The Center for Local, State, and Urban Policy
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FISCAL HEALTH PROJECT
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The Fiscal Health of Michigan Local Governments 2021 - 2022

Executive Summary

Following local government's unprecedented responsibilities as first responders to the COVID-19 pandemic and their subsequent infusions of aid from the federal government, it is essential to check in on the fiscal health of Michigan's local governments. This report analyzes local government financial data reported to the State of Michigan in 2021 and 2022 to develop a set of indicators to capture various aspects of local fiscal health. It finds that for short-term measures related to healthy reserves, adequate cash, and balanced budgets, most communities are doing well. However, when it comes to measures of long-term ability to meet financial and service obligations, there is more variability. Some communities struggle with high liability burdens from debt, pensions, and retiree healthcare benefits. There are also fairly wide ranges in the amounts of spending per capita and the share of budgets spent on public safety, suggesting that communities vary in their ability and/or desire to provide local services. Part of this variation may be driven by local governments' lack of autonomy over revenue policy. They have very limited ability to alter revenues either from property taxes - on which counties and cities are more heavily reliant - or from revenue sharing - on which villages and townships are more heavily reliant. Looking forward, it will be important to monitor local finances not only to ensure that short-term indicators remain strong, but also to proactively respond to any looming warning signs associated with long-term liabilities and inadequate service delivery.

Introduction

As Michigan communities recover from the COVID-19 pandemic and move toward an uncertain economic future, it is important to monitor local government fiscal health so that we may ensure that basic community services are provided safely and consistently. Every day, residents and businesses rely on local services like policing, transportation, water, sewage, and health systems. In order to maintain these services, local governments need to be financially healthy in both the short- and the long-terms.

In response to the COVID-19 pandemic, the federal government made unprecedented investments in state and local governments through the CARES Act (2020) and the American Rescue Plan Act (2021), as well as other more targeted funding programs. Michigan local governments received billions of dollars to protect and bolster local services and invest in infrastructure to support future growth.

However, federal aid is a one-time infusion and is unlikely to address ongoing sources of economic stress including population loss and economic stagnation. In the Spring 2022 Michigan Public Policy Survey (MPPS), only 8% of local leaders thought that federal funding would "significantly" improve their fiscal health, with another 44% estimating that it might "somewhat" improve their fiscal health, but 42% expected federal aid to

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have little to no effect.[1] As of spring 2023, 63% of local governments rate their level of fiscal stress as low while 8% (the equivalent of 148 localities) rate their stress as high, essentially unchanged from 2022 (65%), 2021 (65%), and 2020 (64%). Local leaders also report increasing concerns about long-term fiscal stress and doubts about the long-term impact of federal aid.[2]

Looking forward, while the economic outlook for the state is largely positive,[3] Michigan's local governments face ongoing structural challenges that make them particularly susceptible to fiscal stress and unable to take advantage of economic recovery compared to local governments in other states.[4] While surveys of local officials such as the MPPS can provide valuable insights on local fiscal conditions, it is also important to monitor local financial data, which provides a more standardized picture of financial conditions.

This report analyzes data from Michigan local governments' annual financial statements, as reported to the Michigan Department of Treasury, to establish general facts and trends about different aspects of local government fiscal health. To provide extra context, the report also includes insights from MPPS surveys of local leaders.[5] While this report provides an initial snapshot, ongoing monitoring can help local leaders understand how their governments compare to their peers and identify potential areas of concern to watch more closely in the future.

Data and Method

The data used in this report are from the FY 2021-FY 2022 Annual Financial Report (F-65) submitted by local units of government and compiled by the Michigan Department of Treasury.[6] The data were downloaded in July 2023 and include the following number of observations:

Table 1
Sample size by fiscal year and jurisdiction type

	FY 2021	FY 2022
Cities (275 total)	275	253
Villages (258 total)	251	218
Townships (1,240 total)	1,216	1,077
Counties (83 total)	83	26

Data were cleaned to remove any obvious errors (e.g. values were reported as negative instead of positive) and merged with 2020 Census population data. At the time of the data collection for this report, the data for FY 2022 were incomplete for many counties that have a December 31 fiscal year close. In addition, although certain local units may be included in the dataset, if they did not report complete data, they may not be reflected in all ratios and measures calculated in this report. While the tables found throughout this report typically show both 2021 and 2022 data for all jurisdiction types, numbers in the text as well as data shown in the figures use 2022 data for cities, villages, and townships and 2021 data for counties.

In the scholarly literature, financial condition is defined as a government's ability to meet financial and service obligations. Financial condition is multidimensional and reflects not only a government's financial management decisions (e.g. budgetary decisions) but external economic and political factors that affect resources or constraints on decision-making.[7]

The concept of financial condition or solvency is often measured along a time horizon, where the focus can vary from the very near term to the very long term. Cash solvency focuses on the very near term–whether a government has sufficient liquidity to meet short-term obligations. Budgetary solvency focuses on the sufficiency of revenues to cover spending during the current budgetary period. Long-term solvency focuses on the government's ability to meet long-term obligations a year or more into the future. Service solvency also takes a long-term perspective, but instead of focusing on liabilities, it focuses on the government's ability to maintain high-quality services for its constituents.[8]

For this analysis, we measure each of these dimensions of financial condition using financial ratios that are derived from information found in the F-65 data. The ratios used in this analysis are commonly used by credit rating agencies, state oversight bodies, and researchers.[9]

For each financial indicator, we report median values broken down by year and jurisdiction type. Medians are reported instead of means (i.e. averages) to minimize the influence of outliers that have very high or very low values. While outliers may reflect "true" values, they also can reflect errors. For this analysis therefore, median values better reflect a "typical" case than mean values. For some indicators, the entire distribution of values is shown so readers can get a sense of the shape and range of values.

Michigan local governments' cash solvency generally appears to be quite strong

One way to assess the fiscal health of local governments is to focus on indicators of short-term cash solvency. Measures of cash solvency are intended to capture whether a government has enough liquid resources to meet current obligations or to address an emergency. Although cash solvency measures can be applied to assess liquidity in any fund, they typically focus on the general fund because it is the primary operating fund for most governments. As detailed below, these metrics suggest that Michigan local governments' cash solvency generally appears to be quite strong.

General fund balance ratio

Within the general fund, arguably the most important number is the unrestricted general fund balance, which is the portion of a government's savings that is not restricted in how it can be used. The unrestricted general fund balance often represents the "emergency reserves" or "rainy day" fund for many governments and can be drawn down to respond to emergencies or fill unexpected budgetary shortfalls. The Government Finance Officers Association recommends that governments maintain an unrestricted general fund balance of at least two months of regular operating revenues or expenditures. In other words, the ratio of

Note on Data Limitations

High-quality financial data are essential to monitor the fiscal health of local governments and detect signs of stress early, before a crisis develops. Most researchers consider data from audited financial statements (or ACFRs) to be the best source of information for assessing local fiscal health. While Michigan local governments are required to produce ACFR documents, the information is "locked up" in a PDF, and researchers must devise ways to extract the data for analysis, which is prohibitively time-consuming and expensive.

The data in this report are from the Michigan F-65 form that local governments manually fill out. Much of the information in the F-65 form is also included in ACFRs, so local governments should be copying numbers directly from the ACFRs. However, preliminary research has shown discrepancies between F-65 and ACFR data, likely due to human error or omission, raising concerns about data quality. Efforts to improve data reliability and completeness by digitizing ACFRs (for example through XBRL) could ensure data quality as well as eliminate the time and expense of manually copying data into a redundant format.

unrestricted general fund balance to revenues should be around at least 15 to 20%, although it is not uncommon for governments to keep their fund balances significantly larger. Some local governments, for example, use the general fund balance to save up funding for large purchases (for example, a fire truck) in addition to its role as emergency reserves.

Table 2
Cash solvency indicators (medians) by jurisdiction type and year

	Median general fund balance ratio		Median days of cash on hand: Governmental Funds	
	2021	2022	2021	2022
Counties	0.273	0.241	200.20	222.91
Cities	0.378	0.390	232.78	257.10
Villages	0.784	0.808	454.84	691.70
Townships	1.431	1.468	585.95	490.20

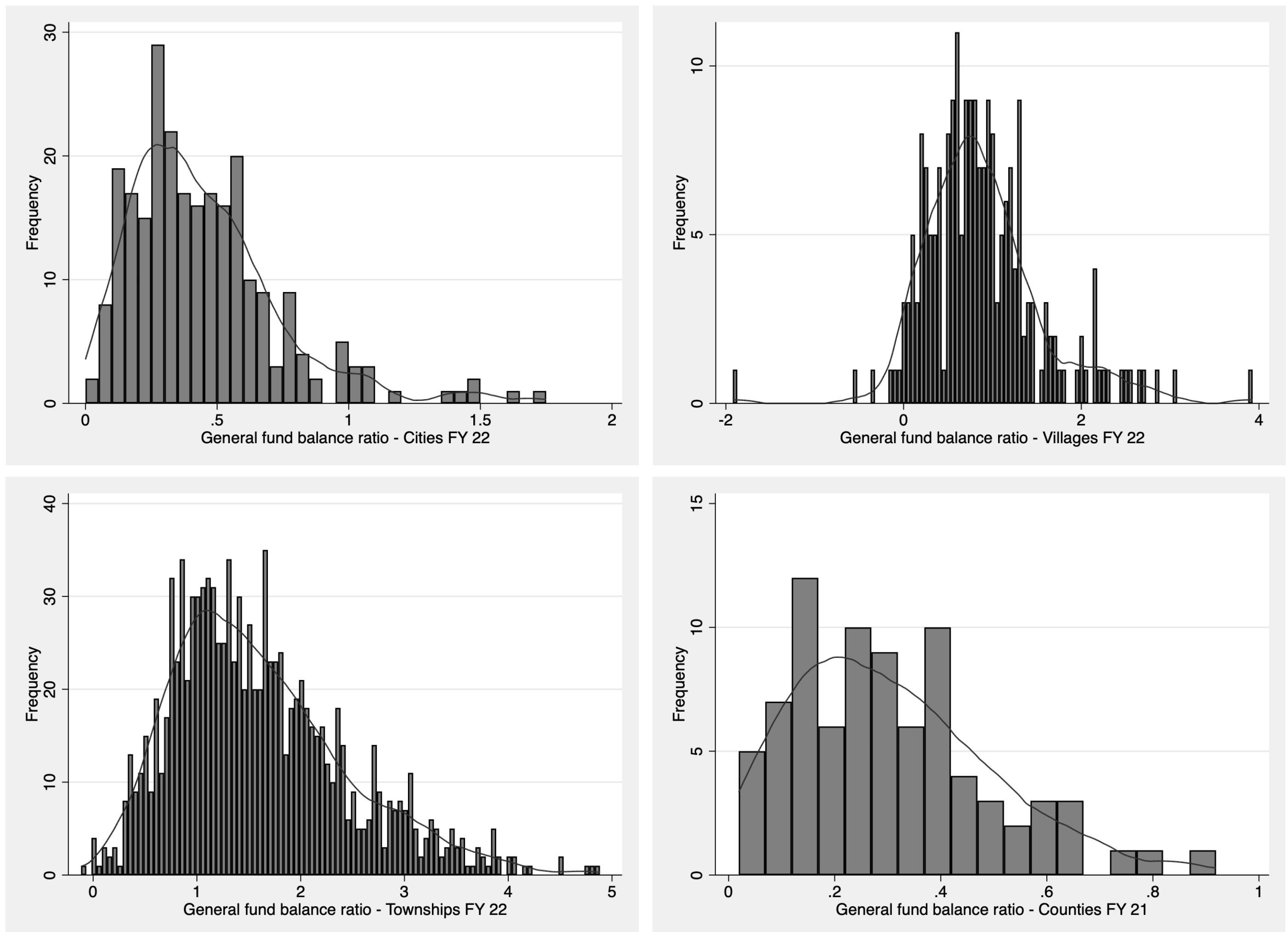
The median unrestricted general fund balance to revenue ratios for counties, cities, villages, and townships are reported in *Table 2*. Counties have the lowest median at 24 - 27%, still comfortably above the recommended minimum. Townships have the highest median, almost 150% of revenues in FY 2022. Cities and villages are in the middle, with medians of 39 and 80% respectively.

Local government officials say:

Most Michigan local officials say their general fund balance is "about right." On the Spring 2023 MPPS, 72% of local officials statewide said their general fund balance is about right while 18% said their balance is too low, and just 6% reported that it is too high. Village officials were most likely to say their balance is too low (30%), while township officials were least likely (15%).[10]

Figure 1 includes histograms that show the ratios of unrestricted general fund balance to revenues for jurisdictions of each type. While most jurisdictions are at or above 15 to 20%, 29 cities (11%), 18 villages (7%), 11 townships (<1%), and 19 counties (23%) have ratios below the recommended values, a potential cause for concern.

Figure 1
Unrestricted general fund balance to revenue ratio, by jurisdiction type



Each distribution is also right-skewed, with most local units near the median but a long "tail" of local units with particularly high ratio values. This right-skew is especially pronounced for townships, where 24% keep fund balances in excess of 200% of revenues. This skew may reflect townships using their general fund as a savings account for expected large purchases or other future large expenses.

Days of cash on hand

Another way to evaluate cash solvency is to assess the government's cash balance. While unrestricted fund balances are typically held as cash, governments may have additional sources of cash or cash equivalent resources they can use to fund operations. In addition, even if unrestricted fund balances are low or negative, governments still need to keep cash (possibly borrowed) on hand to maintain operations. A general rule of thumb is to keep at least 90 days of cash on hand, in case revenue flows were disrupted or emergency expenditures were required (both of which happened with the onset of the COVID-19 pandemic in 2020).

Days of cash on hand is calculated by dividing the government's cash balance by daily operating expenditures. The median values for each jurisdiction type are reported in *Table 2* (above). Median days of cash on hand are very high for all jurisdiction types: in the lower 200s for cities and counties and over 400 days for villages and townships. These figures are likely boosted by federal pandemic aid, which governments received in 2021 and 2022 and have until 2026 to fully expend.[11]

Overall Cash Solvency

Overall, Michigan local governments' cash solvency appears to be quite strong. While some local units still have low general fund balances, most have maintained strong cash positions, buoyed by federal aid. Excluding the largest jurisdictions that received direct aid, the median "non-entitlement unit" in Michigan received $175,268 under the American Rescue Plan Act.[12] In addition, municipalities with fewer than 50,000 residents (97% of Michigan local governments) can use up to $10 million (or up to the size of their grant) of their American Rescue Plan Act aid for "revenue replacement," which means their grant is unrestricted cash that can be used for any purpose, whether replenishing fund balances or supporting expenditures.

Key findings:

- Wide variation in local government general fund balances, but very few are lower than recommended.
- Median number of days of cash on hand is high for all jurisdiction types, but particularly townships and villages.

Federal aid and economic conditions have strengthened Michigan local government budgetary solvency

Another way to assess the fiscal health of local governments is to examine budgetary solvency, which focuses on the current budget period. This dimension of financial condition assesses changes in fund balances and net assets, capturing how consistently an organization's expenses are covered by their revenue. To achieve a more detailed view of budgetary solvency, we separated governmental activities reflected in the general fund from business-type activities reflected in enterprise funds - for example water/sewer system funds, parking funds, recreation center funds, etc. While governmental activities are supported by general revenues like property taxes and state revenue sharing, business-type activities are self-sustaining, relying on customer revenues. Enterprise revenues typically cannot be used to subsidize the government's core operations without legislative approval or a voter referendum.[13]

It is important to keep in mind that budgetary solvency is a function of both revenue and expenditures and there are multiple ways to achieve balanced budgets. A potential deficit can be addressed by either raising revenue, tapping reserves, or (more commonly) cutting expenditures. Therefore, budgetary solvency indicators capture the effects of both external conditions (e.g. economic pressures that slow tax base growth) and internal/management responses (e.g. trimming expenditures). Overall, the indicators described below suggest that Michigan local government budgetary solvency is fairly strong, most likely due to a combination of federal aid and underlying economic conditions.

General Fund Margin

The general fund margin ratio measures how net revenues (revenue - expenditures) compare to total revenues for the general fund - in other words, it is analogous to the general fund's "profit margin." Of course, it is not the goal of government to achieve high margins and earn profits, but municipalities are required to balance their budgets so it is fiscally responsible to ensure that margins are at least slightly positive to provide a cushion against

deficits. Because the general fund is the primary operating fund for public services, this ratio captures how well governmental general revenues like property taxes and state revenue sharing funds are covering expenditures.

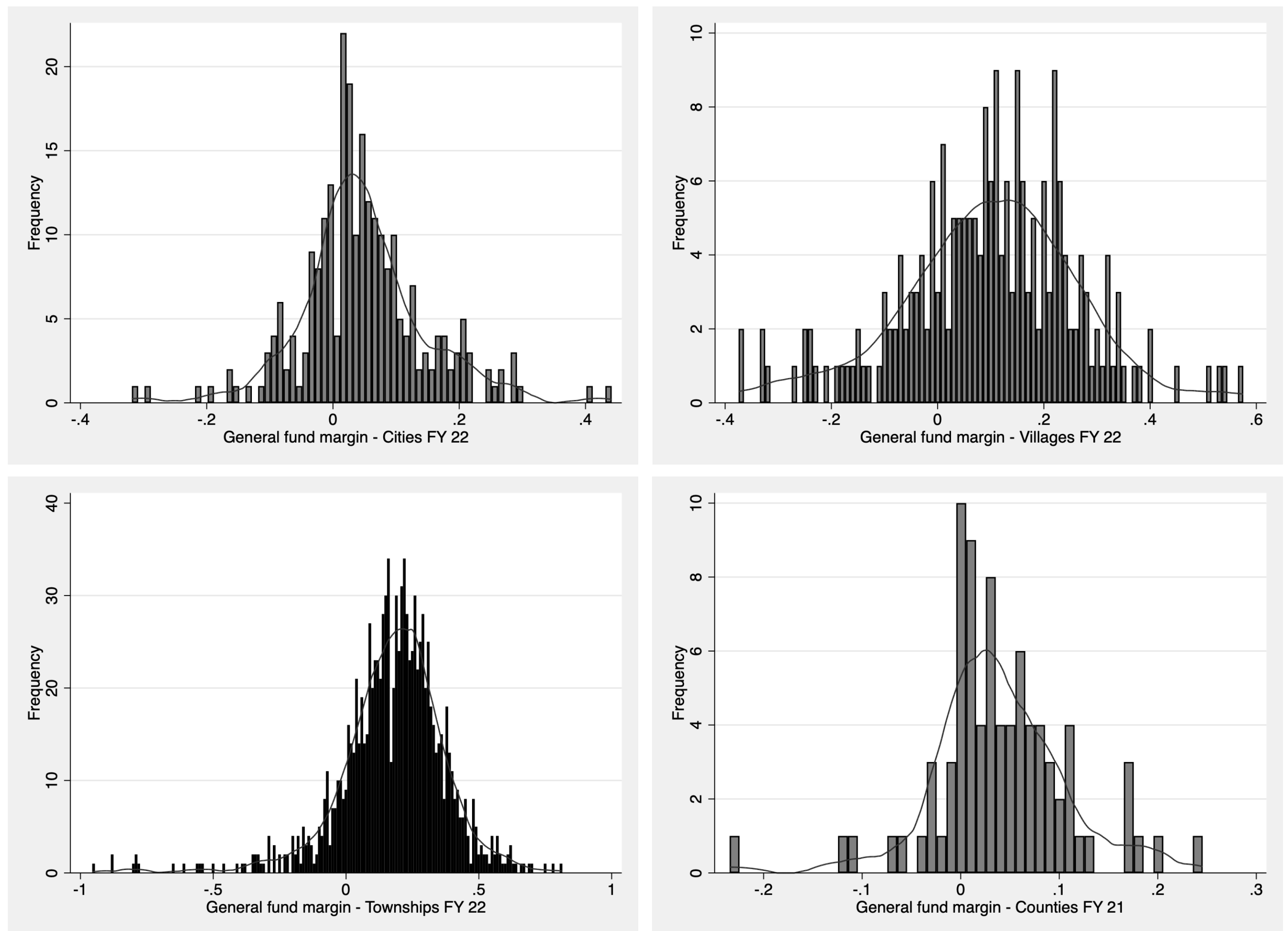
The median values reported in *Table 3* suggest that margins for each jurisdiction type were relatively healthy. Counties had the lowest median of 3.0% in FY 2021 with townships having the highest median of 19.3% for FY 2022. Cities and villages were in the middle, with cities having a 3.6% median margin and villages having a 10.3% median margin.

Table 3
Budgetary solvency indicators (median), by jurisdiction type and year

	Median general fund margin		Median general fund balance growth		Median enterprise fund margin		Median enterprise fund balance growth	
	2021	2022	2021	2022	2021	2022	2021	2022
Counties	0.030	0.036	0.08	0.10	0.180	0.142	0.05	0.04
Cities	0.064	0.036	0.14	0.08	0.102	0.100	0.03	0.03
Villages	0.094	0.103	0.11	0.12	-	-	-	-
Townships	0.130	0.193	0.08	0.12	-	-	-	-

Figure 2 shows histograms for each jurisdiction type of the ratio of general fund net revenue to total revenues. Each jurisdiction type shows a relatively symmetrical distribution around its median. Counties have the smallest dispersion, with most observations between zero and 10% and townships have the widest dispersion, with most observations between zero and 50%, but also a number of outliers with very low and very high margins.[14] Compared to counties and townships, cities (29%) and villages (25%) have a larger portion of observations with negative margins, meaning that expenditures exceeded revenues, which may be a warning sign of fiscal stress.

Figure 2
General fund balance margin by jurisdiction type



General Fund Balance Growth

A similar way to assess the budgetary solvency of a government is to calculate how the surplus/deficit for the year compares to the overall fund balance at the beginning of the year. In other words, this ratio measures how much the general fund balance has grown or declined in the past year. For both FY 2021 and FY 2022, each jurisdiction type shows strong general fund balance growth (see *Table 3* above). In FY 2021 counties and townships had the lowest median growth ratio of 8% with cities having the highest median at 14%. And in FY 2022 villages and townships each increased their median ratio to 12% while the city median growth rate declined to 8%, still quite a strong rate.

Enterprise Fund Margin

Enterprise funds encompass all business-type activities, which typically have fee-for-service type revenue and are designed to be financially self-sustaining. Examples of local government enterprise activities include drinking water systems, sewer/wastewater systems, senior housing, parking, airport, etc. The margin ratio is analogous to a profit margin for the combined enterprise activities of a given government. Again, accumulating profit is not a goal of enterprise funds, but aiming for modest margins allows them to keep fees reasonable while building reserves. For both counties and cities, the median enterprise fund margin exceeds that of the median general fund margin (see *Table 3*, above). Counties have a median enterprise fund margin of 18% while cities have a median enterprise fund margin of 10%. Villages and townships are excluded from these calculations because they are usually smaller and make less use of enterprise funds.

Enterprise Fund Balance Growth

Strong margins mean that enterprise fund balances are growing. As shown in *Table 3* above, counties and cities had median enterprise fund balance growth of 5% and 3% respectively. These growth rates are not as high as the general fund growth rates, but this is likely because enterprise fund balances were stronger to begin with.

Overall Budgetary Solvency

Overall, local government budgetary solvency appears to be strong due in part to underlying economic conditions and pandemic aid. As mentioned earlier, many municipalities are using their pandemic aid funds to support governmental activities, allowing for growth in general fund balances. In addition, although investment in water, sewer, and broadband systems are an approved use of ARPA funds, not all communities have these functions, so ARPA-related support is less likely to show up in enterprise funds. Therefore, the underlying growth and strength of enterprise funds is likely attributable in part to underlying economic conditions.

Key findings:

- While revenues exceed expenditures for most jurisdictions, there are some potential warning signs for cities and villages with negative general fund margins.
- For both FY 2021 and FY 2022, local governments show strong general fund balance growth, across all jurisdiction types.
- Enterprise funds generally show signs of growing revenues and fund balances.

Long-term fiscal solvency indicators show a mixed picture

While cash and budgetary solvency focus on a shorter time horizon, long-term solvency indicators focus on a government's ability to fulfill its obligations several years into the future. Assessing long-term solvency, therefore, usually involves developing measures to scale and compare the burden of balance sheet liabilities, including debt and unfunded pension and other post-employment benefits (OPEB) obligations (e.g. retiree healthcare benefits). Allowing long-term liabilities to grow can exacerbate fiscal stress for governments as it requires them to redirect resources away from current services and toward the fixed costs of debt service and pension/OPEB costs.

When assessing long-term solvency, it is important to remember that debt is not inherently bad. Responsible use of debt instruments can allow governments to invest in infrastructure and assets that will create long-term net benefits for their communities. Therefore, we must assess long-term solvency indicators in the larger context of a government's fiscal health.

While municipal debt is relatively closely regulated by state statute - through, for example, debt limits and required debt management practices - until recently, much less attention has been paid to municipal pension and OPEB liabilities. When governments promise employees pension and retiree healthcare benefits, the estimated monetary value of these benefits becomes a liability for them. In order to offset this liability, governments can "pre-fund" the benefits - set aside and invest funds so that they can be drawn down to pay future benefits.

When pension or OPEB plans are "fully funded", it means that the assets in the plan are expected to be sufficient to cover the estimated future payouts. However, plans can become underfunded for a number of reasons. For example, governments may not pay enough into the plan, invested assets may underperform or lose value in market downturns, or liabilities may grow due to other outside factors such as high rates of healthcare inflation.

Many local governments have run into fiscal challenges in part because they have promised retirees benefits without "pre-funding" them - that is, setting aside funds in advance. As a result, these expected future benefit payouts can become unfunded liabilities for governments. In extreme cases, the heavy burden of unfunded liabilities can facilitate a fiscal crisis. For example, upon entering bankruptcy protection in 2013, about 40% of the City of Detroit's $18 billion in debt was attributable to unfunded pension and OPEB liabilities.[15]

To increase transparency and encourage local governments to address these unfunded liabilities, Michigan Public Act 202 of 2017 required local governments with pension and OPEB plans to report and standardize information about the plans' costs, assumptions, and funded status. The Act also requires plans that are severely underfunded to create a "Corrective Action Plan" to improve their funded status.[16]

In 2022, the State of Michigan took additional action to help local governments with unfunded pension obligations. The FY 2023 budget included $750 million for a Protecting MI Pension Grant Program to help pay down pension debt for local plans that were less than 60% funded.[17] These payments will likely improve the long-term solvency of many struggling municipalities.

Debt to Revenue

Focusing first on ordinary debt, the debt to revenue ratio helps us assess the overall size of a government's debt burden. By dividing debt by revenue, this ratio allows for comparisons of debt burdens across different sizes of municipalities. Generally speaking, debt to revenue ratios below one - meaning that the amount of the municipality's debt is equal to OR less than one year's worth of revenue - are not a cause for concern, but larger ratio values may signal outsized debt burdens.

Table 4 shows the median debt to revenue ratios for each type of jurisdiction. Not surprisingly, cities and villages, which tend to provide more capital-intensive services like drinking water and roads, have higher median ratios - their total debt is around 48 - 56% of annual revenues. Counties on the other hand often provide more labor-intensive services like courts and public health, so they make less use of debt. The median township has no debt at all.

Local government officials say:

In 2023, 15% of local governments said their ability to repay debt had improved compared to the prior fiscal year, while 2% said it had decreased. However, among cities and counties, who received the majority of ARPA funds, 30% reported an improvement in ability to repay debt.[18]

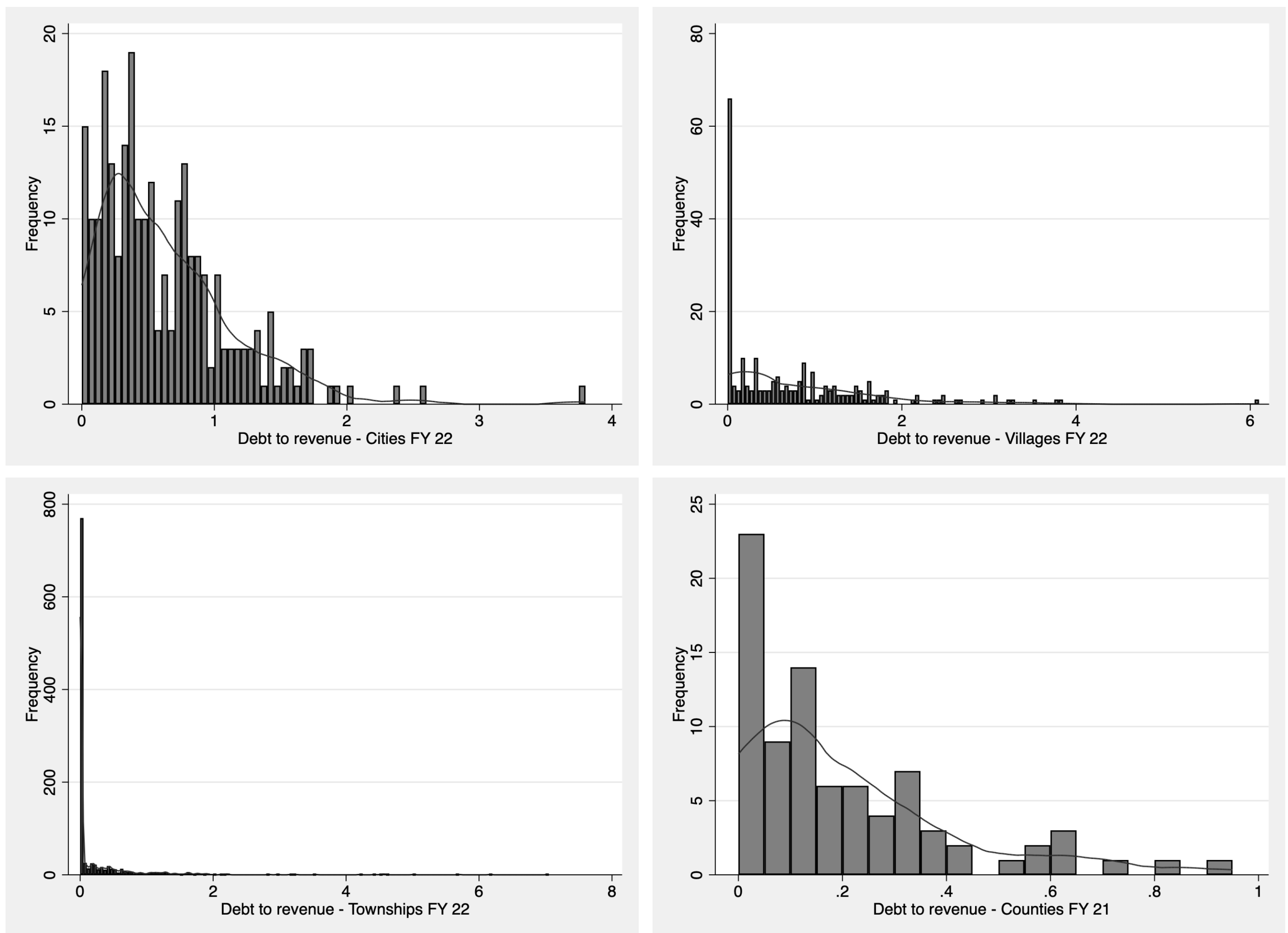
Meanwhile, around 20% of local governments predicted an increase in their amount of debt, while 11-13% predicted a decrease in debt, and 47-52% predicted no change. In 2023, increases in debt were most commonly predicted by cities (39%) and villages (31%) compared to townships (13%) and counties (11%).[19]

Table 4
Long-term solvency indicators (medians), by jurisdiction type and year

	Median debt to revenue		Median debt per capita		Median long-term liabilities to revenue		Median long-term liabilities per capita	
	2021	2022	2021	2022	2021	2022	2021	2022
Counties	0.135	0.095	$196.95	$135.88	0.361	0.289	$692.84	$682.75
Cities	0.489	0.496	$1,137.84	$1,205.43	1.192	0.402	$2,816.07	$2,888.71
Villages	0.564	0.481	$841.37	$823.90	-	-	-	-
Townships	0.000	0.000	$0.00	$0.00	-	-	-	-

Figure 3 shows the entire distribution of debt to revenue ratios for each jurisdiction type. These distributions show that while most municipalities have relatively low ratios near 1.0, each distribution is right-skewed, meaning that there are a small number of outlier jurisdictions (4 cities, 20 townships, and 18 villages) with high debt burdens above 2.0.

Figure 3
Debt to revenue ratios, by jurisdiction type



Debt Per Capita

Instead of dividing by revenue, another way to scale and compare debt burdens is to calculate debt per capita. As shown in *Table 4* (above), median debt per capita is highest for cities at $1,138 to $1,205, followed by villages at $824 to $841. Counties typically carry much less debt per capita, around $136 to $197, while the median township has no debt. There is not necessarily a strict rule of thumb about what is an appropriate amount of debt per capita, but taking on higher than average debt per capita is riskier for communities that have lower than average income or property values per capita.

Long-term Liabilities to Revenue

Turning to a more comprehensive measure of the long-term financial burdens local governments face, we add pension and OPEB liabilities to debt to calculate a ratio of long-term liabilities divided by revenue. Because few villages and townships have pension (67 villages and 18 townships) and OPEB (18 villages and 36 townships) liabilities, these calculations focus on cities and counties (see *Table 4* above). In FY 2021, median city long-term liabilities were 1.19 times the size of annual revenue, considerably higher than the 0.49 ratio that includes only

traditional debt. This means that pension and OPEB liabilities comprise more than half of the overall long-term liability burden for cities. The median ratio of long-term liabilities to revenues for counties was around 0.29 to 0.36, nearly triple the ratio value when only debt is included, implying that for the median county, pension and OPEB liabilities comprise around two-thirds of the overall burden of long-term liabilities.

Long-term Liabilities Per Capita

Using our comprehensive measure of long-term liabilities and scaling by population, we arrive at long-term liabilities per capita. *Table 4* shows median long-term liabilities per capita for cities and counties. The median city had long-term liabilities per capita of $2,816 to $2,889 (compared to $1,138 to $1,205 per capita for debt only), while the median county had long-term liabilities per capita of $683 to $693 (compared to $136 to $197 per capita for debt only).

Pension Funded Ratios

The indicators in *Table 5* take a closer look at pension and OPEB liabilities. First, the table includes funded ratios for only jurisdictions that have these plans. The funded ratio is the ratio of plan assets to plan liabilities. A "fully funded" plan with enough assets to cover expected liabilities will have a funded ratio of 1.0 or 100%. Underfunded plans will have ratios less than 100%, and the government's balance sheet will include a liability for the underfunded amount.

Table 5
Pension and OPEB indicators (medians), by jurisdiction type and year

	General employees pension funded ratio		OPEB funded ratio	
	N	Median	N	Median
2021				
Counties	78	74.50	68	34.20
Cities	218	68.30	182	19.60
Villages	72	76.95	84	37.13
Townships	73	75.75	26	13.79
2022				
Counties	25	73.70	21	8.00
Cities	195	72.22	161	25.00
Villages	67	80.00	18	19.50
Townships	47	79.00	36	24.51

*Note: N = number of jurisdictions reporting having a pension or OPEB plan. Note that as of this data collection, many counties had not yet reported their data for 2022.

Table 5 shows median funded ratios for general employee pension plans, the most common type of pension plan. For counties, villages, and townships, median funded ratios are in the mid-70% range, although a much higher share of counties report having pension plans. For cities, the median funded ratio is slightly lower, about 68 to 72%. Looking ahead to FY 2023 and FY 2024, however, the median (or at least the average) funded ratio should rise as the Protecting MI Pension Grant Program payments are disbursed to municipalities with plans with funded ratios of less than 60%.

OPEB Funded Ratios

Table 5 also shows median OPEB plan funded ratios for jurisdictions that have these plans. In general, compared to pension plans, OPEB plans are less common and less likely to be pre-funded. In fact, it is not uncommon for OPEB plans to have 0% funded ratios, meaning that the jurisdiction follows a "pay-as-you-go" policy, funding the current year's obligations one year at a time instead of pre-funding benefits. In FY 2021, median OPEB funded ratios are higher for counties and villages - in the mid 30% range - and lower for cities and townships - in the teens-range. Because OPEB plans have such low funded ratios, paying OPEB obligations can be a heavy burden on local governments. However, compared to pension plans that have constitutional protections, it is easier for jurisdictions to trim OPEB benefits in the event of fiscal trouble.

Local government officials say:

In spring 2022 and 2023, about one third (32%) of local governments said that the cost of employee pensions was increasing, one of the highest percentages since tracking began in 2009.[20] However, in 2022, just 11% said they planned to increase employees' share of contributions to retirement funds.[21] Meanwhile, about one in five jurisdictions said the cost of OPEB is increasing in 2022 and 2023.[22]

Overall Long-term Solvency

Compared to the more sanguine assessments of cash and budgetary solvency, the picture of long-term solvency for Michigan local governments is mixed. While many jurisdictions have been successful in keeping long-term liabilities low, the data suggest there are a small number of outliers with very heavy burdens, especially related to pension and OPEB plans. Moreover, local governments cannot use their ARPA funds to pay down unfunded pension liabilities.

Looking to the future, it will be very important to monitor local governments with large liability burdens and encourage policies that stabilize and grow their tax bases so that their revenues can at least keep up with their fixed costs.

Key findings:

- While most municipalities are within the desired range, a small number of outlier jurisdictions have high debt burdens, potentially a cause for concern.
- Cities carry the highest median debt per capita, while the median township has no debt.
- Pension and OPEB obligations make up more than half of long-term liability burden for cities, and around two-thirds for counties.
- Pension funded ratios are typically around the mid-70% range, slightly lower for cities, and state support should provide much needed help for jurisdictions with very low funded ratios.

Local governments show wide variation in capacity to deliver services

In the long-term, the fiscal health and sustainability of a government depends not only on whether it can fulfill its formal financial obligations but whether it can also deliver high-quality public services to residents that depend on them. After all, governments incur debts and promise employees benefits precisely so that they can provide services.

Data from financial statements, however, are more focused on financial accountability and control rather than assessing service level and quality, which makes it difficult to measure and assess service solvency. The indicators discussed below provide important clues about services, but there may be greater ambiguity about how to interpret the meaning of the data and we may need to make additional assumptions. For example, a community with high expenditures per capita may be responding to a high community demand for services - suggesting strong service solvency - or high expenditures may be a sign that communities have high fixed costs associated with infrastructure or debt - a potential source of fiscal stress.

It's also important to understand the possible relationship between long-term and service solvency. For fiscally healthy governments, there is little interaction between the two because there are enough resources to meet long-term financial obligations as well as provide quality services. For stressed governments, however, tensions can arise as to whether scarce resources are allocated toward providing current services or paying down long-term liabilities.

Local government officials say:

In 2023, 24% of local officials projected an increase in the amount of services provided in the coming fiscal year, the highest percentage projecting an increase since the MPPS began in 2009. However, these service increases are mostly expected to be modest, with just 2% predicting they will significantly increase the amount of services they provide. Counties were most likely to predict an increase (30%), compared to cities (27%), townships (24%) and villages (22%).[24] Increases in service provision were also more frequently projected in jurisdictions with larger populations.

Expenditures per capita

To gain insight into how well a government entity is balancing its service-related spending to its residents, we can examine the expenditures per capita ratio to see how much is being spent on services per resident in a jurisdiction. In general, we expect higher spending for cities that often have diverse and complex service needs and are more densely populated. Villages and townships, on the other hand, typically have smaller populations and fewer service needs. *Table 6* shows median expenditures per capita, broken down by both jurisdiction type and population size. Consistent with expectations, cities spend the most, a little over $1,200 per capita at the median, about four times the amount the median township spends, with villages and counties in between.

Table 6
Service Solvency Indicators (medians), by jurisdiction type, population category, and year

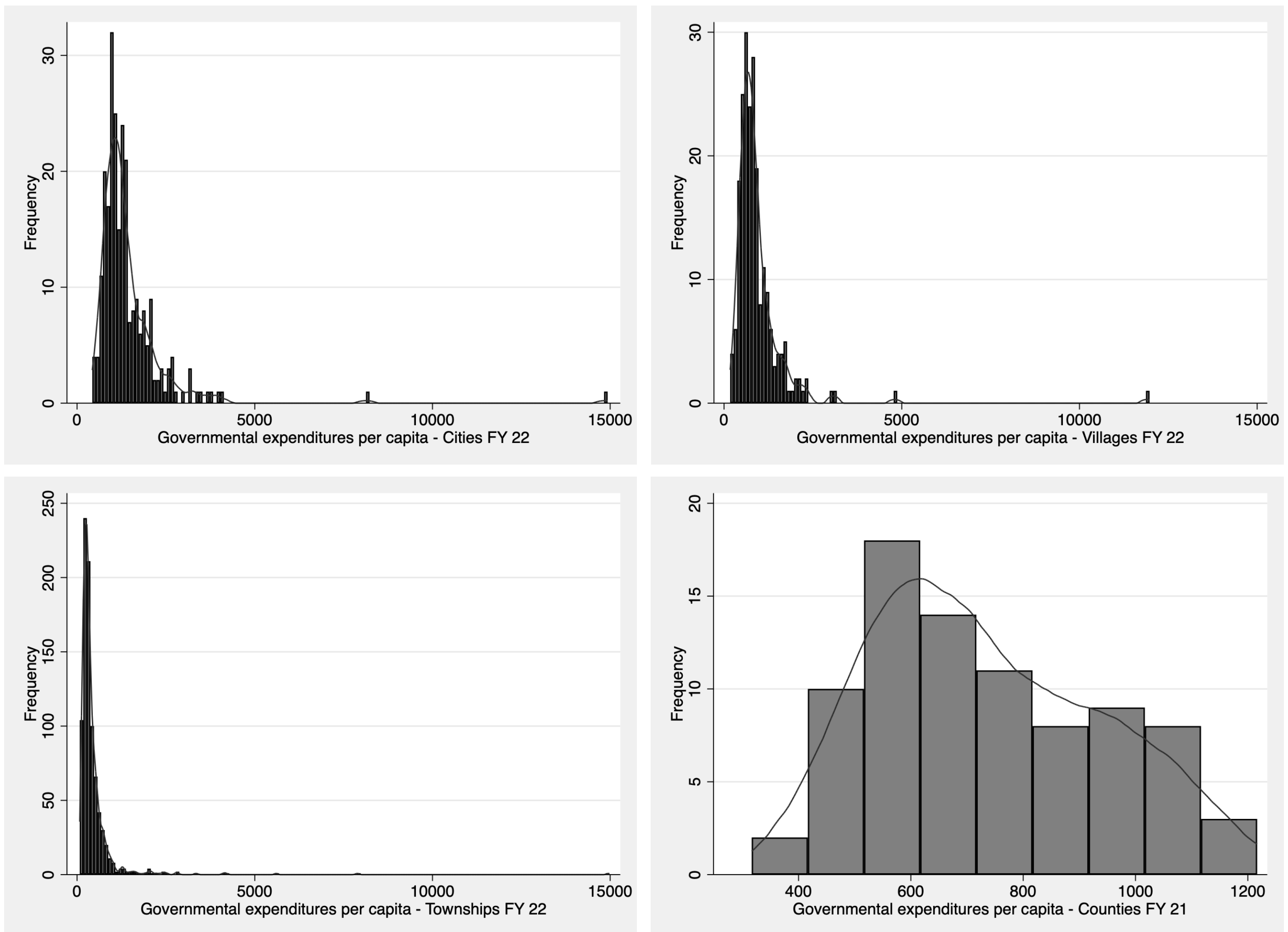
	Median governmental expenditures per capita		Median governmental assets per capita		Median public safety share of general fund spending	
	2021	2022	2021	2022	2021	2022
Counties	$708.75	$702.85	$323.21	$285.58	0.319	0.289
Cities	$1,207.15	$1,212.19	$1,581.90	$1,651.24	0.420	0.402
Villages	$698.37	$776.17	$1,090.48	$1,158.21	-	-
Townships	$307.70	$310.11	$180.46	$183.92	-	-

	Median governmental expenditures per capita				
Population	< 1,500	1,500 - 5,000	5,001 - 10,000	10,001 - 30,000	> 30,000
Counties FY 21	-	$1,082.30	$864.92	$776.71	$623.71
Cities FY 22	$1,062.03	$1,060.29	$1,293.28	$1,269.39	$1,374.66
Villages FY 22	$733.83	$850.99	$925.96	$1,212.39	-
Townships FY 22	$360.86	$282.57	$306.83	$368.99	$578.73

	Median public safety share of general fund spending				
Population	< 1,500	1,500 - 5,000	5,001 - 10,000	10,001 - 30,000	> 30,000
Cities FY 2022	0.143	0.368	0.418	0.470	0.555

Figure 4 provides further detail on the full distribution of expenditures per capita for each jurisdiction type. Each of these figures follow a right-skewed pattern, suggesting that there are a number of outliers with very large expenditures per capita. We can investigate this further by examining how per capita spending breaks down by population size. For cities, villages, and townships there is a general positive correlation that shows that as population increases, municipalities spend more per capita. In other words, jurisdictions with larger populations usually provide more public services (e.g. public safety, economic development, road repair, etc.) and therefore spend more - even on a per capita basis - compared with small communities. However, for counties the correlation is negative, showing that they tend to spend less per capita as population increases. This may be because many services counties provide, such as courts and election administration, have a large amount of fixed costs the county needs to incur regardless of the size of its population.

Figure 4
Expenditures per capita, by jurisdiction type



Governmental assets per capita

While expenditures per capita provides insight into the current level of spending, to gain insight into the wealth and long-term service capacity of an entity we use the governmental assets per capita ratio. Local government assets primarily consist of roads and other infrastructure, but they can also include buildings, land, vehicles, or other equipment governments use to deliver services (Note: this ratio does not include assets in enterprise funds, such as water or sewer infrastructure).

As shown in *Table 6*, in FY 2022 cities and villages have the highest median governmental assets per capita at $1,651 and $1,158 respectively, with counties and townships being significantly lower at $286 and $184 respectively. The higher amount of assets - as well as the greater use of debt described above - in cities and villages largely reflects the more capital-intensive nature of the services they deliver.

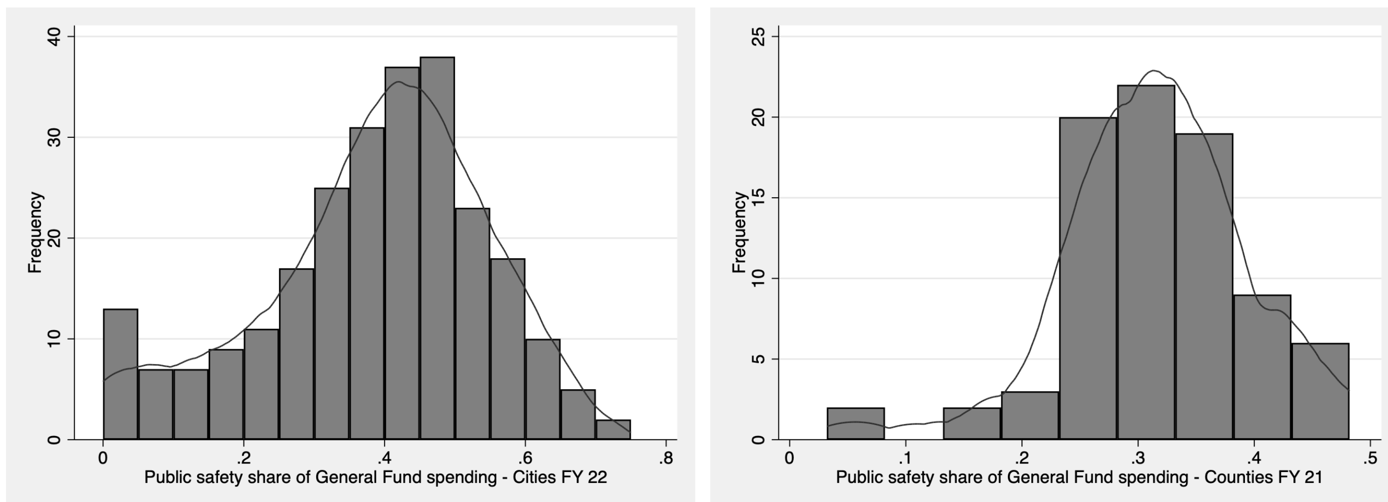
Public Safety as a Share of Spending

Municipalities often display their financial priorities through how they allocate their funds. With a responsibility to ensure the safety and well-being of their residents, public safety services are often the single largest spending

category for general fund budgets. *Table 6* shows that public safety spending as a share of total general fund spending is about 40 - 42% for the median city and 29 - 32% for the median county. Villages and townships were excluded from this calculation as most of them do not have substantial public safety spending

Figure 5 provides a more detailed illustration of the range of public safety spending for cities and counties. Most counties are within 10 percentage points of the median 30%, suggesting that counties are relatively uniform in the level of public safety services they provide.

Figure 5
Public safety spending as a share of total general fund spending, by jurisdiction type



For cities, however, the range is quite wide. Some spend as much as 70 to 80% of their general fund budgets on public safety while others spend less than 10%. This degree of variance could stem from differing community needs, preferences, or resource constraints. *Table 6* provides a further breakdown of how city public safety spending varies with population, and shows that as population increases, so does the share of the general fund spent on public safety. The smallest cities that have a population of less than 1,500 spend a median of 14% of their general fund on public safety while cities that have a population of more than 30,000 spend a median of 56%.

Reliance on Property Taxes

An important aspect of service solvency is understanding where a local government's resources come from and what constraints it faces in ensuring that resources are adequate to ensure its ability to provide high-quality services. For most local governments, property taxes are the single largest source of general revenue. While property tax revenue tends to be reliable and consistent from year to year, there are many restrictions on property tax revenues[26] and they often fail to keep pace with increasing cost pressures. As a result, local officials often have little ability to change their property tax policies in response to local needs and over-reliance on property tax revenue puts local governments at risk of fiscal stress.

Table 7
Service Solvency Indicators - Revenue (medians), by jurisdiction type and year

	Median property tax share of general fund revenue		Median revenue sharing as a share of general fund revenue		Median charges as a share of general fund revenue	
	2021	2022	2021	2022	2021	2022
Counties	0.584	0.580	0.055	0.052	0.113	0.108
Cities	0.504	0.520	0.155	0.166	0.075	0.078
Villages	0.450	0.427	0.220	0.236	0.039	0.053
Townships	0.323	0.296	0.438	0.460	0.026	0.026

Table 7 shows median property taxes as a percentage of general fund revenue for each jurisdiction type, and *Figure* 6 shows the full distributions. Compared to other jurisdiction types, counties are typically most reliant on property taxes. For the median county, about 58% of general fund revenue comes from property taxes, with most counties in the 40 to 70% range.

Cities have the next highest reliance on property taxes at a median of 50 to 52%, with villages slightly lower at 43 to 45%. Both cities and villages have wide ranges of dependence on property taxes, with some jurisdictions near 80% and others at 20% or lower. For townships, while the median reliance on property taxes is for about 30% of general fund revenue, the distribution is notably right-skewed, with 12% of townships reliant on property taxes for majorities of their general fund revenues.

Reliance on Revenue Sharing

The next most important source of revenue for Michigan local governments is state revenue sharing, in which a portion of state sales tax collections are redistributed back to local governments largely on a per capita basis as unrestricted aid.[27] All else being equal, more unrestricted revenue can help support services, but local governments should not be too dependent on state aid because they have no control over the payments. Not only are revenue sharing payments subject to volatile sales tax collections, but for cities, villages, and townships they are also dependent on legislative discretion to make annual statutory appropriations. Since 2002, annual State appropriations have fallen short of "full funding", resulting in the loss of an estimated $8.6 billion for cities, villages, and townships.[28]

Table 7 shows median revenue sharing as a percentage of general fund revenues for each jurisdiction type. At the median, townships are most reliant on revenue sharing, accounting for about 46% of general fund revenues, while counties are the least reliant at only about 5%. For the median city, about 15 to 16% of general fund revenues come from revenue sharing, and for the median village, it is slightly higher at 22 to 23%.

Local government officials say:

Many of Michigan's largest local governments say they are spending ARPA funds on public safety. As of Spring 2023, jurisdictions with the largest populations were significantly more likely to report spending some of their ARPA funding on public safety projects compared to those from smaller communities.[25] For example, officials from 46% of jurisdictions with more than 30,000 residents, as well as 42% of those with 10,001-30,000 residents reported spending some of their ARPA funding on public safety projects. In contrast, only 18% of jurisdictions with populations less than 1,500 planned to spend ARPA funds on public safety.

Figure 6
Property tax revenue as a percentage of general fund revenue, by jurisdiction type

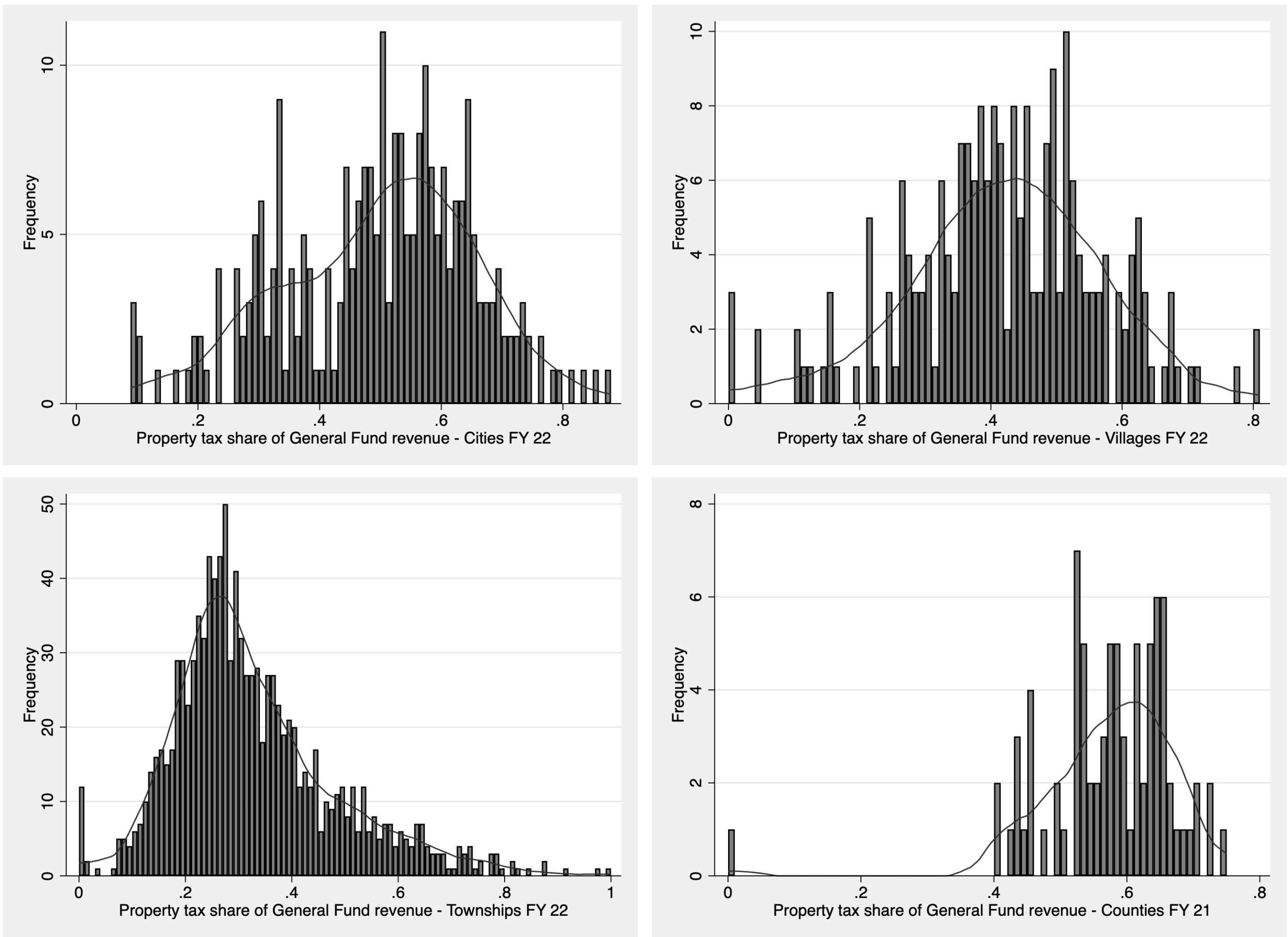
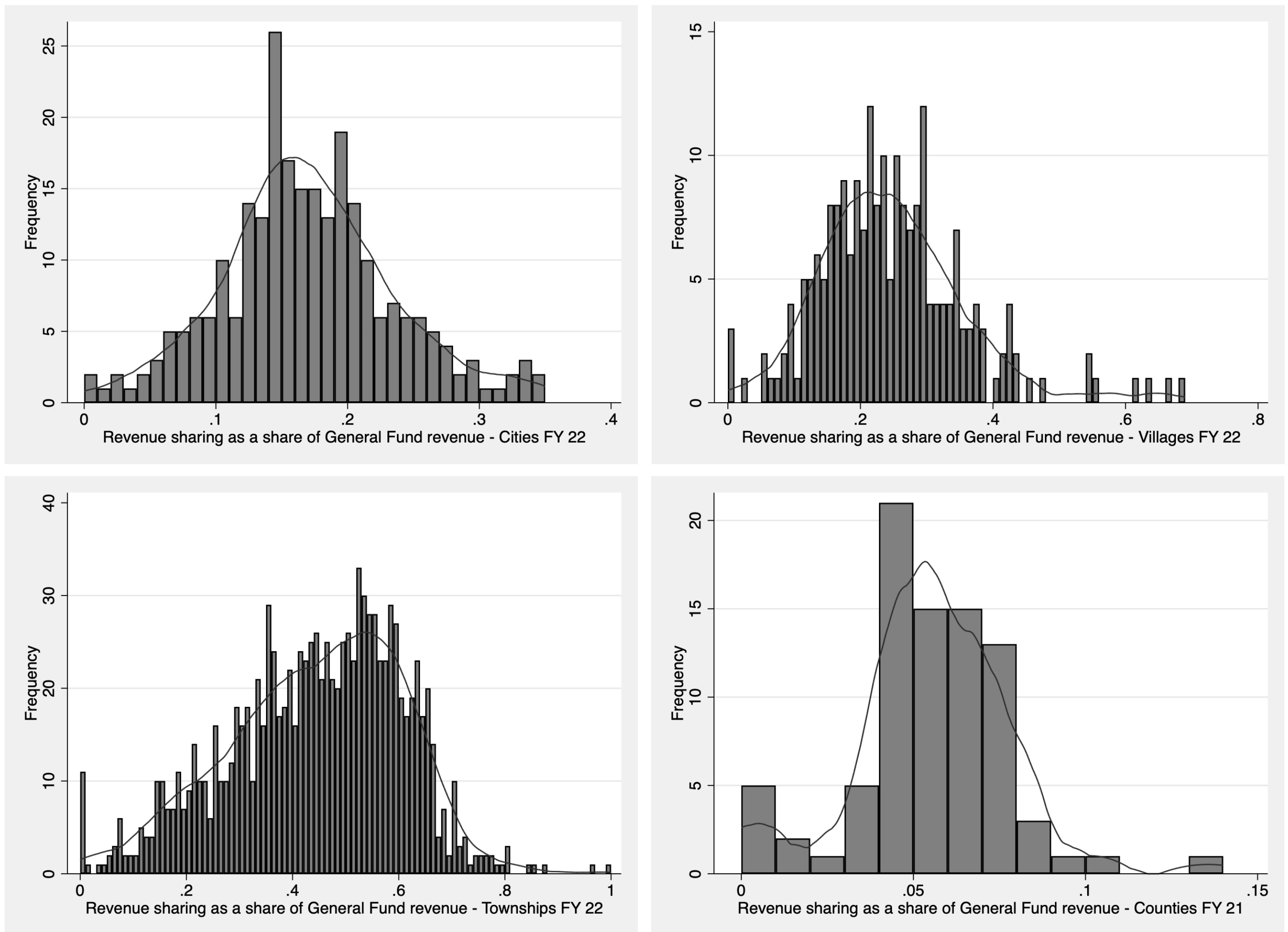


Figure 7 gives more detail on the wide variability in how much different jurisdictions depend on revenue sharing. The distribution for townships is left-skewed, meaning that while there are many townships with low to medium reliance on revenue sharing, almost 8% (representing 83 townships) exceed 65%. The distributions for cities and villages are similar, with most jurisdictions in the zero to 40% range, but a handful of villages are highly reliant on revenue sharing. Reliance on revenue sharing is quite low for all counties.

Figure 7
Revenue sharing as a percentage of general fund revenues, by jurisdiction type

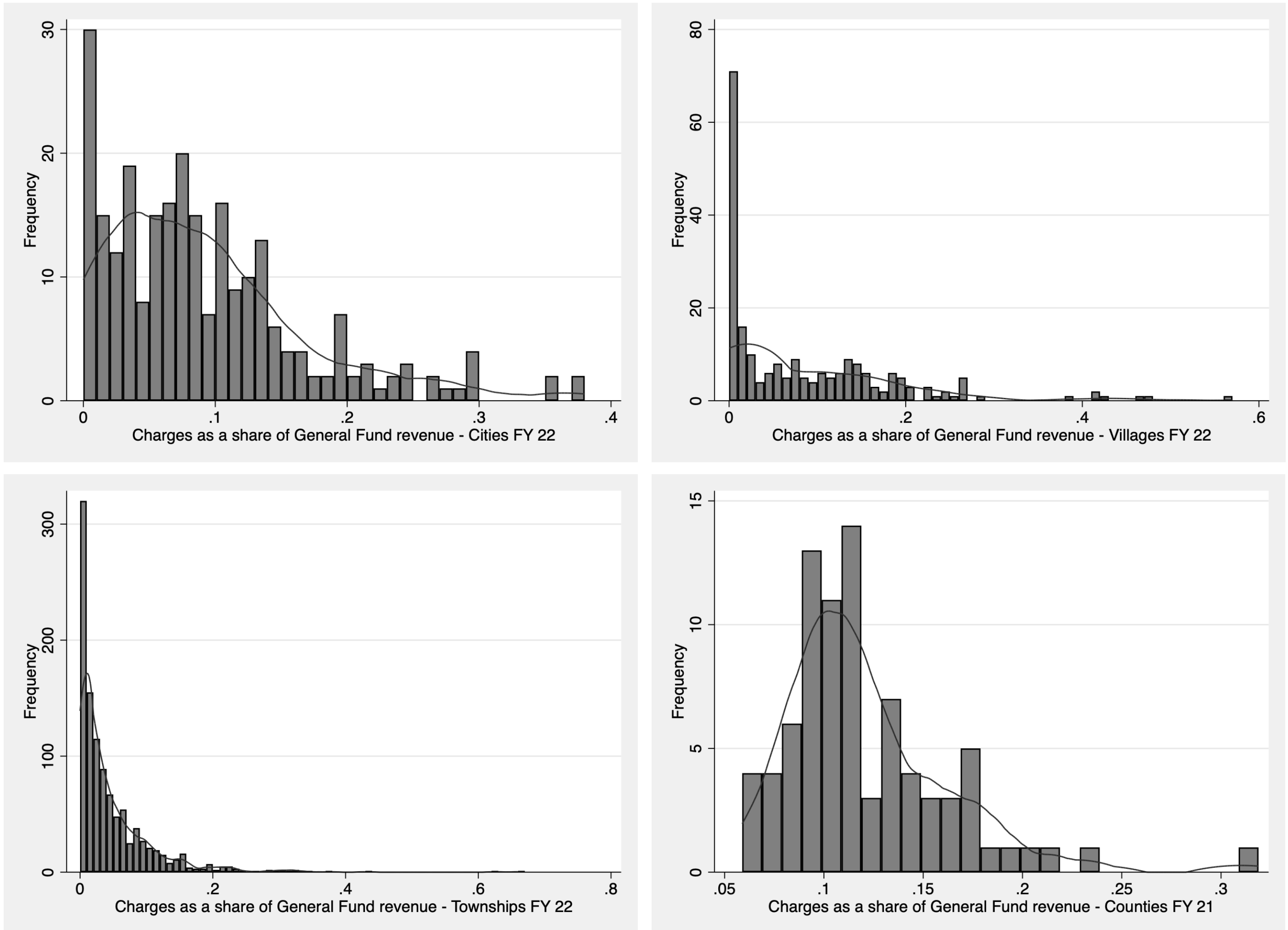


Reliance on Charges

Governments often charge fees for specific types of services like permits, parks, and courts. According to the *Bolt* decision, fees must be voluntary, proportionate to the cost of providing services, and serve a regulatory rather than revenue-raising purpose.[29] While fees can be an important revenue source for local governments, high reliance on fees might suggest that jurisdictions are struggling to raise enough from general revenue sources (e.g. property taxes), looking to fees as an alternative. In addition, reliance on fees can present equity concerns because fees tend to be regressive, falling more heavily on lower-income residents and requiring careful consideration to ensure vulnerable populations are not given an unfair burden.

General fund reliance on charges by jurisdiction type is shown in *Table* 7. Counties have the highest reliance on charges and fees at 10 to 11% at the median. Counties' higher reliance on fees is likely attributable to the types of services they provide. Clerks, courts, and medical services, for example, usually operate on a fee-based structure. Other jurisdiction types typically rely on fees for less than 10% of revenues, with the median city at 7.5 - 7.8%, the median village at 3.9 - 5.3%, and the median township at about 2.6%.

Figure 8
Revenue from charges and fees as a percentage of total revenues, by jurisdiction type



While reliance on charges and fees is reassuringly low for most local governments, a closer look at the distribution of values for this ratio shows that there are some outlier jurisdictions - particularly among cities (25) and villages (29) - that rely on charges and fees for more than a quarter of their general fund revenues (see *Figure 8*). Further investigation may be warranted to determine whether these jurisdictions are overly reliant on charges and fees.

Overall Service Solvency

While it is difficult to tell from financial data how well Michigan local governments are able to meet the service needs of their communities, it is clear that there is a lot of variation in both how much jurisdictions are spending and how they are relying on resources to support that spending. Rather than relying on specified benchmarks, it may be more useful for local governments to use these service solvency indicators to compare themselves to their peers. For example, a community that emphasizes the importance of public safety spending may want to check that it is above the median in public safety spending as a share of the general fund.

It is also important to interpret indicators of service solvency in the context of other indicators of fiscal health. In the absence of other signs of fiscal stress, high expenditures per capita may be a signal of a healthy community successfully meeting a high-level of service demand. However, if a local government is experiencing fiscal stress, high expenditures per capita (especially if coupled with high reliance on fines/fees) may be a signal that the local government is on an unsustainable path.

Local government officials say:

In both 2022 and 2023, almost one third of Michigan local governments reported plans to increase charges for fees and licenses. This expectation was most common in cities, where 52% projected an increase in FY 2024 compared to FY 2023, although very few (2%) projected a significant increase in charges and fees.[30]

Key findings:

- Cities - especially larger cities - have the highest service-related expenditures per capita.
- Larger cities are spending a larger portion of their budgets on public safety.
- Most counties and cities rely on property taxes for at least half of their revenues.
- State revenue sharing makes up almost half of township revenues, raising concerns about over-reliance on a sometimes volatile source of funding.

Conclusion

Overall, financial indicators show a mixed picture of the fiscal health of Michigan's local governments. Measures of cash and budgetary solvency are currently healthy for most jurisdictions. However, this is an area where ARPA funding was particularly beneficial and it is unclear whether federal aid will have lasting benefits for local government fiscal health. It will be important to monitor these indicators as pandemic aid is spent down and leaders hope for continued low inflation and favorable economic conditions.

Meanwhile, the long-term situation is more mixed. Local governments do not generally have much flexibility to respond to changing circumstances, and many are still struggling from the Great Recession and other past challenges. Pension and OPEB obligations continue to be a challenge for many local governments, and the size of these burdens is partially affected by factors outside local governments' control. Policymakers should pay careful attention to the fixed costs of debt service and pension and OPEB expenses to ensure that they do not overwhelm local government budgets and crowd out their ability to provide services to residents.

Reliance on heavily-constrained revenue sources like property taxes and state revenue sharing leave local leaders with little autonomy to adjust their revenue policies in accordance with resident service demands or community goals. Therefore, differences between local jurisdictions' ability to provide services will continue to be driven mainly by underlying trends in population (for revenue sharing) and tax base growth (for property taxes), which local officials have only marginal ability to influence.

Overall, it appears that the recent federal aid and better-than-expected economic resilience have successfully supported the cash and budgetary solvency of most Michigan local governments. Looking forward, however, there is a significant amount of uncertainty, and many local leaders have expressed apprehension about declining fiscal health. Efforts at ongoing monitoring and proactive assistance to local governments will be essential to ensure that Michigan residents can continue to rely on local services.

Local government officials say:

On the Michigan Public Policy Survey, local officials are consistently more likely to predict higher levels of fiscal stress five years down the road, compared to during the current fiscal year, and this trend has worsened over the last two years. Despite short term boosts to fiscal health from ARPA, only half of jurisdictions statewide (52%) expect low fiscal stress in 2028, while 38% expect medium (25%) or high (13%) stress, a record high.[23]

Acknowledgements

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