Financial Health Review Team

Revenue Options
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Adjunct members -- Sue Haka and Ray Vlasin
East Lansing Financial Health Team

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Background & Scope

The Group's charge: consider options for new or increased revenues to stabilize City finances, potential budgetary reductions, and other measures consistent with the need to provide affordable and sustainable services to citizens and Michigan State University, its students, personnel and property within city boundaries. While the 2010 Census indicates the City's residents as 48,579, the aggregate population served is well over 100,000 individuals due to MSU's presence. The challenge from a budgetary perspective is that City services available to and enjoyed by all within the City are paid for almost exclusively by residents.

As part of its due diligence in gathering information, the Group requested and received City Council approval to retain consultants to study two specific subjects.

- First, an **Income Tax Feasibility Study** (October 30, 2016) "Income Tax Study") was conducted by Plante Moran.

- Second, the report **Uncompensated Cost of Michigan State University to City of East Lansing's Public Safety and DPW Budgets** (October 31, 2016) ("MSU Costs Study") was conducted by Great Lakes Economic Consulting, LLC. Related to the MSU Cost Study is an earlier report, **Net Fiscal Impact of Michigan State University on the City of East Lansing** (June 23, 2006), prepared for the University by Anderson Economic Group.

The Group met seven times in public session to address these matters and formulate the Group recommendations. The Group unanimously approved these Recommendations on November 7, 2016, and the Financial Review Team's approval was given on November 14, 2016.

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Observations on the City of East Lansing: Revenue Decreases and Constraints

- The State of Michigan has consistently underfunded Revenue Sharing for municipalities. The devastating impact upon municipalities statewide is starkly presented in the April 2016 Michigan Municipal League report prepared by Great Lakes Economic Consulting, LLC**, Michigan's Great Disinvestment: How State Policies Have Forced Our Communities Into Fiscal Crisis.**

  http://www.savemicity.org/wp-content/uploads/2016/03/mml-glec-michigans-great-disinvestment.pdf

  "Since 2002, Michigan has led the nation in cuts to municipalities (see Exhibit 12). The Census of Governments published every five years by the U.S. Census Bureau reported that from 2002 to 2012, municipal revenue from state sources increased in forty-five states and the average increase was 48.1 percent. In Michigan, municipal revenue from state sources declined 56.9 percent from 2002 to 2012. [chart omitted]

  California, Minnesota, Kansas, and Kentucky reduced state sources to municipalities by an average of 9.41 percent. Kansas was the next largest decline at 14.3 percent – compared to a 56.9 percent decline in Michigan." (pp 32-33).

  For the City of East Lansing for the period 2003-2015, the cumulative revenue sharing cuts is estimated at almost $23 million dollars, according to the Michigan Municipal League: http://www.savemicity.org/search-results/?local=East%20Lansing&county=Ingham.

  Averaged over this 13 year span, the annual reduction is $1.77 million. The average understates the snowballing magnitude of the reductions: in 2015, the City's Revenue Sharing was reduced by almost $3 million.

- Because of lower property values following the 2008 recession, lowered property tax valuations led to substantially reduced revenues. From 2009-2016, East Lansing property values declined 5.7%. **General property tax revenues have declined from $16.5 million in 2010 (at 16.5912 mills) to $16.1 million in 2016 (at 17.5891 mills).** The City's charter authorized millage rate is 20 mills. Due to the operation of the Headlee Amendment and Proposal A in concert with the 2008 Recession and subsequent low inflation, the operative legal general operating millage rate has been 17.5891 mills since 2012, which reduces property tax revenue. Voter approval is necessary to reinstate the 20 mills authority (override the Headlee limit). **Full levy of 20 mills would generate about $2.2 million in additional revenue (based on current valuation).**

- Fire Protection Grants (1977 PA 289) have been underfunded substantially, like Revenue Sharing. PA 289's purpose is to reimburse municipalities that provide fire service to state institutions (such as Michigan State

University) located within their boundaries, under a formula where the grant approximates actual costs of the service. **For the twelve-year period 2004-2015, with total MSU-related fire service costs of almost $27 million, the City's total grants have been $13.25 million, and the underfunding $13.75 million. In 2015, the PA 289 grant was $1.123 million, $2.19 million below cost.**

- The City subsidizes Fire Protection services for Michigan State University, as detailed in the MSU Cost Study. In the late 1940's, when City employees first participated in the Municipal Employees Retirement System, President Hannah recognized the vital importance of Fire Protection services rendered by the City, and entered into a Fire Contract providing the City for areas owned by MSU outside City limits, with annual payments based on a formula. In 1999, the MSU payment was $1,014,400; over the next several years, the payment was decreased substantially, and since 2003, the annual payment has been $326,000. The MSU Cost Study estimates the annual cost of Fire Services provided to the University as $3.24 million, minus offset of PA 289 grant funds and the fire contract payment and other charges totaling $1.56 million, resulting in a net cost to the City of $1.68 million.

Recommendations

1. **To maintain City services at the present level, IT IS RECOMMENDED that Council seek voter approval of a City Income Tax WITH millage reduction based upon the residential income tax estimated to be paid.** The Income Tax Study, conducted at the request of the Revenue Group, was completed by Plante Moran on October 30, 2016. Following the prior study performed in 1998, the City decided to not proceed further with the process to submit to the voters. Since that time, City revenues have been constrained while expenses and required payments have increased. The Income Tax Study calculates that the standard 1% tax on City residents would generate about $5.3 million, and the standard 0.5% rate on nonresidents would yield $4.7 million, for a total of about $10 million; this assumes the standard tax rate, and an exemption amount of $600. The Study further calculates the Income Tax yield if the exemption amount is increased above $600. An increase in the exemption amount will reduce the overall yield, as stated on p 4 of the Study.

   As an integral part of this City Income Tax recommendation, an accompanying reduction in property tax millage would substantially offset the estimated city income tax paid by residents. As an illustration, the City Finance Department (on October 12, 2016, Attachment 1)) calculated a $5 million dollar decrease in millage would reduce the current 17.5891 mills by 5.6034 mills, with a lowered new rate of 11.9857 mills. Depending on the ultimate exemption amount, and determination of the consequent estimated residential income tax that will result, the millage reduction may be established. The millage reduction will continue at the same rate going forward, and will not change in the future based upon the actual residential income tax received by the City.

   The millage reduction applies to all who pay property tax. As Attachment 1 indicates, 46% of the $5 million of millage reduction would apply to residential (homestead) property, and the remainder is spread among other taxpayer categories. Persons and entities who own real property and do not end up paying or owing City income tax will also have the same millage reduction. This is commanded by principles of equality of treatment for all who pay the same property tax rate.

The Study comprehensively states Administrative Issues and Policy Considerations for Council to evaluate, and they will not be restated here. Implementation of an Income Tax requires not only Council adoption of an Income Tax Ordinance, gathering of referendum signatures in support, and ultimately voter approval. This is ultimately a political determination to be made by the City Council, with the approval of the electorate.

The FHT is of the view that due to the exemption of University property from real property taxation, a city income tax offers to the City perhaps the only legally available means to tax monies earned within the City by all residents and nonresidents, and thus deserves serious consideration. The arguments on behalf of not taxing MSU employees are primarily based on the rationale of the 2006 MSU Fiscal Impact Study, that the University's presence has a net positive financial impact on the City even after consideration of actual direct City service costs. By extension then, University employee's earnings within the City ought not be taxed because the benefits conferred by the University are the cumulative result of its employees work activities. However, the City cannot selectively choose to not tax based upon who the employer is, while taxing all others with earnings within the City. While real property of the University is exempt from taxation, the earnings within City limits of its employees are not exempt from the reach of a duly-enacted City income tax. *The FHT strongly encourages City Council to confer with Michigan State University at its Quarterly Meetings on the 2016 MSU Cost Study and the 2006 MSU Fiscal Impact Study, with a view towards mutually finding new and forward-looking ways of equitable cost-sharing that meets the evolving needs of the University and the City.*

In the implementation of an Income Tax, the City is encouraged to maximize collections and minimize administrative expense by contracting with the State Treasurer for the State to administer and collect the City Income tax. Finally, explore creation of a civic fund in which those persons and entities whose millage reduction is in an amount greater than city income tax paid are encouraged to contribute.

2. **As an alternative to Recommendation 1, seek voter-approval of a Headlee Rollback to reinstate the City's 20 mills charter authority.** As stated in the Observations section, second arrow > above, the current Headlee-restrained millage is 17.5891 mills, and a rollback to 20 mills would raise about $2.2 million. Consideration might be given to dedicating a portion of the increased millage revenues for specified purposes, for example, 1 mill for infrastructure renewal, and .5 mills for maintenance of parks and recreation.

3. **Pension Legacy Cost Recommendation #10, Explore Financing Mechanism for Police and Fire Services under 1988 PA 57, is incorporated, relied upon and specifically reaffirmed. In addition,**

FHT encourages the City Council to actively explore combination of services with neighboring communities, in the areas of public safety, the district court, and other service consolidations.

4. **The City Council is encouraged to continuously review fees for services and permits. The expense of providing a City service or amenity should include the actual cost to the City, including compensation and benefits.** In fees, a nonresident participation fee may be to defray expense, or equitably apportion fees between residents and nonresidents to defray expense. In permits, the permit cost should approximate the actual cost to the City.
The FHT notes that the City is prohibited by State law from imposing a direct or excise tax on liquor, wine, or beer. In other areas where State law authorizes imposition of fees for conducting an activity allowed by the City, such as licensing and permit fees for marijuana dispensaries and related businesses, the City should charge the maximum statutory fee or service-cost fee.

   Citizens have advocated at FHT Citizen Forums potential areas where user fees could be charged for an amenity desired by many, for example: annual or monthly 24-hour parking permits where a resident's vehicle (or vehicles) could be legally parked in the street(s) adjoining the residence.

5. **In the context of Revenue Options, the second Recommendation of the Citizen Communications and Services Group, for a 5% budget reduction, is noted with approval and endorsed.**

Attachments

Attachment A: Income Tax Feasibility Study

Attachment B: Uncompensated Cost of Michigan State University to City of East Lansing's Public Safety and DPW Budgets

Attachment C: Net Fiscal Impact of Michigan State University on the City of East Lansing