Retirement System of Michigan showed that 74 percent of the 353 municipal respondents provided retiree health care, with most offering both pre-65 and post-65 coverage.

Most of these arrangements resulted from negotiations with bargaining units at a time when employers could sponsor retiree health care for a few tenths of a percent of active employee payroll. More recently approved labor contracts have built on the labor contracts reached in the older, more established communities. The rapid increase in health care costs has increased the impact of this benefit on local budgets significantly. Most governmental employers have been financing the benefits on a pay-as-you-go basis.

In June 2004, the Government Accounting Standards Board (GASB - the organization that prescribes accounting standards for governmental entities), approved the final set of accounting standards applicable to OPEB, known as GASB 45. The GASB's standards apply differently depending on whether the benefit is provided through a defined benefit plan or a defined contribution plan. For benefits provided through defined benefit plans, the primary requirement is that the long-term cost of the

benefit (e.g. retiree health care) be measured and reported on the accrual basis using actuarial methods and assumptions applied in essentially the same way that they are applied to pension plans. Translated – this means that units of local government will have to fund these future costs on a present basis or their finances will show a deficit.

The offer of wages and benefits to public safety employees arises out of arbitration awards granted as a part of the process for binding arbitration outlined in P.A. 312 of 1969. These awards place upward pressure on the wages and benefits provided to general government employees as well.

The Fiscal Impact of Binding Arbitration: A Review of the Research

Wage Effect

Based on a review of the relevant labor economics literature, there is strong and consistent evidence that public sector union presence, particularly the existence of compulsory binding arbitration statutes (typically for public safety employees), leads to higher average wage levels for public safety employees (Ashenfelter and Hysolp, 2001; Freeman, 1986, Valetta, 1989).[29] These higher public safety wage levels have been shown to have the spillover effect of raising other public sector employee wages, albeit to a lesser extent. These wage effects have been found to be particularly strong in Midwestern states. Even stronger however, the evidence indicates that binding arbitration leads to an even greater impact on fringe benefit costs for municipalities. The overall effect is a significantly higher overall compensation package for binding arbitration states.

Employment Effect

There is also evidence of an employment effect due to unions (Ashenfelter and Hysolp, 2001; Freeman, 1986, Valetta, 1989).[30] The presence of binding arbitration leads to higher average employment levels for public safety employees. However, these higher employments are offset by lower employment levels for other non-public safety employees. The net effect is slightly higher public sector employment due to binding arbitration.

Overall Effect

The overall impact of these wage and employment effects due to binding arbitration is to raise municipal expenditures in binding arbitration states by 3 to 5 percent relative to other states. While small in percentage terms, this impact is large in dollar terms.

[29] Ashenfelter, Orley and Dean Hyslop, "Measuring the Effect of Binding Arbitration on Wage Levels: The Case of Police Officers", Industrial and Labor Relations Review Vol. 54, no. 2 (2001). Freeman, R.B. "Unionism comes to the Public Sector", Journal of Economic Literature XXIV (1986). Valetta, R.G. "The Impact of Unionism on Municipal Expenditures and Revenues, Industrial and Labor relations Review, vol. 42 (3) (1989).

[30] See above footnote for citations

The mandatory arbitration process acts as a safety valve for situations in which bargaining has reached an impasse and public safety employees would otherwise use strikes as a tool to overcome the impasse. Because of the importance of public safety as a service, the Task Force recognized that both local and State leaders must pay closer attention to the future affordability of present-day promises provided either through bargaining or mandatory arbitration while not disrupting the delivery of public service.

Recommendations:

I. Require all participants in the bargaining process, including arbitrators, to obtain actuarial statements of the future costs of retiree benefits that demonstrate the annual contributions required beginning in the first year of implementation to avoid a deficit in the fund.

II. The total economic cost of an arbitrator's award cannot exceed the total percentage of increase of the local units' General Fund Revenue, (excluding reappropriation of fund equity) or the Consumer Price Index, (C.P.I.), whichever is less.

III. Changes in working conditions relating to intergovernmental cooperation and agreements must be exempt from binding arbitration.

IV. Require all local units of government to develop a written plan that addresses how they plan to manage the post-employment benefit liability. These plans should include all of the following:

- **a.** Documentation showing that contributed funds will be adequate to meet the level of benefits provided
- **b.** An amortization of the unfunded actuarial liabilities and a description of actions to accomplish that amortization
- **c.** A description and explanation of any and all actuarial assumptions
- **d.** A schedule illustrating the amortization of any unfunded liabilities
- **e.** A comparative review illustrating the level of funds available to the plan from own-source revenues, including a statement of the assumptions used to predict those revenues
- **f.** A statement by an actuary that the plan is complete and accurate

V. As a short term opportunity for local units that have a large unfunded liability, legislation should permit local units to issue retiree health care bonds as a part of the overall strategy in managing the liability. (Draft legislation is included in Appendix D)

VI. Failure to adopt the plan and build sufficient funding for these legacy costs should result in some kind of regulatory control over the operations of the municipality.

ISSUE 5:

REVENUE SHARING FUNDING

Michigan has one of the most extensive programs of State level tax collection and redistribution in the nation. State revenue sharing has grown in significance over the years and is relied upon by local governments across Michigan for the provision of many of their vital services. Though counties are currently not participating in the state revenue sharing program, they have historically been included and expect to return to the program in the future.

Upon the enactment of each piece of state revenue sharing legislation, local governments were assured that state payments would continue into the future to make up for the lost local revenues that were voluntarily given up as part of the bargain. Essentially, local government revenue generating capacity was diminished with the promise of compensation from the state. However, the legislature has not fully funded the unrestricted state revenue sharing program since the new formula was established in 1998. When the decline in economic activity reduced State revenues in 2000, the state revenue sharing program was the hardest hit by cutbacks in state funding. Statutory revenue sharing reductions accounted for 36 percent of the State's $4.2 Billion GF/GP spending cuts. Thus, a total of over $1.5 billion in statutory revenue sharing was foregone when compared to the full amount outlined in the Michigan Constitution and state statute.

The current fiscal year budget appropriations for statutory state revenue sharing are approximately half of what local governments would receive if the program was funded at the full 21.3 percent of Sales Tax revenues designated in state law. The total appropriation for state revenue sharing is 28 percent less than what was distributed in FY2001, the last year in which the program approached full funding.

The current sales tax system is no longer appropriate for Michigan's information and service based economy. Even with an economic recovery, the sales tax would not keep pace with the increase in costs of government services. Overall in the 1990's, service sector jobs increased by nearly 400,000 across the state. Despite the faltering state economy since 2001, health care jobs have increased by over 12,000.

According to the Federation of Tax Administrators, Michigan currently only taxes 26 of 168 possible service categories.[31] Most states tax more service areas than Michigan. According to the Michigan Department of Treasury, if all services were taxed, the estimated revenue increase would be $7.3 billion.[32] Even taxing a portion of services

[31] Federation of tax Administrators, "Sales Taxation of Services: Updated 2004", Report released May 2005, www.taxadmin.org.
[32] MI Department of Treasury, "Michigan's Sales and Use Taxes 2004" Report released June 2005.

would help reduce the State's budget gap and reduce pressure to cut revenue sharing funding. Recently, Legislative and other initiatives have been undertaken in pursuit of abolishing or substantially changing Michigan's Single Business Tax (SBT) because it is perceived to be detrimental to business development in our state. A consensus has not been achieved, however, as to a business tax to replace the SBT. It is estimated that the SBT will generate $1.9 billion in revenue for the state's General Fund in FY 07. If the SBT is eliminated without an alternative business tax to replace the revenue loss, the consequences would be devastating to any state programs earmarked for local governments, particularly statutory revenue sharing.

Recommendations:

I. Fully-fund and restore the current formula before the sunset in 2007. Extend it into perpetuity.

II. Offer a constitutional amendment to the people to guarantee funding for the statutory component of the state revenue sharing program. As determined in 1998, 21.3% of the first 4% of state sales tax must be distributed to all general-purpose local units of government (cities, counties, townships, and villages). The formula for cities, villages and townships statutory revenue sharing should continue to consider factors other than population, as revenue sharing distributions based on population alone does not correlate to community service demands nor does it reflect municipal or state goals.

III. State owned properties, such as prisons, office buildings, parks, and police posts, are exempt from local property taxes. However, these facilities still require the services of local governments such as fire protection. For the nine year period ending with the 05 Fiscal Year, payments averaged only 36% of full funding under the statutory formula. For the 06 Fiscal Year, the funding now represents 67% of full funding. The State should commit to fully funding its commitment for fire protection grants as described in Public Act 289 of 1977. These funds pay for local fire protection of state buildings, such as universities, prisons, and state agencies. The funding necessary to fulfill this obligation has fluctuated recently between $15 - $16 million. However, grants awarded to communities which protect state facilities have been funded at a rate of 25% - 50% for what the formula provides.

IV. In order to assure adequate funding the state should broaden the base of the sales tax to include services, and should consider adjustments to other taxes to achieve more equitable and stable funding for local government.

V. To avoid further reductions in statutory revenue sharing, the Single Business Tax should not eliminated or reduced unless a replacement Michigan business tax has been adopted that would generate an equal amount of State General Fund revenue.[33]

[33] Minority Report included in Appendix F

ISSUE 6:

LOCAL TAXING OPTIONS

The current property tax system is fraught with inherent disparities. These same disparities were part of the impetus behind Proposal A in the early 1990's. Simply adding new property tax options will not address the underlying property taxable base differences among communities (See Table 2). A broader system of local tax options is necessary. These new local option taxes would remain subject to local voter approval.

Table 2: Tax Base Disparities

CITY TV PER CAPITA	*Top Ten*		*Bottom Ten*
Grosse Pointe Farms, Wayne	78,295	Benton Harbor, Berrien	5,790
Saugatuck, Allegan	87,196	St. Louis, Gratiot	7,960
Birmingham, Oakland	89,254	Olivet, Eaton	7,972
Carson City, Montcalm	92,852	Highland Park, Wayne	8,327
Auburn Hills, Oakland	97,366	Gaastra, Iron	8,452
Harbor Springs, Emmet	111,501	Hamtramck, Wayne	8,983
Orchard Lake Village, Oakland	145,977	Wakefield, Gogebic	9,022
Lake Angelus, Oakland	185,204	Ionia, Ionia	9,164
Bloomfield Hills, Oakland	202,426	Detroit, Wayne	9,383
Mackinac Island, Mackinac	325,557	Whittemore, Iosco	9,491
Total City -Mean	**26,634**		
Total City -Median	**23,737**		
TWP. TV PER CAPITA	***Top Ten***		***Bottom Ten***
Lake, Macomb	166,619	Kinross, Chippewa	4,427
Blue Lake, Kalkaska	170,482	Grant, Oceana	7,056
West Traverse, Emmet	172,237	Bloomer, Montcalm	8,135
Peaine, Charlevoix	173,166	Calumet, Houghton	9,334
Lake, Berrien	194,800	Royal Oak, Oakland	9,693
Grant, Keweenaw	204,298	Lee, Allegan	10,542
Lake, Benzie	209,978	Adams, Houghton	10,619
Bois Blanc, Mackinac	315,176	Osceola, Houghton	11,391
Glen Arbor, Leelanau	316,588	W. Branch, Marquette	11,587
Pointe Aux Barques, Huron	1,001,393	Pentland, Luce	11,696
Total Twp.-Mean	**33,651**		
Total Twp. -Median	**27,171**		
STATE TV PER CAPITA			
Mean	**30,130**		
Median	**26,725**		

Source: 2004 Ad Valorem Property Tax Levy Report, State Tax Commission, Michigan Department of Treasury. 2004 Population Estimates, U.S. Census Bureau

Currently, the income tax is an option for Michigan cities, but is expressly prohibited as an option for villages (Act 284 of 1964). Per the Michigan Constitution, cities may levy a uniform income tax rate whose rate can only vary based on residence or nonresidence/commuter status in the city. Cities with less than 750,000 residents

may levy a tax of up to 1 percent on residents and corporations, but no more than 50% of the resident rate on nonresidents.

There are significant challenges to the implementation of a local sales tax option in Michigan.[34] The first is the general limitation on sales taxation in the constitution (Section 8 of article 9). It is unclear whether this provision applies only to state sales taxation or to all sales taxation at all levels of government. If it applies to all levels of government, the state of Michigan would have to lower its sales tax rate of 6 percent in order for local governments to have access to the sales tax option. Further section 10 and 11 require that "all taxes imposed on retailers" be allocated to local governments and local school districts. Another question is whether locally raised sales tax would have reallocated in the same manner that the state sales tax is currently redistributed.

The state legislature in 1964 passed a law (P.A. 243 of 1964) that disallowed local governments from levying new non-property taxes. Any new taxes, outside of the city income and city utility tax, such as county income tax or local sales tax, would have to have enabling legislation. It is unclear of the constitutionality of this act in regards to the constitutional provision that charter local jurisdictions have the power to levy non-property taxes. According to Public Act 243 of 1964, local governments do not have the authority to levy a local sales tax.

Recommendations:

I. Allow local government units to levy new local option taxes on a regional basis.

ISSUE 7:

EMERGENCY 911 FUNDING

As the frontline for Homeland Security, local public safety officials must have reliable communication capabilities. The majority of revenue dedicated to fund emergency 911 communications comes from a surcharge on traditional hard-wire lines. This base is in decline due to changes in technology that have replaced these lines with wireless and voice-over-internet services.

Recommendations:

I. Updating the surcharge to capture new and existing technologies.

[34] "Issues Relative to the Constitutionality of Local Sales Taxation in Michigan", Citizens Research Council Report No. 305, June 1992.

ISSUE 8:

PAYMENTS IN LIEU OF TAXES (PILT)

State owned lands, for example state forests and parks, are exempt from local property taxes. The state initiated payments in lieu of taxes to compensate local governments for services rendered to these properties. Current payments in lieu of taxes are insufficient to pay for these expenditures.

Recommendations:

I. Restore payments in lieu of taxes to a level sufficient to pay for the services provided by local government.

II. Local governments should work with the State to create a consolidated billing process.

ISSUE 9:

FUNDING FOR ONE COURT OF JUSTICE

The Michigan court system vests the judicial power of the state in "one court of justice" as stated in the Michigan Constitution. While the management of these court operations is directed by the Michigan Supreme Court, the funding of the circuit, probate and district courts remains with local governments. The Michigan Supreme Court itself has addressed the legislature on this very issue and proposed that the state take over the funding of all of Michigan's courts, an action the Task Force believes would lead to an improved system of justice.

Court operations represent a significant cost center for counties and some cities in Michigan. Local units of government have no control over the management of courts, despite the responsibility to fund them. While the state provides partial funding of trial courts, a large burden for funding remains on the counties and cities. Even with the state funding that has grown substantially over the past 25 years, significant locally-raised revenues are needed to fund trial court operations. A brief summary of court system funding in Michigan is provided in Appendix E.

A recent survey completed in December 2004 by Michigan State University for the Michigan Association of County Administrative Officers, examined the costs and revenues associated with performing mandated activities within county government. In total, 27 counties responded to the Survey, and the results found that expenditures associated with performing mandated trial court (circuit and district) activities totaled $183,479,355, of which only $95,502,456 or 52.05 percent was offset with associated revenues. Associated revenues were able to offset only 30.68 percent of the mandated expenditures arising from probate court activities. These unfunded mandates have severely impacted the ability of local governments to pay for and provide other essential

services that would more directly benefit economic development efforts and maintain a strong qualify of life.

Four states were chosen by the National Center for State Courts to serve as case-study sites for the purpose of assessing the effects of transition to state financing. The states were Iowa, Massachusetts, Oregon, and California.[35]

The study explored numerous issues in assessing the effects of state financing of courts. These included fiscal effects, procedural effects, inter-organizational effects, and service effects.

Fiscal Effects

Overall Funding Levels

In sum, for this limited sample of states the adoption of state financing increases slightly the overall level of funding for trial courts. More substantial effects happen in specific areas: expenditures for computers being one, and expenditures for indigent defense being another (although to a lesser degree).

Funding Stability

The general impression gained from the hard budget data (looking at continued year-to-year growth), and from the National Center for State Courts-summarized interview results, is that level of funding (controlling for inflation and for changes in the state-funded program packages) remains fairly stable under state financing.

Effect on Funding Inequities

Another often repeated assumption about state financing is that it will decrease trial-court funding inequities across localities. There is support for this notion in the four-state survey.

Procedural Effects

Fiscal Effects

A near universal effect of state financing is the introduction of standardized budget and accounting procedures. In Iowa, this has meant centralized control of financial management and accounting and auditing procedures, standardization of fees, and bulk purchasing. In Massachusetts, such changes are characterized as “increasing the overall level of accountability for the use of public funds”. In Oregon, improvements to internal controls and accounting procedures were cited as areas of significant improvement.

Efficiency

A prime issue is whether state financing and its attendant procedural controls improves the efficiency of resource utilization. Respondents believed that these changes will occur in the longer run.

[35] National Center for State Courts, The Effects of State Financing: Summary Findings from the Four-State Study, John K. Hudzik, PhD, October, 1990.

Personnel-System Effects

In sum, standardization is the most frequently mentioned effect (and presumed benefit) of state financing on the trial court personnel-management system. This effect is beneficial if one assumes that the introduction of standardized job descriptions and pay scales help to redress locally-spawned inequities and irregularities associated with "political" or personal appointment systems.

Inter-organizational Effects

Survey results indicate a shift of power with regard to trial court inter-organizational relationships as a result of the adoption of state financing. Powers of the state-level judicial branch and state legislative control were seen to increase substantially with regard to trial courts. There was not much change seen in the control exercised by the executive branch. County control over trial courts was seen as decreasing greatly.

For these reasons, we propose the following recommendations that will improve the system of justice in Michigan by alleviating the inequities involved with court funding.

Recommendations:

I. The state must fulfill the legislative intent expressed since 1980 to fund operations of trial courts – circuit, probate, and district courts. This will standardize court operations across the state and make all court staffs employees of the state. Local governments would forfeit any abilities to provide input on working conditions, holidays, work hours, or other conditions that currently can be made consistent with county or municipal conditions.

NOTE: While full funding is recommended, as an interim step a defined level of contribution from local governments to the court system could be established. This contribution would be frozen at the 2005 level of funding. Local governments would have the flexibility to fund over the defined level, but would not be compelled to do so.

ISSUE 10:

CHILD CARE FUND

The Child Care Fund is a joint funding effort between the state and county governments to support programs serving delinquent, abused, and neglected children in Michigan. The CCF cost is shared on a 50/50 basis between the local county and the state. If a child is eligible for federal Title IV-E, due to economic and other conditions, then the federal Title IV-E dollars replace the county side of the Child Care Fund. For fiscal year 2004, the Child Care Fund served an average of 8,170 children per month, provided a total of 1,185,122 days of care, at a total cost of more than $350 million. The following suggestions would provide incentives to both the counties and the state to invest in the best, proven programs for children while containing costs. The Child Care Fund statutes must be reworked to encourage improved care and more efficient service delivery.

Recommendations:

I. Allow counties to receive an increased match rate from the state for community-based placements that demonstrate desired outcomes.

II. Allow a county to keep at least half of any federal money brought down by the county's own direct action.

III. Require the state to pursue Title IV-E funding for youths in secure facilities who are there for their own protection.

IV. Allow counties to use federal funds for Child Care Fund expenditures.

V. Allow counties to negotiate contracts with residential care facilities for lower daily rates.

ISSUE 11:

FRIEND OF THE COURT CHILD SUPPORT ENFORCEMENT FUNDING

Michigan's local Friend of the Court system provides enforcement on behalf of the state for child support payments. The federal government recently changed its policy and no longer allows states and counties to match federal dollars with federal dollars for child support enforcement. To maintain funding for Friend of the Court systems, Michigan and its counties must dedicate $28 million to match the current federal government contribution that is no longer eligible for matching funds. If the $28 million is not found, the state and counties would lose the federal match at a rate of 33/67, resulting in a loss of almost $60 million. The policy change takes affect October 1, 2007. Counties and the state must work together to solve the problem of finding the $28 million to use for matching funds. Additionally, the funding formula agreed to by counties and the state over many years was reaffirmed under SB 242 of 2005, and should remain in place while they work together to mitigate the damage done under the federal policy change.

Recommendations:

I. The federal government no longer allows states and counties to utilize federal dollars for match dollars for child support enforcement. The state must share this increased burden with counties.

II. The state must continue to fund the formula found in SB 242, the supplemental bill for FY2006.

ISSUE 12:

INABILITY TO SET MANY USER FEES AND CHARGES

Many fees charged by local units of government for services rendered are set by State statute. In these cases local units of government in Michigan are not given the flexibility to set fees and charges at levels that are appropriate for that particular unit. Although the ruling in *Bolt vs. the City of Lansing* limits these prices to the costs of service provision, state statutes that establish the amount to be charged limit the ability of individual counties to tailor prices to their own needs.

For example, counties must deal with antiquated fee structures, for services such as marriage licenses.

Recommendations:

I. State statute must not artificially cap fees and charges at levels below the cost of providing services.

II. The State should establish a procedure that would allow local governments the flexibility to override these limitations when they do not accurately reflect the cost to a particular unit.

ISSUE 13:

LOCAL CONTROL OVER TAX INCREMENT PLANS

Tax Increment financing is a useful tool of local government. It uses tax revenues from new development in a specific area, regardless of which unit is levying the tax, to pay for the public improvements designed to bring in the new development. Historically the decision to use the tool was made by one local unit, while that unit and all other local taxing units provided the revenue. While the new use of this tool now requires consent from all taxing units, some units of government may still amend and extend certain existing tax increment financing plans for unlimited periods of time, without regard to what the impact is on those other taxing units.

Recommendations:

I. Establish the duration date of existing tax increment financing plans to the date presently established in the plan, unless a local taxing unit consents to an extension.

NOTE: The Task Force was divided on this issue and a minority report is included as Appendix F.

ISSUE 14:

LEGISLATIVE AND CONSTITUTIONAL INTERPRETATION

Under Proposal A and the subsequent implementing legislation, the uncapped value of property upon its transfer is treated as growth in the existing value of the property. In combination with the Headlee Amendment, the effect has been to artificially reduce property tax revenues since 1994. This interaction disproportionately affects aging communities who can no longer support new growth, and rely on the increase in property value from the uncapping.

Although initial implementing legislation for the Headlee Amendment permitted rolled back millages to be adjusted upward when property tax value increased by less than the rate of inflation, the Legislature eliminated any millage rate recovery for this situation following the passage of Proposal A.

A 2002 Michigan Supreme Court decision (WPW Acquisition v. City of Troy) barred complete implementation of 1994 Proposal A legislation regarding property taxation on commercial rental property. That legislation provided that in calculating the cap for determining the taxable value of commercial rental property, both increases and decreases in occupancy would be treated differently from market value changes affecting other types of property. The Michigan Supreme court ruled that an increase in value due to an increase in a commercial rental property's occupancy could not be used to increase the property's taxable value beyond the constitutional assessment cap established by Proposal A. As a result of this court decision, commercial rental property taxes are based on occupancy decreases and are not adjusted upward if the property's occupancy rate increases.

Recommendations:

I. When property is transferred, treat the increases from the previously untaxed value, as exempt property.

II. Allow local units of government to roll up their millage rates in years when property tax values on existing property increase by less than the rate of inflation.

III. Remove certain commercial rental property from the General Property Tax Act and creating a new specific tax for that property.

ISSUE 15:

STRENGTHEN EMERGENCY FINANCE ACT (Public Act 72 of 1990)

Public Act 72 of 1990, designed to enable the state to intervene when a municipality is in an emergency financial condition, has demonstrated weaknesses. As this report has illustrated, local government fiscal stress is not always the result of mismanagement, but P.A. 72 is inadequate in either instance. Powers issued to emergency financial managers fail to address the issues raised in this report for both well and poorly-managed communities.

The state's interest in local government fiscal health arises in the most direct sense from its responsibility to protect the bond ratings of all Michigan communities. A fiscal crisis and default in one community can impact the credit ratings of other localities in the same state. Further, fiscal crisis can negatively impact local economic development efforts and public service levels, thus decreasing the quality of life for citizens. As stated in P.A. 72 of 1990, "the survival of units of local government is vitally necessary to the interests of the people of this state to provide necessary governmental services." Under conditions of fiscal stress, a community may choose to decrease service levels such as police and fire or possibly eliminate services entirely. The interdependent nature of communities makes it likely that the negative effects produced by these distressed areas will spillover into surrounding communities and the state as a whole.

In the healthcare sector, it is widely agreed upon that emergency treatment is the least efficient method of treatment and is the most expensive. Prevention is far less costly and a better way of dealing with a problem. States can choose to take actions to identify local government fiscal stress before it becomes an emergency. Dr. Beth Walter Honadle and others[36] identified four potential roles for State government before, during, or after a fiscal emergency:

1. Prevent the emergency from occurring
2. Avert an impending emergency
3. Mitigate and already existing problem
4. Prevent re-occurrence

Michigan's fiscal health legislation can be classified as a policy focused primarily on mitigation. Public Act 72 outlines the factors that trigger a preliminary review by the state treasurer, provides criteria to be used when declaring financial emergencies, and

[36] Honadle, Beth Walter, James M. Costsa and Beverly Cigler. Fiscal Health for Local Governments. Elsevier Academic Press 2004.

delegates power to various officials to control the problem. The triggers include the following:

- A request by the governing body
- A claim made by a creditor against a unit of government in excess of $10,000, or 10% of the general fund budget
- Unfulfilled pension obligations to 10% or more of the beneficiaries
- Non payment of government employees for 7 days past scheduled date
- Default bond payment or violation of bond covenants
- Delinquent distribution of tax revenues

These factors help state government to identify an existing problem and grant the authority to fix them. They do not however, attempt to identify fiscal stress before it reaches the point of emergency. Responses from a survey completed in early 2003, found that 15 of the 48 responding states indicated that a system was in place to examine the fiscal health of local governments (Kloha, Weissert, and Kleine, 2005[37]). The research separated the measures found within each system into indicators that could be used to *predict* fiscal distress, *define* the existence of fiscal distress, or to *disseminate public information* regarding local fiscal condition. As shown above, Michigan's system is mainly focused on ex post declarations of fiscal stress, triggered by the unit's inability to make timely payments and the existence of unfunded obligations. This limits the State's ability to prevent and avert impending financial difficulties.

Other states organize their systems around prevention by using early warning indicators. Ohio has 5 indicators used to warn local governments of impending fiscal stress, Florida has 14, while Illinois, Connecticut, and Pennsylvania (in development stages) also use measures suitable to prediction.

Early warning systems often employ the use of operating position variables, such as fund balance, liquidity, and operating deficits to predict fiscal stress. Years of consecutive operating deficits, accompanied by diminishing fund balances may indicate a financial imbalance between revenue and expenditures. Operating position indicators provide a clear oversight of conditions within a unit, and are less ambiguous than other measures of fiscal health such as per capita revenue and expenditures. Four states also examine community need and resources availability to predict impending fiscal distress. These include monitoring real estate market values and income per capita, population changes, and the loss of a major employer or taxpayer.

Recommendations:

I. The Legislature should re-visit the concept of state takeover of local units of government.

[37] Kloha, Phillip, Carol Weissert and Robert Kleine. "Developing and Testing a Composite Model to Predict Local Fiscal Distress", Public Administration Review vol. 65 May 2005.

II. The State should evaluate the benchmarks that determine the local units that are experiencing, or could be experiencing, fiscal stress. These benchmarks should then be tied to proposed solutions.

III. The State should appropriate funds to fulfill the responsibility to monitor the financial status of local governments.

Appendix A: Executive Order

EXECUTIVE ORDER No.2005 – 9
TASK FORCE ON LOCAL GOVERNMENT SERVICES AND FISCAL STABILITY

WHEREAS, Section 1 of Article V of the Michigan Constitution of 1963 vests the executive power of the State of Michigan in the Governor;

WHEREAS, Section 4 of Article V of the Michigan Constitution of 1963 authorizes the establishment of temporary commissions or agencies for special purposes;

WHEREAS, Section 17 of Article V of the Michigan Constitution of 1963 empowers the Governor to present to the Legislature information as to the affairs of the state and recommend measures that the Governor considers necessary or desirable;

WHEREAS, under Section 1 of Article VII of the Michigan Constitution of 1963 each county in Michigan is a body corporate with powers and immunities provided by law;

WHEREAS, under Section 17 of Article VII of the Michigan Constitution of 1963 each township in Michigan is a body corporate with powers and immunities provided by law;

WHEREAS, under Section 21 of Article VII of the Michigan Constitution of 1963, the Legislature must provide by general laws for the incorporation of cities and villages;

WHEREAS, the health of local government is a critical issue for the State of Michigan as local governments deliver vital services for Michigan residents;

WHEREAS, because of the interdependent relationship between the State of Michigan and its local governments, healthy local governments are a key element in Michigan's prosperity;

WHEREAS, many residents of this state, businesses seeking to locate or expand in Michigan, and entities lending money to this state perceive the financial heath of Michigan's local governments as a measure of the financial health of the State of Michigan;

WHEREAS, local governments in Michigan face increasing demand for public services from citizens while at the same time the cost of providing the services is increasing and revenues to provide new and existing services are constrained;

WHEREAS, state laws, regulations, and programs sometimes hinder the cost-effective delivery of public services by local governments;

WHEREAS, state policies and competition for diminished resources can serve as a barrier to greater cooperation among local governments, favoring inefficient independence over efficient interdependence;

WHEREAS, the relationship between the state and its local governments and the system of financing local government should be reexamined to identify policies that encourage fiscal stability, cooperation, service efficiency, and regional economic growth;

WHEREAS, it is important that local governments have a forum to discuss and attempt to address services provided by local governments and local government finances;

WHEREAS, it is appropriate for local governments in Michigan to seek innovative and flexible options that will allow local governments to better meet the needs of their citizens and that allow the state and local governments to more effectively work together;

NOW, THEREFORE, I, Jennifer M. Granholm, Governor of the State of Michigan, by virtue of the power and authority vested in the Governor by the Michigan Constitution of 1963 and Michigan law, order the following:

I. DEFINITIONS

As used in this Order:

A. “Department” means the Department of Treasury, a principal department of state government created under Section 75 of the Executive Organization Act of 1965, 1965 PA 380, MCL 16.175.

B. “Task Force” means the Task Force on Local Government Services and Fiscal Stability created under this Order.

II. CREATION OF THE TASK FORCE ON LOCAL GOVERNMENT SERVICES AND FISCAL STABILITY

A. The Task Force on Local Government Services and Fiscal Stability is created as an advisory body within the Department as a forum for the discussion of issues relating to local government services and fiscal stability by representatives of local governments in Michigan.

B. The Task Force shall consist of 15 members appointed by the Governor, including each of the following:

1. 4 members representing cities or villages.

2. 4 members representing counties.

3. 4 members representing townships.

4. 3 members representing special purpose local districts or authorities serving more than 1 local unit of government or other intergovernmental entities created by more than 1 local unit of government other than a school district or intermediate school district.

C. In addition to the members appointed under Section II.B, the State Treasurer and the State Budget Director, or their designees, shall serve as ex officio, non-voting members of the Task Force.

D. Members of the Task Force appointed by the Governor under Section II.B shall serve at the pleasure of the Governor.

E. A vacancy on the Task Force shall be filled in the same manner as the original appointment.

III. CHARGE TO THE TASK FORCE

A. The Task Force shall act in an advisory capacity and shall do all of the following:

1. Examine existing sources of revenue for local governments in Michigan.

2. Review services provided by local governments in Michigan, including mandated and non-mandated services, and how those services are funded.

3. Identify state laws, policies, regulations, and funding formulas that contribute to any of the following:

a. Imposition of, or contribution to, fiscal constraints on local governments.

b. Inhibiting the ability of local governments to attract economic development and encourage vibrant communities.

c. Hindering the ability of local governments to deliver services effectively.

d. Restraining the ability to maintain an acceptable quality of life for citizens served by local governments.

4. Identify policies or practices that negatively impact cooperation among local governments for efficient delivery of services and recommend incentives for local governments to work cooperatively.

5. Discuss potential changes in policy that would allow local governments to better provide essential services, improve efficiency, support cooperation among local governments, contribute to a more effective relationship between state and local government in Michigan, and spur economic growth.

B. The Task Force shall provide other information, recommendations, or advice as requested by the Governor or the State Treasurer.

C. The Task Force shall complete its work and issue a final report and recommendations, including any proposed changes in law, to the Governor by November 30, 2005.

IV. OPERATIONS OF THE TASK FORCE

A. The Task Force shall be staffed and assisted by personnel from the Department as directed by the Governor, subject to available resources and funding. Any budgeting, procurement, and related management functions of the Task Force shall be performed under the direction and supervision of the State Treasurer.

B. The Task Force shall adopt procedures consistent with Michigan law and this Order governing its organization and operations.

C. The State Treasurer or his or her designated representative shall serve as the Chairperson of the Task Force.

D. The Department shall assist the Task Force with recordkeeping responsibilities.

E. A majority of the members of the Task Force serving constitutes a quorum for the transaction of the Task Force's business. The Task Force shall act by a majority vote of its serving members.

F. The Task Force shall meet at the call of the Chairperson.

G. The Task Force shall establish subcommittees to study specific issues and report recommendations to the Task Force. The Chairperson may designate members of the Task Force as Subcommittee Leaders. The Task Force and its subcommittees may request public participation on workgroups as the Task Force deems necessary. The Task Force may also adopt, reject, or modify any recommendations proposed by a subcommittee or a workgroup.

H. The Task Force may, as appropriate, make inquiries, studies, investigations, hold hearings, and receive comments from the public. The Task Force may also consult with outside experts in order to perform its duties, including, but not limited to, experts in the private sector, organized labor, government agencies, and at institutions of higher education.

I. Members of the Task Force shall serve without compensation. Members of the Task Force may receive reimbursement for necessary travel and expenses according to relevant statutes and the rules and procedures of the Department of Management and Budget and the Civil Service Commission, subject to available funding.

J. The Task Force may hire or retain contractors, sub-contractors, advisors, consultants, and agents, and may make and enter into contracts necessary or incidental to the exercise of the powers of the Task Force and the performance of its duties as the State Treasurer deems advisable and necessary, in accordance with this Order, and the relevant statutes, rules, and procedures of the Department of Management and Budget and the Civil Service Commission.

K. The Task Force may accept donations of labor, services, or other things of value from any public or private agency or person.

L. Members of the Task Force shall refer all legal, legislative, and media contacts to the Department.

V. MISCELLANEOUS

A. All departments, committees, commissioners, or officers of this state or of any political subdivision of this state shall give to the Task Force, or to any member or representative of the Task Force, any necessary assistance required by the Task Force, or any member or representative of the Task Force, in the performance of the duties of the Task Force so far as is compatible with its, his, or her duties. Free access shall also be given to any books, records, or documents in its, his, or her custody, relating to matters within the scope of inquiry, study, or investigation of the Task Force.

B. Any suit, action, or other proceeding lawfully commenced by, against, or before any entity affected by this Order shall not abate by reason of the taking effect of this Order.

C. The invalidity of any portion of this Order shall not affect the validity of the remainder of the Order.

This Order is effective upon filing.

Given under my hand and the Great Seal of the State of Michigan this 18th day of April in the year of our Lord, two thousand and five.

_____

JENNIFER M. GRANHOLM
GOVERNOR

Appendix B: Task Force Documents

Task Force on
Local Government Services and
Fiscal Stability

PROTOCOL FOR OPERATIONS

September 19, 2005

Task Force Meetings

- Meetings will begin on time.
- No alternates may sit in the place of a voting task force member (nonvoting members may send alternates when they are unable to attend).
- Members are requested to raise their hand and may speak when acknowledged by the chair.
- MSU will prepare meeting summaries.
- Task Force members' comments will not be attributed in the summaries.
- The commission shall work toward consensus decisions, but if necessary, decisions shall be by majority vote.
- Minority reports will not be contained in the final report of the task force.
- Task force meetings will be open to the public.

PUBLIC COMMENT

- Public comment will be taken during each task force meeting and at public hearings.
- Persons desiring to make public comment will be restricted in the time allowed for such comment based upon the number of person desiring to comment.
- Each person desiring to offer public comment will be requested to fill out a public comment card and provide it to staff prior to the start of the public comment period.
- Public comment will also be taken in writing:
    - Facsimile: (517) 432-7644
    - Mail: Michigan State University Extension
      State & Local Government Programs
      66 Agriculture Hall
      East Lansing, MI 48824
- All comments received by the task force will be reviewed and considered, but **will not** receive a personal reply.

Task Force on
Local Government Services and
Fiscal Stability

ROLES AND RESPONSIBILITIES

September 19, 2005

Roles and Responsibilities of the Task Force

- Attend all Task Force meetings and meetings of assigned work group
- Attend one or more of the public hearings set by the Task Force to be held throughout the state
- Share individual and organizational perspectives on issues while seeking consensus solutions across stakeholder groups
- Select and examine key issues that, if addressed, will lead to an improved local public finance system
- Receive public comment
- Identify best practices with respect to identified key issues that may be applicable in Michigan
- Develop recommendations that will lead to achievable and measurable change

Roles and Responsibilities of the Task Force Chair

- Facilitate all meetings of the full Task Force
- Participate in all meetings of the project management team
- Assist the Task Force in selecting key issues on which to focus its work
- Establish work groups as necessary to facilitate the work of the Task Force
- Facilitate consensus among members on recommendations to be included in the final report
- Serve as spokesperson for the Task Force and manage external communications for the Task Force
- Facilitate internal and manage external communications for the Task Force

Roles and Responsibilities of the Project Management Team

- Present framework for the Task Force's work and background materials/research
- Manage the work plan of the Task Force
- Convene as necessary for between-meeting planning
- Develop agendas for Task Force meetings and prepare meeting summaries
- Decide on the need for external consultants within budget constraints
- Prepare materials for the Task Force's deliberations
- Coordinate external communication with the Task Force chair
- Develop and manage the engagement of the public and other key stakeholders
- Propose charges for and support work groups
- Provide facilitation support as necessary
- Develop and maintain the work plan of the Task Force
- Review, edit, and format all materials for presentation to the Task Force
- Mail/e-mail all correspondence and meeting materials to Task Force members

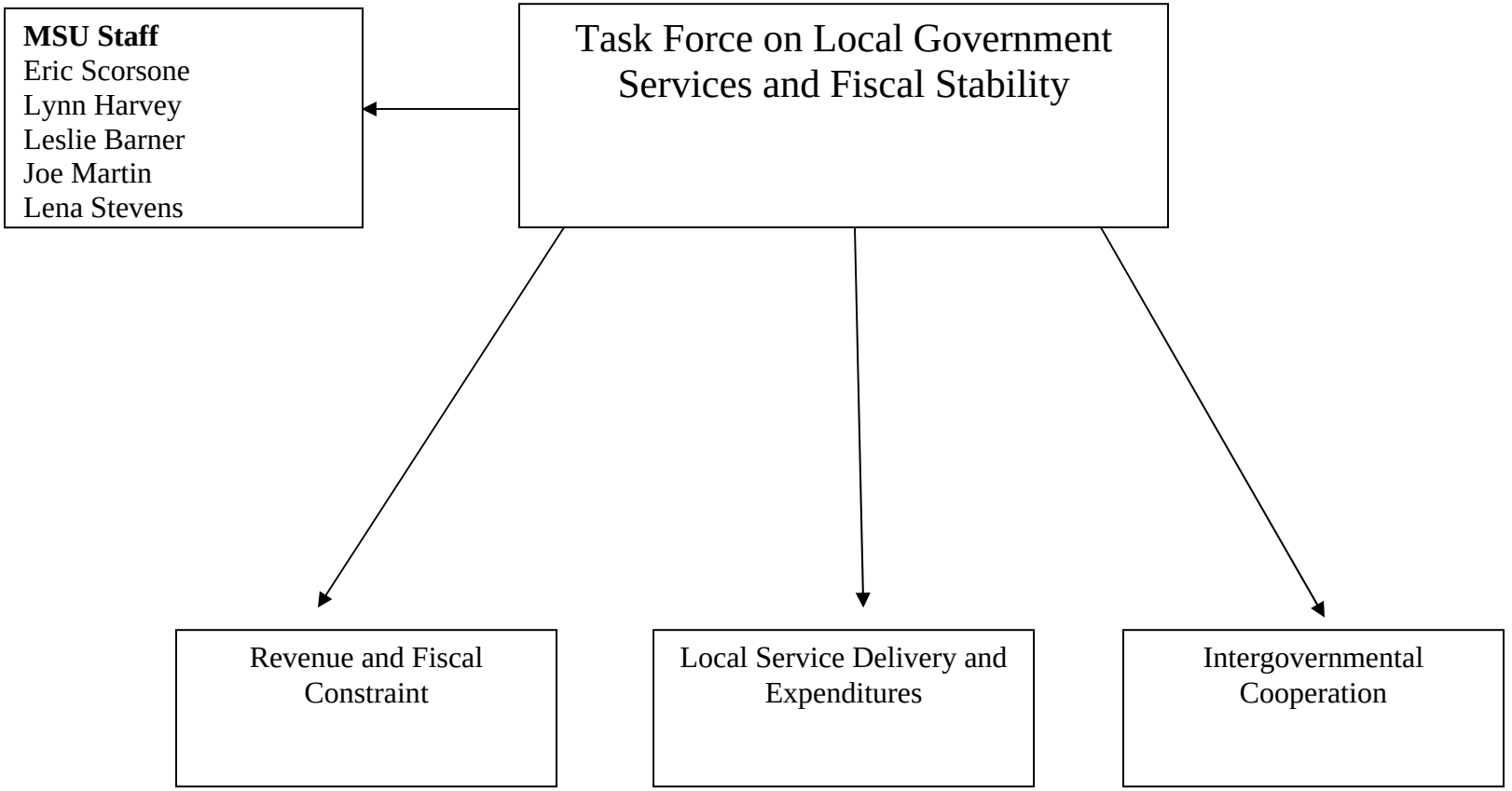
- Coordinate logistics for the Task Force meetings and public hearings
- Staff the Task Force work groups
- Write the final report of the Task Force Task Force

Role of Local Government Organizations

- Provide assistance and research on key issues being addressed by Task Force

Provide logistics and staff support to project management team and Task Force

Organization Chart



Task Force on
Local Government Services and
Fiscal Stability

WORK PLAN OVERVIEW

Date/Organization

September 19 Task Force Meeting 1	**CHARGE/SETTING GUIDING PRINCIPLES** • Receive charge from the Governor/State Treasurer • Review and approve work plan, calendar, roles/responsibilities for task force and project management team, and protocols • Hear presentations on the context and structure of higher education in Michigan • Frame research and strategic questions
September 19- Mid November Work Group Meetings	**ANSWERING KEY POLICY QUESTIONS AND DEVELOPING RECOMMENDATIONS** • Review policy issues in three work group areas • Seek outside expert counsel and research as necessary • Seek out public hearings if desired • Prepare recommended changes
November-January Task Force Meeting 2	**REFINING RECOMMENDATIONS AND POLICY** • Review work group draft recommendations • Make preliminary decisions on proposed draft report
February-March	**REFINING AND FINALIZING RECOMMENDATIONS** • MSU Staff drafts preliminary report
January-March	**FINALIZING RECOMMENDATIONS** • Task Force Reviews Preliminary Draft • Task Force resolves inconsistencies between work groups, revises strategies, and provides tentative approval to recommendations • Obtain public commentary on preliminary recommendations
May	**APPROVING FINAL REPORT** • Adopt final report • Deliver final report to the Governor

Appendix C: County Revenue Sharing Schedule

County State Revenue Sharing Data

County	2004 Taxable Value	2003 Millage Rate	Dec. 2004 Property Tax Collect.	2003-04 SR Payment	SRS Pct Prop Taxes	Deplete Reserve (Yrs.)
ALCONA	618,653,922	4.3507	2,691,578	188,392	7.0	14.3
ALGER	249,736,469	5.4520	1,361,563	161,602	11.9	8.4
ALLEGAN	3,407,613,586	4.7528	16,195,706	1,883,530	11.6	8.6
ALPENA	791,329,437	4.8538	3,840,955	622,705	16.2	6.2
ANTRIM	1,390,866,162	5.1467	7,158,371	379,791	5.3	18.8
ARENAC	454,387,440	5.0195	2,280,798	285,955	12.5	8.0
BARAGA **	176,007,173	8.4797	1,492,488	150,419	10.1	9.9
BARRY	1,512,667,876	5.5937	8,461,410	956,103	11.3	8.8
BAY	2,651,998,662	5.7528	15,256,418	2,213,303	14.5	6.9
BENZIE **	805,938,284	3.8473	3,100,686	267,805	8.6	11.6
BERRIEN	5,091,433,289	4.8381	24,632,863	3,057,187	12.4	8.1
BRANCH	1,060,278,683	4.8445	5,136,520	827,706	16.1	6.2
CALHOUN	3,228,412,954	5.3744	17,350,783	2,564,445	14.8	6.8
CASS	1,365,560,322	4.9719	6,789,429	881,337	13.0	7.7
CHARLEVOIX	1,587,021,381	4.4541	7,068,752	452,266	6.4	15.6
CHEBOYGAN	1,072,942,601	5.3386	5,728,011	441,706	7.7	13.0
CHIPPEWA	802,649,760	6.0897	4,887,896	598,107	12.2	8.2
CLARE **	816,509,604	4.8339	3,946,926	549,712	13.9	7.2
CLINTON	1,921,281,111	5.5211	10,607,585	1,060,683	10.0	10.0
CRAWFORD **	488,360,379	6.1825	3,019,288	251,965	8.3	12.0
DELTA **	915,014,217	5.0952	4,662,180	684,997	14.7	6.8
DICKINSON	776,882,447	6.1203	4,754,754	465,745	9.8	10.2
EATON **	2,868,821,143	5.2591	15,087,417	1,856,076	12.3	8.1
EMMET	2,259,869,504	4.8500	10,960,367	523,920	4.8	20.9
GENESEE **	10,108,083,643	5.5228	55,824,924	8,467,393	15.2	6.6
GLADWIN	754,410,220	4.6836	3,533,356	431,190	12.2	8.2
GOGEBIC	366,068,807	6.5364	2,392,772	284,865	11.9	8.4
GR.TRAVERSE	3,322,297,341	5.2112	17,313,156	1,344,120	7.8	12.9
GRATIOT **	746,189,977	5.5407	4,134,415	736,868	17.8	5.6
HILLSDALE	1,129,766,602	5.0078	5,657,645	803,451	14.2	7.0
HOUGHTON **	533,130,817	6.1319	3,269,105	599,107	18.3	5.5
HURON	1,354,384,349	4.3935	5,950,488	660,362	11.1	9.0
INGHAM	6,847,863,456	6.3512	43,492,150	5,143,586	11.8	8.5
IONIA	1,209,827,651	4.7353	5,728,897	1,016,522	17.7	5.6
IOSCO	935,386,326	3.9961	3,737,897	447,249	12.0	8.4
IRON	339,554,127	6.5300	2,217,288	218,870	9.9	10.1
ISABELLA **	1,224,690,253	6.4700	7,923,746	1,053,085	13.3	7.5
JACKSON	3,790,558,460	5.2022	19,719,243	2,884,601	14.6	6.8

KALAMAZOO	6,757,516,459	4.6871	31,673,155	4,423,254	14.0	7.2
KALKASKA	614,378,603	5.5220	3,392,599	270,635	8.0	12.5
KENT	18,015,373,868	4.2803	77,111,205	10,258,377	13.3	7.5
KEWEENAW	93,967,165	5.9975	563,568	36,507	6.5	15.4
LAKE	394,664,875	6.4652	2,551,587	193,028	7.6	13.2
LAPEER	2,632,809,751	3.8941	10,252,424	1,432,407	14.0	7.2
LEELANAU	1,700,929,546	3.9648	6,743,845	339,062	5.0	19.9
LENAWEE	2,779,704,421	5.0818	14,125,902	1,720,693	12.2	8.2
LIVINGSTON	7,155,611,993	3.4912	24,981,673	2,526,119	10.1	9.9
LUCE	145,403,181	5.6859	826,748	109,542	13.2	7.5
MACKINAC	719,672,113	4.4271	3,186,060	194,029	6.1	16.4
MACOMB	26,980,530,368	4.2000	113,318,228	13,753,192	12.1	8.2
MANISTEE **	838,769,961	5.1303	4,303,142	436,371	10.1	9.9
MARQUETTE	1,401,609,300	5.5687	7,805,142	1,091,224	14.0	7.2
MASON	1,177,622,745	5.1491	6,063,697	487,808	8.0	12.4
MECOSTA	1,002,097,921	5.7909	5,803,049	708,483	12.2	8.2
MENOMINEE **	479,201,617	7.3185	3,507,037	442,821	12.6	7.9
MIDLAND	3,416,287,004	4.8955	16,724,433	1,617,118	9.7	10.3
MISSAUKEE	420,784,553	4.5572	1,917,599	237,395	12.4	8.1
MONROE	5,334,377,371	4.7933	25,569,271	2,506,991	9.8	10.2
MONTCALM **	1,444,153,586	4.4442	6,418,107	1,066,238	16.6	6.0
MONTMORENCY	400,645,443	5.2522	2,104,270	169,765	8.1	12.4
MUSKEGON **	3,795,561,731	5.6984	21,628,629	3,085,536	14.3	7.0
NEWAYGO **	1,112,018,788	5.5483	6,169,814	809,570	13.1	7.6
OAKLAND **	55,986,490,872	4.1900	234,583,397	20,613,444	8.8	11.4
OCEANA	810,470,018	5.4774	4,439,268	436,615	9.8	10.2
OGEMAW	665,491,910	6.3097	4,199,054	362,815	8.6	11.6
ONTONAGON **	189,608,895	6.3645	1,206,766	145,281	12.0	8.3
OSCEOLA	566,650,491	6.4138	3,634,383	481,343	13.2	7.6
OSCODA	301,086,374	6.1452	1,850,236	152,706	8.3	12.1
OTSEGO	1,083,027,404	4.0502	4,386,478	386,280	8.8	11.4
OTTAWA	8,017,866,823	3.4000	27,260,747	4,011,829	14.7	6.8
PRESQUE ISLE	507,033,510	5.7400	2,910,372	245,241	8.4	11.9
ROSCOMMON	1,090,097,164	3.7563	4,094,732	410,755	10.0	10.0
SAGINAW **	4,621,922,499	4.8622	22,472,712	3,903,042	17.4	5.8
SAINT CLAIR	5,571,093,474	5.3287	29,686,686	3,041,601	10.2	9.8
SAINT JOSEPH	1,475,310,925	4.5794	6,756,039	1,179,452	17.5	5.7
SANILAC	1,192,406,396	4.1483	4,946,459	783,062	15.8	6.3
SCHOOLCRAFT	261,370,478	5.4773	1,431,605	153,459	10.7	9.3
SHIAWASSEE	1,524,102,197	5.2401	7,986,448	1,233,314	15.4	6.5
TUSCOLA	1,212,154,896	3.9417	4,777,951	980,593	20.5	4.9
VAN BUREN	2,296,161,391	4.6302	10,631,686	1,317,741	12.4	8.1
WASHTENAW	12,821,032,767	4.6384	59,469,078	5,602,951	9.4	10.6
WAYNE	45,917,929,737	5.6483	259,358,243	42,748,989	16.5	6.1
WEXFORD	796,007,291	6.8302	5,436,889	544,343	10.0	10.0

Calculations from Michigan State University State and Local Government Program; ** Counties with October - September Fiscal Year

APPENDIX D:

PROPOSED AMENDMENTS TO REVISED MUNICIPAL FINANCE ACT, ACT 34 PA 2001, AS AMENDED, PERMITTING ISSUANCE OF PENSION OBLIGATION AND OTHER ACTUARIALLY BASED OBLIGATION BONDS

Definitions.

Section 103

(1) "Fund" means a trust fund or other permanent fund created by a county, city, village, township, public employee retirement system or public employee post-employment benefit system and used to provide retirement or post-employment benefits to beneficiaries and participants.

(2) "Public employee post-employment benefit system" means a post-employment benefit system created and established by a county, city, village or township.

(3) "Public employee retirement system" means a retirement system created and established by a county, city, village or township.

(4) "Unfunded actuarial liability" means the amount by which a fund is short of the amount that will be necessary, computed in accordance with the standards of practice promulgated by the Actuarial Standards Board of the American Academy of Actuaries, without further payments into the fund, to pay retirement or other post-employment benefits to beneficiaries and participants of a public employee retirement system or a public employee post-employment benefit system.

Annual contribution, unfunded accrued actuarial liability and cost of actuarially based benefits related to public employee retirement systems and public employee

post-employment benefit systems; issuance of municipal security to pay cost; notice of intent; petition; referendum; limitations.

Section 518

(1) A county, city, village or township, may by resolution of its governing body, and without a vote of its electors, issue a municipal security under this section secured by the full faith and credit of such county, city, village or township, to pay the costs of (a) the unfunded actuarial liability of a public employee retirement system pension plan of such county, city, village or township, within the meaning of Article IX, § 24 of the Michigan Constitution of 1963; and (b) the unfunded actuarial liability of other actuarially based post-employment benefits including, but not limited to, medical, dental, vision and other health-related benefits of a public employee retirement system or public employee post-employment benefit system of such county, city, village or township, under agreements with such county, city, village or township; provided that the amount of taxes necessary to pay the principal of and interest on that municipal security, together with the taxes levied for the same year, shall not exceed the limit authorized by law. Post-employment benefits may be funded by the county, city, village or township, notwithstanding the fact that the county, city, village or township (i) has no legal obligation to pay the benefits or (ii) has the right to alter or eliminate the payment of those benefits. The funding of post-employment benefits by a county, city, village or township as provided in this act shall not constitute a contract to pay the post-employment benefits.

(2) Before a county, city, village or township issues a municipal security under subsection (1), the county, city, village or township shall publish a notice of intent to

issue the municipal security. The notice of intent shall be directed to the electors of the county, city, village or township, shall be published in a newspaper that has general circulation in the county, city, village or township and shall state the maximum amount of municipal securities to be issued; the purpose of the municipal securities; the source of payment; the right of referendum on the issuance of the municipal securities; and any other information the county, city, village or township, determines necessary to adequately inform the electors of the nature of the issue. The notice of intent shall not be less than 1/4 page in size in the newspaper. If, within 45 days of the publication of the notice of intent, a petition, signed by not less than 10% or 15,000 of the registered electors, whichever is less, residing within the county, city, village or township is filed with the governing body of the county, city, village or township requesting a referendum on the question of the issuance of the municipal securities, then the county, city, village or township shall not issue the municipal securities until authorized by the vote of a majority of the electors of the county, city, village or township qualified to vote and voting on the question at a general or special election. A special election called for this purpose shall not be included in a statutory or charter limitation as to the number of special elections to be called within a period of time. Signatures on the petition shall be verified by a person under oath as the actual signatures of the persons whose names are signed to the petition, and the governing body of the county, city, village or township shall have the same power to reject signatures and petitions as city clerks under section 25 of the home rule city act, 1909 PA 279, MCL 117.25. The number of registered electors in the county, city, village or township shall be determined by the governing body of the county, city, village or township.

(3) Before a county, city, village or township, issues municipal securities under subsection (1), the county, city, village or township shall have prepared a comprehensive plan of finance indicating its ability to manage its unfunded actuarial liability. Such plan shall include (a) documentation that contributed funds from proceeds of issued municipal securities and annual required contributions will be adequate to meet the level of benefits provided; (b) an amortization of unfunded liabilities and a description of actions to accomplish such amortization; (c) a description and explanation of any and all actuarial assumptions; (d) a schedule illustrating the amortization of any unfunded liabilities; (e) a comparative review illustrating the level of funds available to the plan from rates, investment income and other sources realized over the period covered by the plan with the assumptions used; (f) a statement certified by an actuary within 36 months prior to the issuance date of the municipal securities that the plan is complete and accurate; and (g) demonstration that the issuance of the municipal securities will result in a projected present value savings based on the amortization schedule discounted at the true interest cost of the total amount borrowed when compared to the actuarial assumption related to the rate of return on plan assets.

(4) Municipal securities issued under subsection (l) by a county, city, village or township are not subject to section 503 of this Act.

(5) Municipal securities issued under subsection (1) by a county, city, village or township shall have a maximum term of 30 years as determined by such county, city, village or township.

(6) Municipal securities issued under subsection (1) by a county, city, village or township shall have been assigned an investment grade by at least one nationally recognized rating agency.

(7) Municipal securities issued under subsection (1) by a county, city, village or township and currently outstanding shall not exceed 5% of the State equalized valuation of the property assessed within that county, city, village or township.

(8) Notwithstanding any other provisions of this Act, up to 50% of the principal amount of any municipal security issued under subsection (1) by a county, city, village or township may be sold at a discount exceeding 10%.

(9) A municipal security issued under subsection (1) by a county, city, village or township may mature annually or be subject to mandatory redemption requirements, with the first annual maturity or mandatory redemption requirement to fall due 5 years or less from the date of issuance and some principal amount shall mature or be subject to mandatory redemption in each subsequent year of the term of the municipal security.

(10) Municipal securities issued under subsection (1) by a county, city, village or township shall not on a cumulative basis exceed 75% of current unfunded actuarial liabilities of such county, city, village or township.

(11) A county, city, village or township issuing municipal securities under subsection (1) may enter into indentures or other agreements with trustees and escrow agents for the issuance, administration or payment of such municipal securities.

(12) Proceeds of municipal securities issued under subsection (1) by a county, city, village or township shall be deposited in a fund under the terms and conditions established by such county, city, village or township, and shall be dispersed as directed

by the county, city, village or township. The monies in the fund shall be invested as directed by the county, city, village or township in investments allowed under Act 314, P.A. 1965, as amended, MCL 38.1121-38.1140.

Appendix E: History/Funding of Michigan's Court System

Provided by the Citizens Research Council of Michigan
January 2006

Article VI, Section 1 of the Michigan Constitution states: "*The judicial power of the state is vested exclusively in one court of justice which shall be divided into one supreme court, one court of appeals, one trial court of general jurisdiction known as the circuit court, one probate court, and courts or limited jurisdiction that the legislature may establish by a two-thirds vote of the members elected to and serving in each house*."

Prior to adoption of the 1963 Constitution, Michigan was served by a myriad of municipal, traffic and ordinance, justices of peace, and common pleas courts. Provisions of the 1963 Constitution established a multi-tiered court system. Appeals courts, the Supreme Court and the Court of Appeals are *state* courts. Trial, circuit, probate, and district courts are maintained at the *county* and sub-county levels.

This move to "one court of justice" caused the greatest amount of change with the creation of district courts. With the exception of a few municipal courts that were grand fathered to remain unchanged, these local courts were replaced with district courts. Michigan currently has 104 district courts serving entire counties, parts of counties, or only one or two individual municipalities. There are 57 judicial circuits serving single or multiple county jurisdictions. The state is served by 78 probate courts serving single or multiple county districts.

While streamlining the court system to create "one court of justice," neither the Constitutional Convention nor the legislation implementing the constitutional provisions addressed the need for a unified system of court finance. All of the trial courts are organized under the direction of the state Supreme Court. They are subject to state court rules and must follow operating procedures established by the state court. Court organization however relied upon the local governments to serve as the funding units for the trial courts. The county governments, alone or in tandem, are the funding units responsible for funding the circuit and probate courts.

As funding units, the counties and municipalities must perform careful balancing acts to provide needed funding without intruding into the affairs of the trial courts. Every year the chief judge in each court must submit a proposed budget to the county or municipality responsible for court funding. Generally the courts and funding governments are able to work together to agree on a budget that the governmental bodies can afford and that will meet the needs of the courts. However, the separation of powers provisions in the constitution prevents the counties and cities from having any real controlling powers over the management or operations of the courts when conflict exists.

Conflicts can be taken to arbitration before the state court administrator's office or are brought to suit before courts of higher jurisdiction. From the local government

perspective, this system is designed to ensure the courts received the funding that they feel is needed. One of the most significant cases to be decided on court funding, *Wayne Circuit Judges v Wayne County*, 386 M 1 (1971), found that the judiciary possesses an inherent power to determine and compel payment of those sums of money which are reasonable and necessary to carry out its mandated responsibilities.

Over time, there has been some recognition by the state legislature that the state should bear the responsibility for funding the "one court of justice." The first movement in this direction was necessitated by the financial difficulties of the City of Detroit and Wayne County in the early 1980s. In 1981, the state assumed funding responsibility for the Third Circuit Court in Wayne County, Detroit's Recorder's Court, and Detroit's 36th District Court. Pursuant to PA 438 of 1980, this state action was to be the first phase of a state reorganization that would ultimately result in full state funding for the trial courts. Act 438 laid out a six-year timetable for the state to fund trial court operational expenses on a statewide basis. While the state met its funding obligations for the Detroit and Wayne County courts, sufficient funds were never provided to fund court operations statewide.

The State created new sources of funding for court operations by restructuring and increasing certain court fees in 1993 (Public Act 189). Funds from those fees were earmarked to a newly created State Court Fund, which allocated funding to trial court funding units pursuant to a formula based on the state's paying a percentage of trial court costs. Some court funding units benefited from this allocation, others did not. Again, the state was not able to provide sufficient resources to fund court operations statewide.

The legislature again attempted to restructure the court system and provide equitable state funding of trial courts in 1996. Detroit's Recorder's Court was folded into Wayne County's Third Circuit Court. The Third Circuit Court and the 36th District Court no longer received special funding. New funds were established to provide operational funding to trial courts statewide.

While the state provides partial funding of trial courts, a large burden for funding remains on the counties and cities. Even with the state funding that has grown substantially over the past 25 years, locally-raised revenues are needed to fund trial court operations.

A recent survey completed in December 2004 by Michigan State University for the Michigan Association of County Administrative Officers, examined the cost associated with performing mandated activities within county government. As part of the survey, statutory mandates related to court activities were identified, and respondents were asked to report the expenditure associated with performing the mandated activity, along with the corresponding revenue. Included in the definition of associated revenue were any fees, charges, state/federal grants, or dedicated millage, reflecting the performance of the mandated court activity. General operating millage was explicitly excluded from

the associated revenue, thus permitting a calculation of the net costs to counties for performing the court activity.

In total, twenty-seven counties responded to the Survey, and the results found:

- Expenditures associated with performing mandated trial court (circuit and district) activities totaled $183,479,355, of which only $95,502,456 or 52.05 percent was offset with associated revenues.
- Friend of the Court activities were able to offset 74.54 percent of the mandated expenditures, but still left over 12 million in net costs to the counties.
- Associated revenues were able to offset only 30.68 percent of the mandated expenditures arising from probate court activities.

Appendix F: Minority Responses

Although consensus was reached on an overwhelming majority of the issues discussed by the Task Force, several members felt that a minority response was appropriate to address their specific concerns. Two minority reports are included in this appendix.

ISSUE 3: INTERGOVERNMENTAL COOPERATION
***Recommendation I*:** Transfer assessment of property values to the county level and all equalization responsibilities to the State level

Minority responses as stated by Task Force member(s): Patricia Pikka, Larry Rutledge, Timothy J. Braun, Ruth Ann Jamnick

All of the township officials of this task force are in opposition to the movement of assessment responsibilities from the township level of government. The assessment function involves much more than the process of evaluating the value of the property. Virtually every township function depends on assessment information. Moving this function out of the township has potentially detrimental implications on overall township operations.

The assessor must communicate on a virtual daily basis with multiple departments. The most obvious information sharing takes place between the assessor and treasurer. However, in order to properly assess property the assessor must work with the building department as well as zoning and planning to assist in new development and to insure that new construction is added to the rolls. The assessor must also work with the supervisor on issues involving land splits. The assessor must work with the clerk and supervisor to identify properties and owners who must receive notices for rezoning proposals or special assessment considerations. If townships do not employ the assessor, the assessor will communicate with the townships when it is convenient to the assessor, regardless of when the township needs the information. This proposal creates a very different dynamic than currently exists for example in Oakland County where County equalization works under contract to various cites and townships to meet their assessing needs.

From a financial perspective, the private competitive market drives assessing costs in many ways. Some townships employ their own assessor; many contract with private companies or with individuals for this service. In other cases the township supervisor performs the service and in some situations the township contracts with the counties to perform the service. This proposal would eliminate the private market competition that currently exists. To assume that the county with its employee benefit costs would provide a cost savings for this service has not been the experience of townships across the state.

Finally, this proposal assumes the state will willingly accept the costs of equalizing and that counties will accept the cost of assessing and assume the liability associated with defending the assessments.

ISSUE 5: ***REVENUE SHARING FUNDING***

Recommendation IV: To avoid further reductions in statutory revenue sharing, the Single Business Tax should not eliminated or reduced unless a replacement Michigan business tax has been adopted that would generate an equal amount of State General Fund revenue

Minority Response as state by Task Force member(s): David M. Hieber

The position of the Task Force is that the SBT should not be eliminated until replacement revenue or a "new tax" is in place. I believe Michigan needs to eliminate the SBT and create an equitable tax system for the business community not replacing it dollar for dollar.

I feel the State of Michigan should eliminate the SBT, reduce spending, and encourage private sector business growth and intergovernmental cooperation.

ISSUE 13: ***LOCAL CONTROL OVER TAX INCREMENT PLANS***

Minority Response as stated by Task Force member(s): Scott Buhrer, Karl Tomion, Alex Allie, Sean Werdlow

The above stated members of the Task Force unanimously opposed this subject as an issue and the recommendation. We do not agree with the argument that tax increment financing (TIF) should only be used for infrastructure improvements, and that once the costs of the "bricks and mortar" are paid off, there is no need to continue to collect such dedicated revenues. The DDA Act, as originally adopted and amended, envisioned a comprehensive approach to redevelopment of City centers that extends beyond bricks and mortar. The Act has served core communities and their local government partners very well.

Downtown Development Authorities (DDAs) need more than public improvements to revitalize older central business districts. The physical setting as well as their management structures require reinvention and continued work. This places them at a substantial competitive disadvantage with suburban malls.

Individual business owners cannot individually compete with shopping centers that employ centralized marketing, parking, and maintenance organizations. They need to use the TIF revenues generated by their investments to pay the cost to promote area wide sales, train employees, and maintain parking and other common areas.

Michigan's economic resurgence will only take place in communities where young professionals and other residents can enjoy a wide-ranging and quality downtown experience.

Local partner taxing units benefit from the reinvention of tax base within tax increment districts. Tax base growth within a district creates jobs and activity within an entire community. The alternative, failure of a district, would have the opposite effect. Finally, the impacts of tax increment financing on local units is inconsequential. Reduction of the rate of capture would have marginal impact on the bottom line of any one taxing unit. Sunset of expiration date is also inconsequential in that the term is far in the future.