COVID-19 LOCAL FISCAL STRATEGIES GUIDE

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Capital Assets & Projects

Capital Spending During an Economic Crisis

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Key Points

- Be strategic in reducing capital spending
- Prioritize reductions that free up cash immediately.
- A detailed Capital Improvements Program is vital to informing crisis decision-making.

As local governments look for ways to reduce spending and plan for a current or impending financial crisis, some may look to their Capital Improvements Program (MCL 125.3865 of PAA 33 of 2008, as amended) as one area to reduce spending in the short term. The focus in a crisis is on funding essential services and capital spending may be seen as something that can be put off until later. Certainly, reducing capital spending is an option, and as capital assets are often expensive, even a slight reduction in spending could result in savings that will go a long way to helping fund essential services.

Capital Improvements Program is Essential to Supporting Informed Decision-Making

While some may be tempted to ignore capital spending in a crisis, the annual Capital Improvements Program (CIP) process is hugely important to informing crisis decision-making. If fewer funds are available for capital purchases or improvements, or if spending must be delayed, it is even more vital to have consistent criteria and a thorough inventory of capital needs on which to base decisions.

- For a comprehensive CIP checklist, see Adopting and Updating a Capital Improvement Program
- For more information about capital planning in Michigan, see Capital Improvements: What's in your plan?

General Considerations for Spending Reductions

If local units are looking at reducing capital spending to save money and balance their budgets, spending reductions in general should have three qualities (Kavanagh and Casey 2020, pg. 2):

- **Short time-to-benefit:** Prioritize reductions that free up cash immediately or in the very short term.
- **Not complex:** It should be easy to understand the short-term savings, and long-term impacts.
- **Reversible**: It can be undone with reasonable effort. For capital expenses, this may mean postponing a capital asset purchase. If the financial crisis is not as bad as expected, or a recovery happens more quickly and planned funds remain available, the purchase can easily be made later.

Questions to Guide Capital Spending Decisions

Strategy to Reduce Capital Spending	Important Considerations
Postpone capital project or purchase	• How long can it be delayed? o Avoid delays that force relying on obsolete or unsafe assets • Will there be increased long-term costs associated with this delay? • Avoid postponing purchases vital to the ongoing provision of essential services • If possible, avoid deferring projects or purchases that reduce long-term costs
Reduce the scope of capital projects	• If a capital project cannot be delayed, look for non-essential features that can be trimmed • Be careful not to reduce the scope so much that the asset doesn't meet minimum needs
Examine Financing Options	• Are there financing options available that would allow deferring costs of important capital investments? • Will voters support a debt or capital millage at this time? o For planned millage proposals, re-examine whether it should still be pursued given economic conditions.

GFOA Recommendations

Additionally, the Government Finance Officers Association (GFOA) recommends the following primary steps related to capital expenses, as well as specific cautions to ensure long-term fiscal health is not compromised:

- **Improve Capital Project Management**: Aggressive monitoring of delayed and soon-to-be-canceled projects may free up funds for other uses.
- **Comprehensive Capital Project Planning**: If a CIP is not already in place, make sure to have a detailed understanding of upcoming capital projects, including operating and maintenance costs, to inform decisions related to these expenses.
- If using debt to fund a capital expenditure, pair it with a policy that limits the life of the debt to the life of the asset.
- Be careful not to defer or cancel capital projects or replacement that are crucial for community viability or that increase costs in the medium or long-term.
- If debt is considered to fund existing pay-as-you-go projects, make sure a debt policy is in place to keep debt within responsible limits.

TREATMENTS FOR CAPITAL AND DEBT
Primary Treatments: • Improve Capital Project Management • Start Comprehensive Capital Project Planning • Refinance Debt for Lower Interest Rate
Treatments to Use with Caution: • Use Short-Term Debt to Pay for Vehicles • Defer and/or Cancel Capital Projects, Maintenance, and/or Replacement • Use Debt to Fund Pay-Go Capital Projects • Restructure Debt
Treatments Not Advised: • Shift Operational Costs Into Capital Budgets

Strategic Capital Improvements Planning in an Economic Crisis

- Identify capital projects that may qualify for Federal or State infrastructure grants, such as the American Recovery and Reinvestment Act (ARRA) during the 2009 Great Recession. Further information on the ARRA is described in a companion paper here. These grants are often used as an economic stimulus, and they typically prioritize projects that are "shovel ready."
- Identify cash that may be available to match grant funds that might become available. Applicants that have available matching funds often score higher than those with little or no matching funds.
- Re-evaluate financing options for all capital projects to be sure you are getting the best deal. Rates and programs are changing during this crisis, which means alternative funding options may be more appropriate.
- Refinance existing debt while rates are low to reduce debt service obligations for future years
- Re-evaluate capital projects in light of expected changes in community priorities. Moving ahead with some projects, like a new carport for City Hall, may cause the public to question local leadership's ability to meet community needs in a time of financial crisis.
- Consider combining several smaller projects that had been planned for cash financing into a single capital debt issue. Focus on preserving cash.
- Evaluate the option of debt-financing some projects that might typically be funded with pay-as-you-go resources, like street improvements, which may otherwise need to be cancelled if Act 51 funding declines significantly.
- For existing revenue bonds, such as for water and sewer systems, consider how supporting revenues are being impacted by the current crisis. When considering future revenue bonds, be sure to consider the resiliency of the underlying revenue source to future economic shocks.
- In the current crisis when few professional and construction firms have been working for weeks, keep in mind that there will be a pent-up demand for engineers, construction crews, equipment and supplies needed for many projects. This will drive costs higher. Deferring less critical projects to the future may result in lower costs.

Sources and Additional Information

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This memo is part of a series of memos in the Local Government COVID-19 Fiscal Strategy and Resource Guide, available at closup.umich.edu/COVID-19. CLOSUP has partnered with public finance experts from universities, consulting firms, and research institutions from around the state to provide local governments up-to-date information as well as a set of ideas and tools that will help them strategically navigate the new fiscal landscape.

Have additional questions or issues you think we should address?

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Federal Aid

What Does the CARES Act Mean for Local Governments in Michigan?

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Key Points

- The CARES Act "Coronavirus Relief Fund" provides $150 billion worth of monetary aid to state, local, and tribal governments to fight COVID-19
- The State of Michigan will receive ~$4 billion, with a 20% share going directly to the 5 local governments with populations over 500,000—City of Detroit and Counties of Macomb, Kent, Wayne, and Oakland
- Funds can only be used for eligible expenses, and use of funds for ineligible purposes turns into a debt owed to the federal government. By meticulously documenting expenditures, local governments will be better able to demonstrate why an expense is CARES Act relief fund eligible.
- Congress passed new COVID-19 relief funding legislation on April 24, without including more local and state government funding. For more information regarding federal relief aid as well as updates on if and when more is coming, try contacting your local representatives and senators. Other good resources include the Michigan Department of Treasury and the Michigan State Budget Office.

On March 27, 2020, the United State Congress passed the Coronavirus Aid, Relief, and Economic Security (CARES) Act to address the economic fallout caused by the pandemic that has swept across the nation and the world.

Title V of the CARES Act is called "Coronavirus Relief Funds" and provides monetary relief for states, territories, and tribal governments to help fight the COVID-19 pandemic. The Act provides $150 billion to these government entities to use for monies spent in responding to the current public health crisis dealing with COVID-19. These funds were made available in anticipation of the financial stress and decline this pandemic has caused and will continue to cause.

Not all states will receive an equal share of the $150 billion. The funds will be allocated based on population proportions. Every state will get a minimum amount of $1.25 billion, even if that state has a small population. Further, local governments with populations over 500,000 are also eligible for aid allocated by population. That said, this aid is not in addition to whatever other CARES relief funds their state, as a whole, receives; instead, any relief funds directly granted to local governments with populations over 500,000 is subtracted from the amount that state was going to receive.

Funding for Michigan and its Local Governments

Michigan will receive $3.873 billion, with an estimated $3.081 billion share going to the state and an estimated $792 million share going to local governments with over 500,000 people. There are 5 local governments in Michigan (the City of Detroit and Counties of Macomb, Kent, Wayne, and Oakland) that qualify to directly receive relief funds; the $792 million going to those local governments makes up about 20% of the total Coronavirus Relief Funds allocated to Michigan.

The Act states that "[n]ot later than 30 days after the date of enactment of this section, the Secretary shall pay each State and Tribal government, and each local government [with population of 500,000 and over]… the amount determined for the state, tribal government, or unit of local government, for fiscal year 2020 under subsection c." While Title V provides detailed instructions on how the federal government must allocate the relief funds to States, the CARES Act does not discuss how (or if, for that matter) States should allocate those funds to local governments. For the current fiscal year, the Michigan Department of Treasury anticipate the state will lose between $1 and $3 billion in revenue; for fiscal year 2021, the State stands to lose a similar amount. The State will need to decide how it wishes to allocate the estimated $3.081 billion to Michigan local governments as well as how much it intends to keep for its own COVID-19 expenses.

Eligible Expenses

These relief funds cannot be used indiscriminately; they can only be used for certain, "eligible," expenses. These expenses:

1) Must be necessary expenditures incurred during the coronavirus pandemic;
2) Must not be accounted for in state or local government's most recent approved budget; and
3) Must have been incurred between March 1, 2020 and December 30, 2020.

The U.S. Department of Treasury's Inspector General is responsible for determining whether relief funds are used for eligible expenses.[1] Michigan governments should keep this important caveat in mind—"fund payments that are deemed for ineligible purposes are treated as a debt owed by the implementing government to Treasury." If the funds are spent for ineligible expenses, a government could find itself in an even worse fiscal situation than the one it started in. It is critical that governments remain vigilant and ensure relief funds are used for eligible expenses only, when all three requirements are met.

A month after the CARES Act was signed into law, U.S. Treasury issued guidance for governments regarding the eligibility requirements of the Coronavirus Relief Fund and the permissible uses of Fund payments.[2] It also provides a non-exhaustive list of eligible and ineligible expense examples. Examples of eligible expenses include COVID-19 testing, expenses to facilitate distance learning[3], as well as "payroll expenses for public safety, public health, health care, human services, and similar employees whose services are substantially dedicated to mitigating or responding to the COVID-19 public health emergency." Some ineligible expenses include the State share of Medicaid, damages covered by insurance, and workforce bonuses other than hazard pay or overtime.

On June 24th, U.S. Treasury released additional guidance on governments are permitted to use Coronavirus Relief Fund money. This document goes into more detail regarding the process to secure the relief funds as well as detailing how the funds may be used. Importantly, Treasury clarifies that governments may presume that any

[1] A state receiving a payment from the federal government may transfer funds to its local governments provided that the transfer qualifies as a necessary expenditure incurred due to the public health emergency and meets the other eligibility requirements under the Act. "Such funds would be subject to recoupment by the Treasury Inspector General if they have not been used in a manner consistent with the Act."

[2] Additional details on how U.S. Treasury interprets the eligibility requirements set forth in the CARES Act *available at* https://home.treasury.gov/system/files/136/Coronavirus-Relief-Fund-Guidance-for-State-Territorial-Local-and-Tribal-Governments.pdf

[3] This includes technological improvements in connection with school closes to enable compliance with COVID-19 precautions.

payroll costs for public safety and public health employees are allowable expenditures under the relief fund program as a matter of administrative convenience.[4] Further, relief fund monies can be used as non-federal match for the Federal Emergency Management Agency's (FEMA) Public Assistance program cost-sharing requirements. Otherwise, this FEMA program requires local governments to provide a 25% cost-share to support eligible COVID-19 related activities.

Budget Strategies Using CARES Funds

While CARES funds may only be used for unbudgeted expenditures, relief funds can be used to indirectly help shore up revenue shortfalls in cases where expenditures paid for by the CARES relief fund would otherwise increase the gap between government expenditures and revenues. For example, let's say that as a result of COVID-19 City of XYZ's revenues are $700 million lower than expected and XYZ has $500 million in new COVID-19 related expenses, creating a $1.2 billion fiscal gap. Then the City receives $300 million in Coronavirus Relief Fund assistance. The $300 million will reduce the fiscal gap (from $1.2 billion to $900 million). If the city does not have any COVID-19 related expenses, then this cannot happen, even if the government has decreased revenues. The municipality must have COVID-19 related expenses for the above example to occur. The purpose of these funds is not to offset revenue shortfalls. Instead the idea is to provide funding for these unexpected emergency and public health related expenses.

The more funds spent on COVID-19 expenses, the less there is to provide essential services and make statutorily required debt payments, such as pension liability payments. Governments will be able to utilize the relief funds for COVID-19 expenses, leaving other resources available to be put toward everyday expenses and services.

In Michigan, this is especially important. Due in large part to the passage of both the Headlee Amendment and Proposal A, local governments are severely hampered in their ability to generate revenue. Even in normal times, locals only have so many viable revenue-raising tools in their toolboxes. Now, during this pandemic, tax and other revenue sources will be down. The Coronavirus Relief Fund is another tool for these governments to utilize in their efforts to serve their communities during this time of crisis.

While the CARES Act provided a significant amount of relief to state and local governments, it will not be enough. The State of Michigan and the Governor are speaking and working with the federal government, in order to emphasize the need for additional and direct local government relief aid as well as increased flexibility in how the funds can be used. On April 24, 2020, President Trump signed legislation that sends much needed relief to small businesses and hospitals and provides additional funding for COVID-19 testing. This bill does not provide additional funding for local and state governments. Even so, various politicians, including Speaker Nancy Pelosi, have spoken about the next CARES Act (CARES 2) and the necessity of adding additional local and state relief funding to such an Act. Media reports have also indicated that CARES 2 is in the works as well as the idea that one of its focuses will be sorely needed additional state and local government relief.

Latest update from the Michigan Treasury

On July 8th, 2020, State Treasurer Rachael Eubanks announced two new grant programs funded through the CARES Act, called the First Responder Hazard Pay Premiums Program and the Public Safety and Public Health Payroll Reimbursement Program. Eligible local units of government can apply for a grant from these programs, which total

[4] The U.S. Treasury document can be found here: https://home.treasury.gov/system/files/136/Coronavirus-Relief-Fund-Frequently-Asked-Questions.pdf.

to $300 million in funding for local governments, with $100 million for the First Responder Hazard Pay Premiums Program and $200 million for the Public Safety and Public Health Payroll Reimbursement Program.

The First Responder Hazard Pay Premiums Program is intended to be used to fund additional compensation for eligible first responders, who include those who "performed hazardous duty or work involving physical hardship related to COVID-19," and a list of eligible employees can be found on the First Responder Hazard Pay Premiums Program application webpage.

The Public Safety and Public Health Payroll Reimbursement Program is to be used for reimbursing cities, villages, townships and counties that did not receive a direct payout from the CARES Act. This grant program will be used for cities to reimburse eligible public safety and public health payroll expenditures incurred from April 2020 to July 2020.

The applications for both grants can be found at the Michigan Treasure website under "Treasury Cares Programs."[5] The First Responder Hazard Pay Premiums Program application is open until September 30th, and the Public Safety and Public Health Payroll Reimbursement Program application is open until July 17th, 2020.

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- Erica Werner and John Wagner, "House and Senate on collision course over coronavirus response as leaders map out conflicting agendas," *The Washington Post*, April 27, 2020. https://www.washingtonpost.com/us-policy/2020/04/27/democrats-coronavirus-guaranteed-income/

[5] The application and more information on the First Responder Hazard Pay Premiums Program can be found here: https://www.michigan.gov/treasury/0,4679,7-121-1751_2197-532758--,00.html. Also, the application and more information on the Public Safety and Public Health Payroll Reimbursement Program can be found here: https://www.michigan.gov/treasury/0,4679,7-121-1751_2197-532764--,00.html.

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Michigan and Federal Aid: Brother, Can You Spare Some Stimulus?

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Key Points

- State and local governments face a one-two punch from crises such as the COVID-19 pandemic—emergency spending demands increase while lower economic activity means lower revenues.
- As in most states, Michigan and its local governments don't have many options to absorb revenue shortfalls without dramatically cutting public services.
- So far, the federal government has not acted to provide significant budget support to state and local governments as it did in the Great Recession and earlier recessions. Legislation to do so is currently under discussion in Congress.
- Michigan local governments should develop plans in case substantial federal aid does not arrive, and in the meantime, local leaders should work to press their case with federal lawmakers.

Michigan state officials have projected that the combined state budget for the *current fiscal year* will fall short by almost $3 billion, putting tremendous stress not only on state spending but on revenue sharing and state aid for local governments and school districts ("Economic and Revenue Forecasts for Fiscal Years 2020, 2021 and 2022" 2020). State revenues are not projected to return to fiscal year (FY) 2019 levels until 2024 at the earliest. By state law, however, state and local governments must maintain balanced budgets and have few tools to absorb revenue declines without making substantial cuts to public services.

In the last two recessions, the federal government stepped in with economic stimulus measures as well as fiscal support for state and local governments. However, federal assistance provided so far during the coronavirus pandemic has only covered new emergency spending and cannot be used to backfill lost revenues ("Coronavirus Relief Fund Guidance for State, Territorial, Local, and Tribal Governments" 2020). These restrictions were met with major disappointment by the mayors of 309 US cities, who penned a letter demanding provisions for less populous localities in subsequent relief packages (US Conference of Mayors 2020). Local governments need to develop plans to weather these shortfalls. Strategies such as short-term borrowing and use of fund balances may be helpful as a tactic to buy time for more orderly reductions and service adjustments (Leiser and Norton 2020; Driessen 2020b). But legal restrictions on borrowing that extends beyond the end of the fiscal year limits the flexibility of state and local governments. In the meantime, local leaders should be forthright with federal lawmakers about the fiscal situation they face.

Federal Response to Economic Recessions: Then and Now

In general, Congress has three main fiscal policy tools to address an economic downturn.

- Direct aid or tax relief to individuals and businesses;
- Support for new state and federal spending;
- Fiscal support to state and local governments to offset temporary revenue declines.

In response to the recession in the early 2000s, Congress passed the Jobs and Growth Act of 2003 that offered some support for state and local governments. The measure included $320 billion in tax cuts but only $30 billion in new spending, of which $20 billion went to state and local government as fiscal support and increases to Medicaid reimbursement funding (almost $28 billion in today's dollars). Increasing the federal contribution to Medicaid costs directly reduces the burden on state budgets and has become a standard fiscal support tool.

During the Great Recession, the American Recovery and Reinvestment Act of 2009 included substantial funding for both new programs and fiscal support (Driessen 2020a). The ARRA included over $575 billion in new spending along with $212 billion in tax cuts. Some $192 billion went to state and local governments, with $120 billion available to support state and local budgets to offset revenue losses and a further $72 billion for infrastructure and restricted education spending (which could not replace local funds). A year later, the Education Jobs Act of 2010 provided $26.1 billion in additional support for state and local governments: $10 billion to maintain K-12 education systems and $16 billion in additional Medicaid reimbursements. Overall support for state and local governments in these bills totaled $218 billion ($259 billion in today's dollars).

As of this writing, the measures enacted by Congress only support state and local governments with increased costs directly connected with the pandemic, as well as provisions to keep the municipal bond markets functioning. That is, they focus solely on the demands for new spending caused by the emergency. However, these measures do not address the sharp declines in state and local operating revenue.

The Families First Coronavirus Response Act, enacted in mid-March, included $192 billion in overall spending, of which about $50 billion was increased funding for Medicaid in anticipation of sharply increased demand for medical care. The Coronavirus Aid, Relief, and Economic Security (CARES) Act, enacted in late March, included $1.3 trillion in new spending, but only $150 billion went to state and local governments and that was restricted to unanticipated expenses directly caused by the pandemic. Only local governments with populations over 500,000 received direct funding in the CARES Act. An additional $454 billion was earmarked for the Federal Reserve to keep the municipal bond markets liquid. Any bonds issued must still be repaid, so those federal funds will be recovered as the bonds mature.

None of the measures passed so far would allow backfilling for revenue losses, though bills allowing it have been introduced (*H.R. 6800 - HEROES Act* 2020; *S. 3608 - Coronavirus Relief Fund Flexibility for State and Local Government Act* 2020; *S. 3638 - Coronavirus Relief Fund Flexibility Act* 2020; *State Municipal Assistance for Response and Transition Act* 2020). The table below compares federal stimulus spending directed at state and local governments in the past two recessions with the current situation and pending measures.

Major stimulus legislation since 2000 with state & local government funding

Legislation	Total spending amount	Amount for state & local governments	Michigan share of spending	Amount allowed for revenue backfill
2001 Recession				
Jobs and Growth Tax Relief and Reconciliation Act of 2003 (PL 108-27)	$350 billion ($487 billion, 2020 $)	$20 billion ($27.9 billion, 2020 $)		**$20 billion ($27.9 billion, 2020 $)**
Great Recession (2007-09)				
American Recovery and Reinvestment Act of 2009 (PL 111-5) and **"Education Jobs" Act of 2010** (PL 111-226)	$813 billion overall ($980 billion, 2020 $)	$218 billion ($259 billion, 2020 $)	$9.7 billion ($11.5 billion, 2020 $)	**US: $149 billion MI: $4.75 billion** ($5.7 billion, 2020 $)
Pandemic recession (2020)				
Families First Coronavirus Response Act of 2020 (PL 116-127)	$192 billion	$50 billion to states as Medicaid reimbursement increases	~$531 million in Medicaid expected to be offset by higher costs; $32.4 million for added pandemic costs only	**Currently, none.**
Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020 (PL 116-136)	$1.7 trillion overall net, $1.3 trillion in new spending $454 billion to Federal Reserve to support municipal borrowing (expect to recoup)	$150 billion to state, local & tribal governments for pandemic-related & unemployment expenses	$3.9 billion ($793 million to counties and large cities) $834 million for K-12 & higher ed, cannot replace state spending	**Currently, none.** (H.R. 6800 would allow flexibility, as would S. 3608)
Currently pending				
HEROES Act (H.R. 6800, passed House, now in Senate; future unclear)	$3 trillion in new spending	$915 billion for lost revenue $76 billion added Medicaid reimb. $35+ billion for other assistance	$14.3 billion (estimated) of fiscal relief funds	**US: $991 billion MI: at least $14.3 billion**
SMART Act (H.R. 6954 & S.3752, have bipartisan support)	$500 billion	Entire amount	Not known, $2 billion minimum	**US: $500 billion MI: minimum of $2 billion**

S.3608 would allow state & local governments to use CARES Title V Coronavirus Relief Fund allocations for operating expenses unrelated to COVID-19 but also prohibit their use for any state pension fund.
S.3638 would allow the use of those same funds to replace revenue shortfalls resulting from COVID-19 during the period March 1 through December 31, 2020.

Sources: (Olson 2009; House Fiscal Agency 2009; 2011; Brass et al. 2009; Jen 2009; Senate Fiscal Agency 2020; Driessen 2020a; Gielczyk 2020; Congressional Budget Office 2020; Center on Budget and Policy Priorities 2020).

Similarities and Differences: ARRA vs CARES Act

As with the ARRA, the bulk of federal spending under the CARES Act, and other coronavirus-related legislation passed as of this writing, is targeted to individuals and businesses. Other spending is earmarked for federal and state emergency public health spending (instead of the financial market stabilizing measures needed in the Great Recession). Of the $1.7 trillion net spending under the CARES Act, the largest buckets are:

- $377 billion for the Paycheck Protection Program and other SBA grant and loans;
- $293 billion in "recovery rebates" to individuals and families;
- $268 billion for increased unemployment insurance costs; and
- $161 billion from increased limits on losses that businesses and individuals can claim on their taxes (Swagel 2020).

Under the ARRA and "Ed Jobs" acts, the federal aid that Michigan received was split almost evenly between funds that could be used to cover revenue losses and funds that had to be used for new projects (e.g. "shovel-ready" infrastructure projects). In the 2020 pandemic-related legislation enacted so far, nearly all the aid provided to Michigan must be used for unplanned expenses attributable to the pandemic or for increased health-care costs caused by the coronavirus. If this situation continues, both the Michigan state budget and local government budgets are likely to be hard-hit for the current and the next fiscal years, if not longer.

CARES Funding: Strings Attached

Restrictions on CARES Act funds apply to payments for state and local governments under the Coronavirus Relief Fund [CARES Act, Division A, Title V] and most of the grants from the Education Stabilization Fund to K-12 and higher education agencies [Division B, Sect. 18001 et seq.]. Grants to school districts may be used to fund existing federal programs, but the funds may also be used for "other activities that are necessary to maintain the operation of and continuity of services in local educational agencies and continuing to employ existing staff…."

That apparent flexibility is constrained by the law's "maintenance of effort" requirement, where state spending on K-12 education must at least equal the average of the three prior years [Sec. 18008]. Since about three-quarters of all Michigan school operating funds flow through the state School Aid budget ("2018-19 Bulletin 1014" 2020), that requirement is a stringent one. The Act does give the Secretary of Education authority to waive the requirement "for the purpose of relieving fiscal burdens on States that have experienced a precipitous decline in financial resources," [Sec. 18008 (b)] though there is as yet no indication of how the Department will view such waiver requests. Further information on CARES Act funding can be found in a companion paper here.

The ARRA and CARES Act also differ on the accountability systems required for state and local government assistance. Distribution of ARRA funds was aided by close coordination among federal, state and local authorities. The White House, the Office of Management and Budget, and the National Governors Association arranged for frequent communication with, and technical assistance for, state authorities. The ARRA act also created a Recovery and Accountability Transparency Board to track spending, ensure compliance with conditions on funding, and prevent waste (Pew Charitable Trusts 2019). How coordination will develop for the state and local disbursements under the CARES Act's Coronavirus Relief Fund is not yet clear, but the legislation assigns monitoring and oversight authority over these payments to the Inspector General of the US Department of Treasury (*Coronavirus Aid, Relief and Economic Security Act (CARES Act)* 2020).

Light at the End of the Tunnel?

Many members of Congress are alert to the fiscal cliff that state and local governments face and some have proposed possible solutions. Among the simplest is to remove the restrictions on state aid already included in the CARES Act so that it could be used to cover revenue losses (e.g. S.3638). At the other extreme, there are bills under discussion which would provide substantial, new, fiscal support to state and local governments.

The Health and Economic Recovery Omnibus Emergency Solutions Act (*H.R. 6800 - HEROES Act* 2020) is the second major COVID-19 stimulus and support bill federal lawmakers are considering. The bill has passed the US House and is currently under consideration by the Senate. The legislation includes wide-ranging provisions totaling a combined $3 trillion in spending and $400 billion in revenue reductions (Congressional Budget Office 2020). The Act:

- Creates a "Coronavirus State Fiscal Relief Fund" ($540 billion) and a parallel "Local Fiscal Relief Fund" ($375 billion), half of which would be available immediately and the rest would be distributed by May 2021;
    - The State funds are distributed by a formula that includes a minimum for each state as well as amounts distributed on the basis of population and on the basis of COVID-19 cases. The funds may be used to replace lost revenue, but only to the extent that they were unanticipated revenue declines not foreseen as of January 31st.
    - The local funds would be divided, with a portion going to certain municipalities (this time, with a minimum 50,000 population), another portion for counties, as well as a portion allocated to other local governments proportionately by population. Current estimates indicate Michigan would receive a total of $14.3 billion over the next year (Center on Budget and Policy Priorities 2020).
- Increases and extends the higher federal Medicaid reimbursement rates included in the "Families First" Act in March, relieving states of a further $76 billion in expenses they would normally have to cover;
- Allows relief funds allocated to state and local governments under Title V of the CARES Act to be used on unanticipated revenue losses;
- Expands the authority of the Federal Reserve under Title IV of the CARES Act to allow direct purchase of bonds issued by local, state, territorial and tribal governments given the "unusual and exigent circumstances" of COVID-19;
    - Eligibility for support from the Municipal Liquidity Facility (described in a companion paper here) would be extended through December 31st, 2021, along with other changes. Further information about Michigan-specific recessions can be found in a separate companion paper here.
- Authorizes $5 billion for community block grants, which will be available until September 30th, 2023.

Where Things Stand Today

In early May, there seemed to be bi-partisan support in Congress for measures that would relieve the pressure on state and local governments from revenue losses during this pandemic (Krawzak 2020). However, the HEROES Act narrowly passed the House and was declared "dead on arrival" in the Senate. While other, narrower, measures are moving forward, for the most part they do not include fiscal relief for states and local governments. A notable exception are the bills (H.R. 6954 & S.3752) creating a State and Municipal Assistance for Recovery and Transition (SMART) Fund, which would provide $500 billion in fiscal support to all state and local governments. While these matching bills have not passed either chamber, they appear to have bi-partisan support (*State Municipal Assistance for Response and Transition Act* 2020; Cochrane 2020). Despite widespread calls for such aid, some lawmakers in Congress—and in Lansing (*HR 267 - A Resolution to Memorialize the Congress of the United States to Not Enact a Federal Bailout for States* 2020)—have said they do not believe such relief is necessary.

Nevertheless, with a projected shortfall of some $3 billion in the combined Michigan General Fund and School Aid budgets and only about $1.2 billion in the state "rainy day" fund ("Michigan's Economic Outlook and Budget Review: FY 2019-20, FY 2020-21, and FY 2021-22" 2020), substantial cuts to state spending—including local revenue sharing and school aid—will be required to balance the budget as required by law, unless federal fiscal assistance becomes available.

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Financial Management Strategies

How to enhance liquidity during a crisis

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Key Points

- Financial ratio analysis with peer governments and over time is helpful for understanding a government's liquidity position.
- It would be useful to anticipate immediate- and short-term revenue declines.
- There are strategies for boosting cash reserves, but a government should also be mindful of their ramifications.
- A team with diversified expertise is needed for sound and prudent financial decision-making.

Coping with an unprecedented crisis requires a government to focus on short-term resources available, while maintaining a long-term vision. The fluid situation also adds challenge. This memo discusses strategies to understand and enhance liquidity, while recognizing and addressing long-term ramifications.

Understand Liquidity Position

Financial ratio analysis is useful for gaining understanding of a jurisdiction's liquidity position. For government operations, the ratios are often focused on general fund, but the calculations can be applied to other fund types. Three ratios serve as good starting points to examine liquidity:

- **Cash ratio**, calculated as cash divided by current liabilities, indicates a government's ability to repay its short-term debt with cash at hand. Ideally, the cash ratio should be greater than one.
- **Days of cash on hand** represents the number of days of operating expenses that a government can pay with its current cash available. It is calculated as the sum of cash and cash equivalents (i.e., money that a government can cash out easily) divided by the governmental daily average operating expense (i.e., annual expense divided by 365). Typically, 90 days of cash on hand is considered the recommended minimum.
- **Fund balance ratio**, calculated as general fund balance divided by operating expenses, indicates how much saving a government has to cover operations. Ideally, the fund balance ratio is at least 15 to 20 percent.

It is helpful to compare the ratios with peer governments as a benchmark. The cohort of peers should be ones that the government finds comparable in terms of its socioeconomic characteristics and revenue base, and ones that have acceptable fiscal health. An examination of the changes of ratios over time is also useful, with a focus on the time when the government was hit by a crisis. For example, what was the government's liquidity position during the recession in 2008? How did the government leverage cash and fund balance reserves? What were the lessons learned then and could they be applied to the current situation? Draw from past experience is useful to not only understand the current situation but also to forecast into future.

In addition to monitoring liquidity ratios, governments should also examine their fund balances to understand their liquidity positions. Often viewed as a rainy day fund, the general fund balance can be used as a buffer to weather an external shock like the pandemic. However, one should be mindful of different types of fund balance, including nonspendable, restricted, committed, assigned, and unassigned fund balances. Each type of fund balance comes with different restrictions for its uses. Unassigned fund balance is usually the most flexible. However, the committed and assigned portions of the fund balance may be repurposed with approval of the governing body.

Anticipate Cash Fluctuations

It is important to monitor the cash position on a regular basis, if not more frequently, during times of uncertainty. A government's cash reserve can fluctuate over the course of the fiscal year depending on the timing of inflows and outflows. Identifying major revenues and their decline, while mapping out the timing of payments, can help governments plan ahead.

On the spending side, governments should carefully forecast the anticipated timing of essential cash payments. These will include regular payments, such as payroll and debt service, as well as expenditures that are concentrated during particular times of the year, such as election expenses or road maintenance.

The cash forecast for revenues will be more uncertain. At the beginning of the crisis, governments should expect immediate revenue decline due to suspensions of pay-for-service programs, such as childcare services, fee-based recreation programs, and building rentals. Shortly thereafter, governments should anticipate declines in tax revenues, such as city income taxes, and state revenue sharing payments, which are reliant on sales tax collections. The April revenue sharing payments are mainly based on revenues collected from January and February, and thus are expected to be steady. However, the following payments will likely be significantly below trend. In the medium-term, unemployment and economic conditions could also lead to property tax delinquency.

Use this cash outflow/inflow forecast to estimate cash balances over the course of the year and identify times when liquidity is of particular concern. For more information, see economic forecasting by Research Seminar in Quantitative Economics at the University of Michigan and best practices of cash flow forecasts by GFOA listed in the "Sources and Additional Information" section.

Assess Potential Strategies and be Mindful of Pitfalls

Local governments can take some actions to free up cash or tap into surplus resources. Each action has immediate benefits as well as long-term impacts. The table below lists these potential strategies for consideration, as well as pitfalls about which policy makers should be cautious.

Strategy to Increase Liquidity	**Pitfall & Caution**
Accelerate account receivables	• May not always be feasible since the payer also faces cash flow challenges
Delay payments to vendors	• Give up early payment discounts • Risk straining the relationship with vendors • Cause hardship with the vendor • Hurt credits if missing the payment
Reduce frequency of purchases and payments	• May cause shortfall in supplies for government operations • Should prepare for larger amounts of cash outflows in future purchases and payments
Reallocate underspent budget line items	• Understand why the item is underspent • Have a plan to rebuild the surplus if it is reserved for a purpose.
Redesignate general fund reserves	• One-time emergency withdrawal and not sustainable • Would defer projects that the reserves are intended to fund
Interfund borrowing	• Certain funds may have restrictions on how resources can be used • Consider the liquidity position of the loaning fund • Have a financial plan that reflects a repayment schedule an any applicable interest • Should be an interim arrangement with the life of loan below 180 days (GFOA recommendation)
Evaluate banking relationships	• Look for opportunities to reduce fees or earn a better rate of return on short-term deposits
Short-term borrowing	• Recognize that it is still debt that needs to be repaid • Balance usually must be repaid within the fiscal year • Unsecured notes typically require a higher interest rate
Monetizing assets (e.g., building, ad space, parks, water towers)	• May undersell the assets in a soft market • Require capacity for valuation and marketing • May not materialize in time to meet the need for cash • Privatizing assets that provide public service functions has its own consequences that require thoughtful analysis
Implement new fees	• Ensure fairness, transparency, and accountability through communication with stakeholders

The adoption of any strategy should be made prudently based on sound understanding of local financial position. Therefore, it is important to have a team with relevant expertise that focuses not only on immediate coping mechanisms but also long-term recovery to ensure fiscal sustainability. It is critical to form a team for crisis management and recovery, and staff the team with members with knowledge of accounting, financial management, government operations, and public relations and communications. For smaller communities that may not be able to form a special task force, soliciting inputs from departments is a critical step. Both strong leadership and stakeholder engagement are more important than ever in a fluid situation.

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Strategies for Short-Term Cash-Flow Borrowing

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Key Points

- Local governments should think carefully about their cash flow needs during this period of economic interruption and might consider short term borrowing as an option to support liquidity.
- Local governments in Michigan can issue Tax Anticipation Notes (TANs) to borrow against their property tax operating levies.
- The Michigan Finance Authority is considering creating a pooled TAN issue to reduce borrowing costs for local governments that participate.
- Short-term borrowing is intended to address temporary cash-flow needs, and should not be used to replace revenue or "paper over" actual budget deficits.

In the coming months, most local governments will be facing a combination of falling revenues and increased emergency expenses, making cash management increasingly challenging. Cash outflows, such as payroll, are likely to continue on schedule, or even accelerate if a local government has significant emergency expenditures. However, receipts of cash may be delayed due to extended deadlines, waiving of fees and penalties, or late and partial payments.

In cases where cash flow interruption is sudden and dramatic, liquidity management will be critical (read more about enhancing liquidity in a crisis here). Short-term cash flow borrowing may be an option to help smooth out the uneven availability of cash to ensure that there is no interruption in operations or unnecessary budget cuts. However, like any debt, the benefit of short-term cash-flow relief comes at the cost of interest expenses. Short-term cash borrowing is normally relatively uncommon among local governments in Michigan. However, in the current crisis, some local governments might consider it as a way to ensure that they can maintain sufficient liquidity to meet their current obligations while protecting fund balances for the recovery ahead.

Short-Term Borrowing by Michigan Local Governments

Many local governments issue bonds to finance long-term capital projects, such as infrastructure or building projects. These bonds are long-term debts, maturing in anywhere from a few years to 30 years. The term "municipal bonds" commonly refers to these more familiar long-term obligations, but local governments can also issue short-term debt not for capital projects but for cash-flow purposes.

In Michigan, short-term borrowing by local governments is governed by the Revised Municipal Finance Act (PA 34 of 2001, MCL 141.2401-2415). The Act allows local governments to issue short-term general obligation municipal securities "in anticipation of and payable from taxes." The debt is repaid when the revenues are received, which must be one year or less from the date of issuance. Therefore, local governments may issue and repay these obligations within a fiscal year, or borrow against revenues in the following fiscal year. Issuing short-term securities may be done by a resolution of the governing body and does not require a vote of the people.

There are two main types of short-term securities local governments may issue: Tax Anticipation Notes (TANs), which are borrowed against property tax operating levies, and Revenue Anticipation Notes (RANs), which are borrowed against anticipated revenue sharing payments. TANs may be issued for up to 75 percent (although a typical amount is usually around 50 percent or less) of the amount of operating taxes remaining to be collected when the resolution is adopted. Alternatively, if TANs are issued against the following year's operating levy, they cannot exceed 50 percent of the expected levy.

Used much less frequently than TANs, RANs may be issued for up to 50 percent of the amount the local government received in total revenue sharing payments in the prior fiscal year. When issuing either TANs or RANs, local governments must set up a special fund to set aside amounts to be used for the payment of principal and interest on the notes.

Although short-term cash-flow borrowing is relatively uncommon among general purpose local governments, school districts regularly issue State Aid Notes (SANs) in the spring and summer to provide cash flow support through the summer and into the fall as they begin the new school year. Each year, the Michigan Finance Authority (MFA), part of the Michigan Department of Treasury, facilitates this process by creating a pooled SAN offering that districts can participate in. This pooled structure allows districts to take advantage of lower borrowing costs.

In August 2019, the SAN program purchased $344.4 million in debt from 165 school districts with an average borrowing amount of $2 million. The 2019 notes will mature after one year, in August 2020.

Policy Efforts to Support Local Government Cash Flow

In response to the COVID-19 crisis, the MFA is exploring the possibility of creating a pooled TAN offering that local governments could participate in. This would be similar to the pooled SAN program for school districts. MFA would act as a "conduit issuer," pooling multiple smaller amounts of debt from multiple local governments into a single larger pool.

The pooling process creates economies of scale that allow transaction costs to be spread across more borrowers. Therefore, while it may be cost prohibitive for many local governments to issue a stand-alone TAN, participation in a pooled TAN may be cost-effective. The pooled structure also allows local governments to potentially take advantage of savings from a higher credit rating because the MFA would have the authority to intercept state aid payments if necessary to repay the debt. Therefore, borrowers can be offered a lower interest rate.

In addition to policy support at the state level, the Federal Reserve (Fed) has also recently taken action to support short-term borrowing by local governments after short-term municipal bond yields rose dramatically in March. In April, the Fed announced a Municipal Liquidity Facility program to support municipal debt markets by directly purchasing up to $500 billion in short-term municipal securities from states and large local governments.

The Fed's actions to support municipal debt markets (and other credit markets) are unprecedented. It is the first time the Fed has directly purchased municipal debt – no such policies were adopted during the Great Recession. Even for the majority of local governments that are not directly eligible for the Municipal Liquidity Facility program, the Fed's actions should help stabilize the entire market and ensure that most local governments can obtain short-term financing at reasonable rates.

Determining Whether a TAN is Right for Your Government

When considering whether short-term borrowing with a TAN might be an option for your local government, there are several things to consider:

- **Cash-flow borrowing is not intended to cover deficits** – Governments should keep in mind that short-term borrowing is intended for cash flow purposes only – to smooth out the timing of cash inflows to better match outflows. For example, it can be used to bridge unexpected shortfalls and help governments make a more orderly adjustment to new budget realities. However, if revenues and expenditures are fundamentally out of balance, borrowing should not be used to replace revenues. Governments using short-term borrowing to "paper over" persistent budget deficits can quickly find themselves in an unsustainable "rolling notes" situation, becoming dependent on continuous borrowing.

- **Ensure the reliability of cash flow forecasting** – Local governments should consider their expertise and past success with cash flow forecasting. Having more accurate estimates of cash flows and cash balances will help governments know exactly how much they might want to borrow, so they can avoid borrowing too little or too much.

- **Account for revenue uncertainty** – Governments should also consider the level of uncertainty regarding revenues that are pledged to repay debt. For example, compared to state revenue sharing, property tax revenues are likely to remain relatively stable but may be affected by taxpayers' ability to pay in full and on time. A greater proportion of the levy paid by individual taxpayers, as opposed to escrow agents (e.g. mortgage companies), will introduce more uncertainty into timely collections.

- **Optimize use of fund balance** – In times of tight liquidity, most local governments turn first to their general fund balances. If the fund balance is large enough, it can be temporarily drawn down and replenished later. However, in this time of uncertainty, local governments may be reluctant to let fund balances get too low in case of continued COVID-19 outbreaks or prolonged economic recovery. Local governments should think carefully about their fund balance policies as they plan to weather this recession. A strategy of short-term borrowing combined with drawing down fund balance may be a good option for some governments.

- **Consider internal financing options** – Local governments may also want to explore internal financing options such as inter-fund borrowing. A short term loan to the general fund from another fund, such as a water or sewer fund, may be a way to help general fund cash flow while avoiding paying interest to an external party. However, governments should be aware of legal or externally-imposed restrictions on the use of monies in certain funds (e.g. debt service funds).

- **Credit ratings affect the cost of borrowing** – Credit ratings on long-term debt will influence the credit worthiness of short-term debt as well. Poor credit can make short-term borrowing prohibitively expensive. However, governments with ratings too low to issue TANs on their own may still find it advantageous to participate in a pooled TAN if a program is available.

- **Draw on experience**– Research shows that governments with more experience using short-term bond anticipation notes (BANs) in their capital financing strategies are more likely to use TANs for cash-flow borrowing purposes. BANs are often issued to provide cash to start a capital project before the proceeds of long-term bonds become available. Familiarity with other types of short-term borrowing may play an important role in local governments' comfort levels using TANs.

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This memo is part of a series of memos in the Local Government COVID-19 Fiscal Strategy and Resource Guide, available at closup.umich.edu/COVID-19. CLOSUP has partnered with public finance experts from universities, consulting firms, and research institutions from around the state to provide local governments up-to-date information as well as a set of ideas and tools that will help them strategically navigate the new fiscal landscape.

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Planning for Reduced Operating Expenses

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Key Points

- Consider long-term impacts of spending cuts such as reducing capital spending and hiring freezes.
- Avoid across the board cuts that take funds away from higher priority programs and services.
- Prioritize cuts that have a short time-to-benefit, are not complex, and are easily reversible.

Local governments may be looking at ways to cut costs in some areas as they face current or anticipated revenue decreases and cost increases related to the COVID-19 pandemic.

Before making cost-cutting decisions, local governments should ensure that they clearly understand their financial situation and clearly articulate their goal. That goal could be something very specific like "Find $50,000 that can be re-allocated for emergency response operations." It could also be something broader such as "Reduce total spending in the short-term by 10% to increase reserves if emergency response is necessary" or "Plan for 10% reduction in spending to adjust for decreased revenues in coming months." Strategies to enhance liquidity are outlined in further detail in a companion paper here.

Governments should also examine their rainy-day fund. A healthy rainy-day fund could cover increased costs or fill gaps in revenue in the short term. Under normal circumstances, the Government Finance Officers Association recommends maintaining an unreserved general fund balance that is equal to about 15 to 20% of general fund revenues, and many local governments maintain fund balances well in excess of this threshold. This approach must also be paired with a medium or long-term plan to reduce spending so that reserves aren't completely drawn down before local budgets regain stability after the pandemic. For those with a healthy fund balance, using cash reserves can be considered as a first step to mitigate painful budget cuts. Those with less healthy reserves should immediately focus on reducing costs where possible to preserve cash.

In general, governments should consider reducing spending in areas where any short- or long-term impact is minimal, and where the decision is easily reversible if conditions are not as bad as expected.

Possible Process to Guide Decision-Making

Whatever cuts are considered, it is important to make decisions with as much information as possible. The more detailed information local governments have about programs and services provided, the better they can make decisions related to these programs. The following steps may help determine how to ensure essential services continue, and identify where some cost savings may be found:

- Identify all programs through a program inventory
- Identify essential vs. non-essential programs
- Evaluate savings (or potential costs) of performing or not performing each program or service
- Assess which employees support essential vs non-essential programs (and which programs need back-up support if an employee gets sick)
- Determine the mandate, reliance, and partnership opportunities for each program

Proven Strategies

While the current pandemic is unlike anything previously experienced in many ways, prior experience with local government fiscal crises does offer some guidelines on strategies that have proven effective in mitigating crisis situations. For example, Ammons and Fleck (2010) examined the cost cutting strategies local governments used during the 2008 great recession that can provide useful insights for today (the article can be found here). Governments should consider these principles to guide decisions as they navigate this crisis:

- Cut quickly; avoid delay – an early, deep cut, produces better results and is less harmful to morale than a steady stream of smaller cuts. This also allows cuts to be restored if the crisis is not as bad as feared. Good surprises are better than bad ones.
- Take a long-term view - Does the proposed reduction create increased costs in the future?
- Focus on core mission purpose, and highest priorities
- Emphasize innovation - empower departments and staff to come up with creative solutions to cut costs while maintaining services.
- Manage revenues as carefully as expenditures
- Examine and improve organizational design and processes
- Foster stewardship – be creative about encouraging all departments to engage in cost savings. Think about what might be done to incent departments to reduce spending.
- Look for areas of consistent surplus in prior budgets – reallocating these funds doesn't reduce costs, but frees up funds for high-priority use.
- Create a sense of mission, responsibility, and sacrifice, devise a workable schedule, stick with it
- Commit to communicating with all stakeholders (Miller and Svara 2009)

If cuts are going to be made, useful questions to consider include:

- Is the proposed reduction a one-time reduction, or an ongoing reduction?
- Is this a true reduction in spending or a deferment?
    - If it's a deferment, what is the plan to pay for it in the future?
- When is the greatest benefit related to this cut realized? Short term or long-term?
- What is our plan for this post-pandemic? Restore funding? Restructure?

Specific Considerations Related to Common Cuts (Kavanagh and Casey 2020)

Potential Action	Potential Pitfalls and Other Considerations
Short-term hiring freeze	• Should be targeted, rather than general. Evaluate whether not filling a position is going to create a staffing gap for an essential service. • Savings should be returned to a centralized pool so they can be directed where they are needed most.

Share personnel	• Consider if personnel can be shared across departments to meet increased needs in some areas. • Make sure personnel are qualified to adequately assist in the area they are being shifted to. • Be mindful to maintain integrity of internal controls.
Voluntary part-time status or voluntary furlough for employees	• Consider repercussions such as eligibility for benefits, pension calculations, etc. • Limit who can participate (make sure essential services are adequately staffed). • If these are precursors to potential mandatory time off or layoffs, be very clear about that.
Unpaid furloughs	• Clear rules needed for how to ensure essential functions are still performed.
Reduce energy usage	• Changing turn-off schedules or tightening temperature controls for buildings can save money. Some of these savings may be automatic if buildings are closed while employees work from home.

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Assessing Collaborative Readiness

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Key Points

- Strategic collaborations can reduce costs and increase service satisfaction.
- Collaborations rarely set the stage for either short or long-term success if all partners are not adequately prepared.
- Collaborations are more successful when all preconditions and signals for strategic collaboration readiness are met.

Strategic collaborations can allow local governments to reduce costs while ensuring goods and services are provided to their citizens. Under normal circumstances partnerships which are not well planned are rarely successful and can create long-term distrust in collaborative efforts. In emergency, ad hoc situations it is essential all partners are adequately prepared to engage in strategic collaborations if the efforts are to be successful. A quick, ten-point assessment can help in the decision making of whether organizations should collaborate or not. Additionally, this assessment can help highlight potential barriers to success.

Strategic Collaborations

Local governments in Michigan operated in an era of "fend-for-yourself" federalism with decreasing tax revenues, ongoing and increasing service demands, and reductions in state funding well before the onset of COVID-19. With the advent of the current pandemic, many governments may be looking at ways to reduce costs while maintaining services. Strategic collaborations allow a collective approach to address public policy problems and reduce the financial burden on local governments. By bringing together knowledge, perspectives, and ideas strategic collaborations can lead to desired outcomes, increased capacity and competence, and new resources and opportunities.

Local governments in Michigan have four primary avenues for collaborations.

- *Contracting out services:* Arguably the most common type of collaboration, contracts provide an agreement between government and the private sector to provide goods/services.
- *Public-private partnerships (P3s):* While usually looked at in terms of capital investments, public-private partnerships can be used whenever there is a need for a partner with unique capabilities.
- *Networked governance:* Collaborative structures which work interdependently with government and other partners and are responsive to a broad range of nongovernmental stakeholders.
- *Independent public-service providers (IPSP):* Self-directed entities which are composed of government(s), non-profits, and for-profit businesses that collaborate to provide public goods.

During emergencies, governments should first look to expand their current collaborative efforts which have shown success. For most local governments this will be limited to expanding existing contracts and P3s. New collaborations should also focus on contracts and P3s as the time required to set up successful networks and IPSPs is likely nonexistent. However, in order to be successful these new partnerships need to be strategic, well thought out, and have a high likelihood of success. Before entering partnerships, local governments should assess their collaborative readiness.

Assessing Readiness

In order to assess their readiness to engage in strategic collaborations, local governments should focus on five preconditions for successful collaboration. These include:

- *A legitimate and pressing need to collaborate*: This is important to many groups and goods/services are not otherwise being provided (or will stop being provided).
- *A critical mass and representation of key stakeholders*: The correct people are at the table and involved in direct decision making.
- *Skilled and competent leadership*: Leaders have the correct skills (people, analytic) and community connections to be effective.
- *Established competency and ability to collaborate*: Partners have a successful track-record of collaboration and/or have appropriate trust from community members and partners in their ability to collaborate.
- *A reasonable probability for change*: There is a good chance that the collaborative efforts will be successful.

For each precondition, appropriate signals and tasks are outlined. Government leaders should be able to complete this ten-point assessment quickly, especially if all partners are indeed adequately prepared for collaboration.

Precondition	**Signal**	**Task**
Assessing Need	Issue is important to key stakeholders.	Identify key stakeholders and estimate the level of importance that each would place on the issue driving the collaboration.
	Need for and purpose of the collaboration is clearly articulated and does not duplicate other efforts.	Draft a statement of purpose for the collaboration, identify key projects and agencies that relate to this purpose, and estimate the degree of overlap with already existing collaborations.
Assessing Critical Mass & Sufficient Representation	Individuals and agencies that have a stake in the purpose and anticipated outcomes of the collaboration are likely to engage in the work of the collaboration.	Identify the key interests that must be represented and the extent of overall engagement that can be anticipated from these key interested parties.
	The set of key agencies and participants with needed expertise are willing to actively engage in the work of collaboration.	Identify the essential tasks that need to be done, and then predict the willingness of key agencies or participants to be engaged and their expertise areas.

Assessing Leadership Capacity	Key participants have the necessary leadership and facilitative skills to guide the design and evolution of the collaboration and are willing to serve in leadership roles.	Identify the participants who are likely to lead the collaboration, and assess their leadership skill level.
	Prospective leaders have adequate community connections and the skill level to recruit participants and to generate resources.	Assess the capability of the anticipated leaders of the collaboration to obtain resource commitments and to enlist support.
Assessing Openness to Collaboration	Positive history of productive relationships and collaboration.	Identify the examples of recent collaboration efforts within the community, and assess whether the experience was positive or negative.
	Key participants have sufficient levels of trust within the group to work through the initial steps of forming a collaboration and to sustain the collaboration.	Identify the participants who are likely to be involved in the collaboration and assess the strength of the relationships with each other.
Assessing the Window for Change	The time is right.	Articulate the pressing reasons or forces that justify proceeding now. List the key environmental conditions, initiating forces, and tactical drivers that are propelling collaboration.
	System-level barriers can be identified to become targets of opportunity.	Identify key obstacles specific to the issue driving the collaboration, and estimate the likelihood of innovation or reinvention.

Adapted from: Norris-Tirrell, Dorothy & Joy Clay. *Strategic Collaboration in Public and Nonprofit Administration*. New York: CRC Press, 2010.

Decision Making

When all tasks are completed, governments must assess which signals have been met and which have not. This should serve as a guide on whether to proceed with the collaboration or not.

- *All signals are met*: There is a high likelihood that the collaboration will be successful, and the partnership should proceed.
- *Mixed signals*: If some signals are met but not others there is a medium likelihood of success, and if the collaboration proceeds it should be with caution. Unmet signals should point out potential future obstacles to success.
- *Few or no signals met*: There should be no collaboration. If political/community factors force collaboration to proceed, governments should proceed with extreme caution.

Failure to engage in an assessment of collaborative readiness can negatively impact local governments in both the short and long-term. In the short-term, prematurely entering into collaborations can result in the desired goods/services not adequately being provided and/or an increase in costs. In the long-term, poorly planned collaborations can damage government reputation and integrity along with the potential for future collaborations. Overall, local governments should—at a minimum and during an emergency—conduct a quick collaborative assessment before entering collaborative arrangements. While the benefits (such as cost savings) of successful collaborations are promising, there are several long-term negative ramifications for entering into partnerships when not adequately prepared to do so which can make the "cure worse than the disease."

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Should We Contract This Service Out?

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Key Points

- Local governments have a long history with contracting out services to reduce costs.
- There are many potential negative repercussions associated with contracting out if done poorly including increased costs and damaging government integrity.
- Governments should ensure that contracting out services is an appropriate course of action using the COMPARE assessment.

As governments prepare their responses to COVID-19, there could potentially be increased pressure to contract out specific services in order to reduce government spending. Historically, the services best suited to being contracted out are support services with significant discretion (i.e. legal, engineering) and standalone services (i.e. refuse collection). However, before deciding to contract out services governments must properly assess whether they are getting a “good deal,” whether they can prevent corruption and promote integrity in government operations along with accountability to the public and be “fair” with prospective vendors. Cost savings cannot, and should not, be the only consideration. The COMPARE method is an easy, straightforward approach to assessment which includes an examination of 1) cost efficiency and competitive dynamics, 2) organizational impacts, 3) management issues, 4) political considerations, 5) accountability issues, 6) risk assessment, and 7) equity and effectiveness concerns.

Contracting Services

For the last 40 years governments have increasingly contracted out specific government services. Common programs/services which tend to be better suited to contracting include:

- Those which are new.
- Those which are easy to specify outputs for.
- Those which require specialized skills.
- Those which require high numbers of low skilled labor.

This occurs because governments either do not want to provide the service, or, more commonly, governments do not have the ability (expertise, workforce, money) to provide the service. With the onset of COVID-19, local governments are faced with decreased revenues (most likely), a major shift in how many government employees work (i.e. remotely) which allows easier access to outside expertise/skills, and new governmental challenges and problems that need to be addressed. These conditions create a climate rich for new government contracts. For any contract, governments should keep three goals in mind.

- *Get a "good deal"*: Will this save the government money without unintended adverse consequences? All partners should be benefiting in some way.
- *Prevent corruption and promote integrity*: Can government ensure that services will be properly administered and reflect positively on government operations?
- *Be "fair" with prospective vendors*: Is there a fair and equitable procedure in place to select who receives the contract?

All three goals should be met when designing/entering new contracts, and governments should be focused on "best-value" contracting rather than simply "lowest cost" contracting. To achieve this governments should focus on setting clear expectations for what they do and do not want to see happen, having an assessment method for deciding whether to contract out services or provide them internally, having specific criteria for selecting vendors, being as transparent as possible about the process, having a system of monitoring vendors to ensure compliance, and having an evaluation process to ensure expectations are being met.

In times of fiscal crisis, it is essential that governments have a strategic method for assessing whether contracting out for specific services adheres to the aforementioned goals. At best, entering into "bad" contracts can end up increasing the cost of services, and, at worst, damage government integrity and trust long into the future. The COMPARE method is one straightforward approach to assessing whether services should be contracted out, while another approach for assessing collaborative readiness is outlined in a companion paper here.

COMPARE Assessment

The COMPARE assessment aids policymakers in decision making by helping ensure consideration is given to more than just the financial impact of contracting out services.

Cost Efficiency and Competitive Dynamics	1. Will contracting be less expensive? In the short-term? Long-term? 2. Is there a competitive market in the private sector that will reveal the best-value approach? 3. Are there economies of scale in the private sector?
Organizational Impact	1. Is the function inherently governmental and therefore should not be contracted out? 2. Will contracting be consistent with agency mission? 3. Are services/functions intermingled, or are they discrete?
Management Issues	1. Does the government agency have sufficient contract management skills? 2. Are you contracting for expertise that government does not have? Would it be better to develop those skills in-house? 3. Will contracting out reduce the desire/ability of the public workforce to provide high-quality goods/services?
Political Considerations	1. Is there a strong legal environment for contracting? 2. Can you minimize political interference in the selection process? 3. Are there union considerations?
Accountability Issues	1. Can you hold the contractor accountable to the public and for measurable results? 2. Can you prevent waste, fraud, and abuse in the contracting system?
Risk Assessment	1. Can you identify and allocate risks in an appropriate manner? 2. What are the consequences of contractor failure?
Equity and Effectiveness Concerns	1. Can you take into account issues of equity and other socioeconomic factors? 2. Will the contractor be effective in achieving the public purpose?

Adapted from: Forrer, J., Kee, J. and E. Boyer. 2014. *Governing Cross-Sector Collaboration*. New Jersey: John Wiley and Sons.

Decision Making

During times of fiscal stress, cost saving measures are paramount for local governments. For several decades, contracting out services has been a primary cost savings approach governments have adopted. However, even in unprecedented financial times governments must be sure to take the time to critically assess whether contracting out services is the correct decision or not. The COMPARE method allows a straightforward assessment strategy that helps move decision makers past just the question of financial savings. Ideally, government officials should be able to answer "yes" to all of the pertinent questions in the assessment before moving forward with soliciting vendors. However, under some circumstances, it may still be advisable to contract services if assessment answers are unknown or negative based on political and/or community considerations. Responding with uncertainty can help highlight where potential issues might arise in the future should the decision be made to go forward with contracting.

The new frontier local governments are likely to face in the wake of COVID-19 will be one ripe with the promise of contracting out services for cost savings. Local governments will be facing new problems which require new solutions, and the changing dynamics of "how we work" will allow for broader specialization and geographic considerations. During this time of emergency and uncertainty, it is paramount that local governments fully assess whether contracting out services meet all stated goals, not just those of reducing costs.

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Workplace & Personnel Strategies for Michigan Local Governments: Q&A

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Managing personnel and workplace issues amid the COVID-19 crisis response is a challenging task that local government leaders are grappling with across Michigan. Every government must approach the task differently based on factors such as state policy, the way COVID-19 impacts a community, accessibility to resources, and local ordinances.

Today, local governments are in the process of allocating federal relief dollars that they have received, managing the switch to remote workplaces, reevaluating staff furloughs, and bringing team members back to work. The following are a series of frequently asked questions from local government stakeholders as well as frameworks and suggested strategies to help the stakeholders arrive at the best answers for their communities. The strategies and suggestions discussed apply broadly, but some of the policies discussed are specific to the state of Michigan.

Q. What types of activities are eligible for FEMA funding?

A. It is important to ensure that local units of government are only seeking reimbursement through FEMA funding for covered activities. If an entity receives reimbursement funding to cover costs that are later deemed ineligible, that entity will have to refund that money to FEMA. Furthermore, FEMA is the funding source of last resort, meaning that other available funding sources—including insurance where applicable, and other federal and state funding streams—are taken into account and deducted from the total cost of a project or other reimbursable activity.

In order to determine whether or not a particular employee's activities are eligible for FEMA funding, a government must first consider whether an employee's labor is **budgeted or unbudgeted**. Only overtime work is eligible for budgeted employees, whereas straight-time and overtime work can be eligible for unbudgeted employees. Here is some further clarification on these two categories of employees:

- *Budgeted employee*s are permanent employees, or seasonal employees working normal hours during a normal season of employment. Budgeted employees are only eligible for overtime work that relates to the COVID-19 response. Administrative leave and similar labor costs incurred by budgeted employees sent home or told not to report to duty in response to COVID-19 (meaning furloughed employees) are not eligible costs.
- *Unbudgeted employees* are permanent employees called in either from scheduled leave or a normally scheduled day off, essential employees called back from administrative leave, temporary employees hired specifically to perform eligible COVID-19 related work, seasonal employees working outside of their normal season of employment, or permanent employees funded from an external source. These employees are eligible for straight-time and overtime work. Furloughed employee hours are not considered eligible unless employees are called back into work for emergency work.

Local government leaders should first determine whether an employee is unbudgeted or budgeted to determine whether or not their labor will be reimbursable. As the above descriptions indicate, the work of unbudgeted employees is far more likely to be reimbursable, though they are often less readily available than budgeted employees, given the nature of their working relationship with an organization.

Next, the **type of work** the employee is conducting must be considered. A few common scenarios are:

- *Preventative work*, or overtime work completed in advance of a pandemic outbreak for preparation purposes, is eligible, with the caveat that the cost must be reasonable and equitable with the local market rate for the type of work being performed. An example of preventative work is spending time to develop a policy for bringing employees back on site or back offsite as based on the way that COVID-19 is affecting your community.
- *Re-assigned employees* performing work outside of the normal job duties and directly related to the pandemic are eligible. Note that this work will be reimbursed at the employee's normal pay level, not in accordance with the reasonable rate for the newly assigned work. As in all cases, whether the work is reimbursable for overtime or straight-time will depend on the employee's budgeted or unbudgeted status.
- *Surge hires* who are hired to perform emergency work are eligible during the emergency period.
- *Backfill employees*, or employees assigned to cover the duties of employees who were reassigned to perform emergency work, are eligible for funding to cover overtime costs only.

Asking employees to assist by logging their own hours and providing detailed information about the duties that they perform each day is the best first step in ensuring compliance with FEMA reimbursement rules. Because these guidelines do not cover every possible funding eligibility scenario, local government leaders are encouraged to regularly consult guidance posted by the U.S. Treasury, FEMA, and other federal agencies when relevant.

Q. Can employees still file for unemployment insurance benefits in Michigan?

A. Yes. Federal Pandemic Unemployment Compensation is still available through July 25, 2020. Employees who have been furloughed are eligible for the $600 per week benefit through this date.

Q. Should certain positions remain remote even after public spaces begin to reopen?

A. While the answer to this question is entirely dependent on the specific positions in question and the constituents being served, now is a great time to evaluate whether certain positions can sustainably be performed in a completely or partially remote environment. The benefits of offering remote work options extend far beyond the public health concerns that demanded an immediate switch to remote work in response to COVID-19. For years, studies have shown that workers increase their productivity when they switch from an on-site to a remote setting – including workers in customer-facing roles such as call center representatives. Furthermore, a 2017 study conducted on a national scale shows that the job applicant applying for an office job is willing to accept 8 percent less pay in exchange for the option to work remotely. State and local governments are particularly at risk of losing talent to higher paying positions in other sectors. Offering remote and flexible work options is a great talent attraction and retention tool for local government entities when offering higher compensation might not be an option.

In order to determine whether positions should remain remote as employees return to work, government leaders should develop a framework including factors such as health risks, data security concerns, cost of equipment, ease of service provision, ease of communication, and possible effects on overall organizational culture. The determined framework can be used by leadership to facilitate conversation with employees in the roles in question; developing a ground-up understanding of the positions in question is critical to effective decision-making.

Q. How can we safely bring our team back on site?

A. There are several precautions that governments can take to safely bring people back on site. While every organization is different, there are some key activities that can guide your back-to-work plan:

- Regularly assess federal and state guidelines for safe workplace standards. Consider assigning a person or a group of people to hold this responsibility and notify leadership of necessary adjustments.
- Establish a temperature screening process. Make sure to consider protocols for building entry, building re-entry, non-compliance with social distancing guidelines, and isolating individuals who arrive with an elevated temperature.
- Establish a random testing policy for employees who are on site and compare the results with the level of community spread in your community to help monitor whether your organization's social distancing efforts are effective and look for areas of continuous improvement.
- Procure enough personal protective equipment (PPE) to keep the team safe in the event of a shortage. A good rule of thumb is to have a 30-day supply stored at all times.
- Consider establishing a staggered shift schedule to avoid long lines in peak hours, being sensitive to the fact that employees who are also caretakers might have constraints upon their schedules.
- Consider employing peer-to-peer monitoring tactics, such as asking employees to sign a pledge stating that they have read and understand the public health guidelines that they must uphold and publicly posting the pledges. Or consider establishing regular peer-to-peer best practice sharing sessions. These tactics have been shown to increase compliance with organizational policy by 16 to 20 percentage points in the workplace.
- Establish thresholds and triggers to quickly transition back to a remote environment if being on site becomes a risk to the health and safety of employees and the public. There should be clear protocols for moving all or part of the team back into quarantine if the building becomes exposed. Similarly, there should be clear protocols for bringing the team back on-site once the public health threat has been mitigated.
- Look for opportunities to rearrange or redesign physical spaces to ensure social distancing, including options from moving desks further apart to installing Plexiglas shields to separate employees from customers and each other. These changes will look different for different categories of employees, depending on their level of contact with the public and one another.
- Set customer expectations. It is important to clearly communicate updated deadlines, payment due dates, payment channels, processes, and other changes to the public. Whenever possible, it is also helpful to let customers know what to expect before interacting with the government, in particular when they must do so in person.

Above all, emphasize the fact that all these changes to processes and procedures exist for the purpose of protecting public health. Being less available in person flies in the face of longstanding norms around good customer service, meaning that staff might need multiple reminders that this is simply not the case in today's environment. For now, good customer service means limited contact with customers, as counterintuitive as that might feel. Establishing that mindset early on is the surest way to ensure the success of a transition back to on-site work at this time.

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Guidehouse

Regionalizing Services

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Key Points

- Local governments in Michigan were created in the 1800s and generally reflect the needs of that time.
- Regionalizing some services could be beneficial for sound fiscal policy, and local governments have many tools at their disposal to do so.
- It is likely the state government will have to incentivize local governments to regionalize some of their services.

The National League of Cities suggests that local budget shortfalls could reach $360 billion over the next few years. This comes on top of years of declining resources and growing expenditure pressures for local governments in Michigan. Local governments will require a combination of federal aid, state and local revenue increases, service cuts, and changes to service provision to mitigate this predicament.

While much work has been done on the need for more revenue options for local governments, this is only one-half of the fiscal equation. Changes to how local governments provide services is an equally important part of the solution. Local governments are often challenged by vertical fiscal imbalances where their ability to raise revenues does not match their required or desired level of service provision. In 2000, at least half of all local governments did not have sufficient revenue bases to support a basic level of service provision (Walker 2000). This situation has not improved. Additionally, horizontal fiscal imbalance--where local governments of the same type vary greatly in their ability to provide services--has led to increasing social, economic, and service disparities both within metro areas and between metro and non-metro areas as local government structures have become increasingly fragmented.

Local Governments in Michigan

Michigan local government as we know it today was put into place in the 1800s when methods of communication and transportation were drastically different. As a result, many local services are provided by cities and townships instead of counties because they were closer to the people. Today, counties are underutilized and could provide various local services to both residents and their constituent local governments (Citizens Research Council of

Michigan 2017). Regionalizing services opens the possibility to review if services are still needed and how to provide them most efficiently and effectively.

Service delivery at the city and township level allows local units to customize services to meet the demands of their residents, but it is often inefficient when there are large fixed costs each government must meet. Redundancies, including duplication of equipment and personnel, are necessary in this model. Even if local governments are operating as efficiently as possible within the current structure, it is past time to question if the current model is appropriate for the 21st century. The COVID-19-induced recession provides us with the impetus to do just that.

For example, research suggests that benefits can be realized without consolidating governments, but by expanding the county role to handle more functions. Counties already provide a regional form of governance and they are well-suited to administer services to residents of smaller municipalities, such as contracting county sheriff deputies to provide law enforcement services. They can also partner with larger municipalities to maximize economies of scale so that services can be efficiently provided to benefit residents. A number of services that might benefit from an expanded county role include information technology and administration/general government services. Counties could be positioned as a regional support system capable of delivering services, performing functions, and facilitating cooperation that will enable cities, villages, and townships to concentrate their efforts on developing the identity and placemaking that will attract people and businesses.

Government reforms usually fit within one of three areas:

- Consolidation: most general-purpose government roles/responsibilities are moved into a single county or metro government.
- Public Choice: leave government structures unchanged but promote competition and let people "vote with their feet."
- Collaboration: local governments work together with a multifaceted response which crosses traditional jurisdictional boundaries.

Of these, collaboration seems the most promising for regionalizing services in Michigan.

Types and Tools of Regionalism

There are four primary types of regionalism found across the United States (Miller, 2002). These include:

- Coordinating Regionalism: making use of regional councils and area wide organizations.
- Administrative Regionalism: creating interlocal agreements, special districts, urban counties, etc.
- Fiscal Regionalism: regional sharing of the tax-base.
- Structural Regionalism: changing government structures through annexation, consolidation, etc.

When regionalizing, local governments have access to 18 tools (Walker 1987), which allow a balance between local autonomy/identity and working across jurisdictional boundaries.

Easiest	Middling	Hardest
informal cooperation	local special districts	one-tier consolidation (city-city, city-county)
interlocal service contracts	transfer of functions	two-tier restructuring (county-city-city. Ex: Metro Dade County)
joint-powers agreements	annexation	three-tier reforms

		(several municipalities and counties. Ex: Twin Cities Metropolitan Council)
Extraterritorial/cross-jurisdictional powers	regional special districts and authorities	
regional councils/COGs	metro multipurpose districts	
federally encouraged single-purpose regional bodies	reformed urban county	
state planning and development districts		
contracting (private)		

However, the ability of local governments to overcome fragmented regional structures is often constrained by state statutes/constitutions and limited local authority. Additionally, state governments outline how much collaboration can occur among local governments without state legal intervention, and often local governments do not have the authority to make formal agreements with other local governments. As such, it is often contingent on the state government to provide incentives for collaboration and regional decision making among local governments.

Carrot and Stick Incentives

States can incentivize local governments for regional collaboration through both bottom-up (carrot) approaches and top-down (stick) approaches (see Krane, Rigos, & Hill 2001; Miller & Cox 2014). Research has indicated the following approaches are the most successful in spurring regional collaborations.

Bottom-Up (Carrot) Approaches	**Top-Down (Stick) Approaches**
Expanding authority for local governments to enter into service sharing, transfer, or consolidation agreements.	Imposing limits on local revenues and the creation of new local units.
Facilitating local management improvement practices, such as collective purchasing and private contracting arrangements.	Strengthening the authority and capacity of counties to serve as regional governments, expanding their scope of authorized services, and sorting out and mandating transfer of functional responsibilities between counties and municipalities.
Authorizing the use of regional COGs or state areawide districts to provide local services.	Transferring financial and/or administrative responsibility for a service to the state.
Liberalizing or standardizing procedures for initiating annexation, downsizing governing boards, changing forms of government, and consolidating or dissolving jurisdictions.	Creating metropolitan authorities to provide services on an areawide or regional basis.

Providing state funding to support local planning studies for charter revisions and other actions to enable shared or consolidated services and merger or dissolution of local units.	Mandating interlocal or regional cooperation in service delivery.
Strengthening the power of voters to compel service or jurisdictional mergers.	Mandating regional consolidation of a local service.
Designating a state office to provide technical assistance to local government service sharing or merger initiatives and structural reform efforts.	Eliminating or reducing the number of nonviable units—such as some townships, rural school districts, and small general-purpose local units—that have very limited size and functional responsibilities, weak own-source financial bases, or heavy dependence on state and federal aid.
Providing incentives in state aid formulas for regional collaboration or local unit consolidation.	Curtailing or terminating state aid or local revenue authority to units that fail to meet effectiveness criteria (size, cost-savings, etc).
Establishing a statewide benchmarking system to provide the public and policy makers with information about local productivity and progress.	

Recreated from: Nelson, Kimberly & Carl Stenberg. 2018. *Managing Local Governments*. Washington, D.C.: CQ Press, p.77.

Discussion

State and local policymakers can use the list above to incentivize enhanced regionalism in Michigan. Some incentives are already possible under existing legislation, and others may need action by the state legislature to achieve. Local governments are already allowed to create metropolitan area councils (MACs) in statistical areas with less than 1.5 million residents, and these MACs have authority to provide nearly all municipal services (McGee, M.P. & Trebilcock, C.M.). Michigan has 14 metropolitan statistical areas that could create a MAC to share services, some of which already do have MACs. Studies on collaboration provide examples of what can be done.

The Michigan Public Policy Survey, which is an annual survey done by the Center for Local, State, and Urban Policy at the University of Michigan, found that local leaders are generally positive about intergovernmental cooperation and interested in expanding cooperation. In fact, in 2011, 72 percent of local of local jurisdictions report that they are already involved in some form of local cooperation (MPPS March 2011). Survey respondents suggest that their reasons for desiring increased collaboration include wanting to improve the quality of existing services and decrease their costs (MPPS 2010).

Despite positive feedback on intergovernmental cooperation, local governments need additional support and assistance, which may come in the form of revenue sharing incentives. In 2011, 50% of local governments said that revenue sharing incentives would be effective to encourage more cooperation (MPPS March 2011). In 2015, former Michigan Governor Rick Snyder recommended revenue sharing practices which allowed for further collaboration between municipalities, however, further incentivization with revenue sharing could be beneficial

(Snyder). Grants are another consideration, which could offset higher costs in the first few years of new collaborations, or support planning and innovative pilot programs that local governments would not be able to afford otherwise (MPPS March 2011). Beyond grants and fiscal incentives, the Michigan state legislature could consider amending statutes to improve cooperation and providing locals with more technical support (e.g., legal services, contract design).

Conclusion

The COVID-19 recession is going to cost local governments hundreds of billions of dollars in lost revenue across the United States. Rethinking how local governments provide goods and services to citizens throughout Michigan is going to be essential for sound fiscal policy. Long-term strength and resiliency will take strategic, multifaceted actions. Regionalizing some services should help alleviate both vertical and horizontal fiscal imbalances across governments in Michigan.

However, there is no crystal ball or perfect formula to ensure success in regionalizing services. As discussed in an accompanying memo on assessing collaborative readiness (Staley 2020), collaboration is hard work and should not be taken lightly. For local governments to truly be able to adjust how they provide goods and services across jurisdictional boundaries it will likely take state action (both carrot and stick) to incentivize local governments to do so. As Beverly Cigler (2007) noted, regionalism remains "an unnatural act among nonconsenting adults."

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Revenue Sources

City Income Taxes and the COVID-19 Recession

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Key Points

- Twenty-four Michigan cities levy an income tax, which supplements property tax and state revenue sharing and, on average, produces one-third of general-fund revenue.
- In a recession like the one we are in now, income-tax revenues will fall as unemployment rises, which will have an impact on local services.
- Income taxes tend to be strongly pro-cyclical and highly sensitive to changes in the economy.
- For several reasons, income tax revenue losses are likely to be starker for cities than for the state.

The 2020 COVID-19 recession touches people and institutions alike, and local governments are no exception. They are incurring new costs – as operations change to keep workers and the public safe – while revenues decline, related to reductions in economic activity. While property taxes remain stable in the near term, city income tax revenues are another matter entirely.

About the Tax

Any one of Michigan's 276 cities may levy an income tax, under an ordinance approved by a city's legislative body and with voter approval. Currently, 24 cities levy an income tax; they range in size from very small (Hudson) to the state's largest city (Detroit). Fifteen percent of the population lives in a city that levies the tax.

The tax is a direct tax on income for residents, including salaries, net profits, investments, and other income. For nonresidents, it is a direct tax on earnings related to work or business activities conducted in the city. For corporations, it is a direct tax on income earned in the city with allocation based on property, sales, and payroll. The Michigan Supreme Court recently sided with Detroit in a case against a law firm arguing that corporations must include revenue for all services performed within the city, even if a client was in another community.

State law sets the tax rate at 1.0 percent on residents and corporations and 0.5 percent on nonresidents. Some cities are allowed to levy higher rates, but the nonresident rate cannot exceed one-half of the resident rate. For most, the revenue generated is deposited into the city's general fund; a portion of Detroit's city income tax revenue is earmarked for the city's police budget.

Cities, like other Michigan local governments, rely heavily on local property taxes. A Citizens Research Council report suggests that property tax revenues are not sufficient to support local budgets and are disconnected from the local economy. These revenues are supplemented with state revenue sharing, which has been cut substantially over the years. Problems with these sources have led to calls to allow local governments in Michigan to levy more types of taxes (e.g., income, sales, gas, etc.). But so far, the state has largely limited this option to city income taxes. Further information on state revenue sharing for cities, villages and townships can be found in a companion paper here.

While property taxes are generally stable (one major exception: the Great Recession), income taxes grow with the economy and diversify city revenue sources and tax dependence. Their downside is the reverse: Since income taxes are more connected to the economy, they are more sensitive to the business cycle than property taxes and more likely to fall during recessions.

Researchers often measure the sensitivity of tax revenues to changes in the economy using a measure called "tax revenue elasticity."[6] Past research suggests that state income tax revenue in Michigan was stable during the 1930-50 period.[7] Research using more recent data and more sophisticated research methods found that state income tax revenue in Michigan has been much more volatile in the short- and long-run.[8] However, it must be noted that the measure of tax revenue sensitivity in this study generates substantially different results if one does not account for changes in tax rates and points toward a stable state income tax system in Michigan.[9]

Unfortunately, much less is known about the sensitivity of local income tax revenue in response to changes in income. One such study, in the context of school district income taxes in Ohio, shows that local income tax yield grows proportionally to income in the long-run but varies sharply in the short-run.[10] Preliminary analysis using 1996 to 2018 data from eight Michigan cities[11] suggests that city income tax revenues in Michigan are highly volatile. In the long run, a one percent increase in local GDP (used to measure aggregate income) will lead to a disproportionally large increase in city income tax revenue by 1.932 percent. This also implies that, in percentage terms, tax revenue declines will be even greater than declines in local aggregate income or gross local economic activity. In relative terms, this implies that city income tax revenue is more sensitive to income changes than state income tax revenue.

Due to this sensitivity to economic conditions, city income tax revenues will fall quickly when the economy declines. Already, more than a quarter of Michigan's workforce has filed unemployment claims and payroll employment declined by 26 percent in the second quarter of 2020. Cities that rely on income taxes could experience deep financial pain.

City Income Tax Revenue Trends

It helps to look at revenue trends over time. The chart below shows state and city income tax revenue growth as well as city property tax revenue growth statewide. City and state income taxes largely fell from 2000 to 2010 due to Michigan's single state recession and the immediately succeeding Great Recession. The period of economic expansion that began around 2010 saw city income tax revenue grow faster than property tax revenue, but much more slowly than state income tax revenue.

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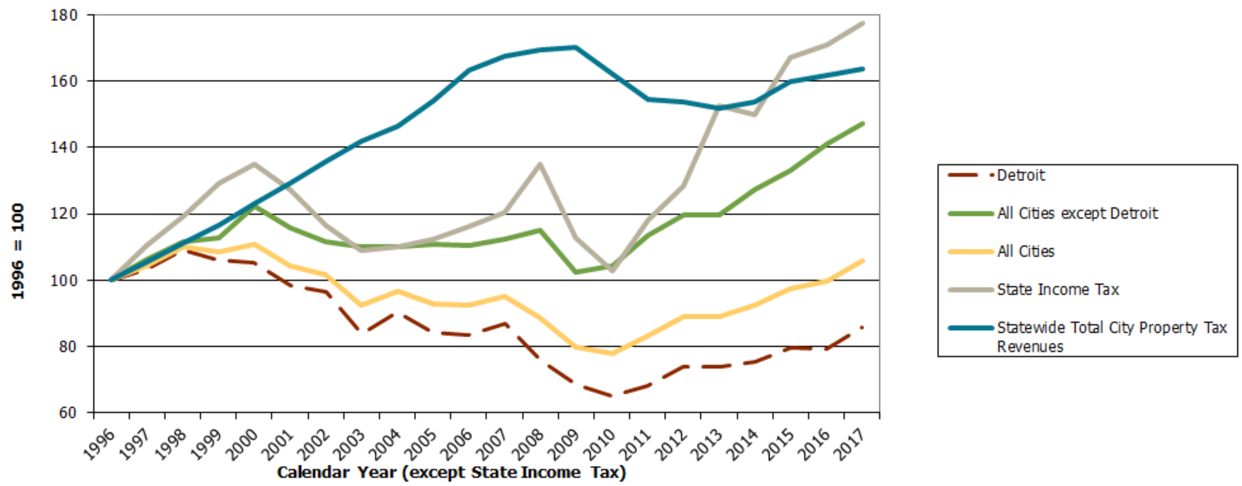
[6] An elasticity estimate less (greater) than unity is indicative of a(n) stable (unstable) tax system, meaning that tax revenue grows or declines slower (faster) than income.
[7] Elasticity = 0.53; Groves and Kahn, 1952.
[8] 1967-2000 state income tax revenue growth: long-run elasticity = 1.879, 1967-2000 state income tax revenue variability: short-run elasticity = 3.21; Bruce et al., 2006.
[9] 1967-2012 state income tax revenue growth: long-run elasticity = 0.753, 1967-2012 state income tax revenue variability: short-run elasticity = 0.7777; Anderson and Shimul, 2018.
[10] 1990-2008 school district income tax revenue growth: long-run elasticity = 1.04, 1990-2008 school district income tax revenue variability: short-run elasticity = 2.54; Hall and Koumpias, 2018.
[11] Battle Creek, Detroit, Flint, Grand Rapids, Jackson, Lansing, Muskegon and Saginaw.

Income and Property Tax Revenue Growth, 1996-2017



Source: Citizens Research Council of Michigan, Outline of the Michigan Tax System; Michigan Department of Treasury

Why the mismatch between state and city? Because income taxes in Michigan are often levied by the state's struggling cities. The local data captures population out-migration and economic losses in core cities. For example, when we pull Detroit out of the equation, we can see growth improves for the other income tax cities.

If we take a close look at total general fund revenue generated (see table below), we find that these cities get approximately 16 percent of their revenue from the property tax, 34 percent from the income tax, and 19 percent from state revenue sharing.

2018 City General Fund Revenue in Income Tax Cities

City	2018 Population	2018 City Revenue	% from Property Tax	% from Income Tax	% from State Revenue Sharing
Albion**	8,477	$4,328,120	23.6%	22.4%	25.6%
Battle Creek	51,247	$50,035,818	31.3%	33.4%	11.6%
Benton Harbor*	9,826	$7,694,016	26.2%	5.5%	30.1%
Big Rapids*	10,395	$8,079,497	40.6%	28.4%	19.3%
Detroit	672,662	$1,005,999,069	11.8%	30.8%	19.9%
Flint	95,943	$50,936,640	9.1%	30.4%	29.8%

Grand Rapids	200,217	$131,146,695	10.5%	62.2%	13.9%
Grayling**+	1,838	$1,665,545	52.2%	0.0%	12.4%
Hamtramck	21,716	$17,455,737	37.9%	15.7%	19.5%
Highland Park**	10,806	$12,543,287	21.9%	30.3%	24.5%
Hudson**+	2,217	$1,963,609	37.2%	0.0%	13.0%
Ionia*	10,952	$5,517,281	11.8%	45.5%	19.9%
Jackson*	32,605	$24,794,433	33.9%	36.5%	18.6%
Lansing*	118,427	$130,362,534	29.5%	29.5%	14.5%
Lapeer**	8,621	$12,218,788	23.4%	26.7%	6.5%
Muskegon	37,287	$28,729,919	25.9%	30.5%	14.5%
Muskegon Heights**	10,731	$7,185,955	30.3%	13.5%	21.7%
Pontiac*	59,772	$35,241,739	24.3%	37.8%	28.2%
Port Huron	28,927	$22,843,436	29.3%	28.4%	19.4%
Portland***	3,927	$2,095,367	51.1%	0.0%	20.4%
Saginaw	48,323	$33,620,591	10.7%	40.8%	24.9%
Springfield**	5,203	$4,093,232	34.6%	24.3%	17.9%
Walker*	24,880	$17,827,957	10.4%	66.6%	11.4%
Total		$1,616,379,265	15.7%	33.6%	19.1%

Note: East Lansing is omitted from the table because it passed a city income tax in 2019 and did not start levying the tax until 2020.
Source: Comprehensive Annual Financial Reports; U.S. Census Bureau; CRC calculations
* State revenue sharing data includes intergovernmental and/or all state revenue from CAFR and may overstate unrestricted state revenue sharing.
** Data from Michigan Department of Treasury F-65 data as reported to Munetrix
*** Portland has a City Income Tax Fund where the $978,774 in 2018 income tax revenues went to support debt service and general government.
+ These cities use income tax revenue for purposes other than to support their General Fund.

Issues That Could Impact City Income Tax Revenue

As the 2018 data show, income taxes make up approximately one-third of general fund revenue, on average, for income tax cities. However, this number ranges from zero percent in cities that use their income tax revenue for other funds to over 60 percent in Grand Rapids and Walker. Given this large share, local services will be impacted because of the current recession as income tax revenues dry up in the short term. The outlook for city income tax collections is worse than that for the state tax. Unemployment insurance benefits are not taxable under a local income tax, but they are for state purposes. Thus, cities will experience greater contraction of their tax bases than the state.

Another challenge presented for cities is the extension of the income tax filing deadline (from April 15 to July 15), which could create cash flow problems (strategies for short-term cash-flow borrowing are described here). While this extension provides valuable relief to taxpayers, it shifts settlement of tax obligations into a new fiscal year for those cities with a July-to-June fiscal year.

For the 2020 tax year, revenues will be affected by the migration to at-home work during the pandemic. Nonresidents are taxed on the income earned while working in the city; those who have transitioned work to their homes will count less of their income as being earned in the city, which will likely be especially problematic for Detroit, Grand Rapids, and Lansing. If people return to the office later this year, this will be a one-time impact; however, if telecommuting and work-from-home becomes more pervasive, this will have a more permanent effect on city finances.

How individual cities fare may also be dependent on their population growth and percentage of residents versus nonresidents. Cities in Michigan levying an income tax have experienced substantially different population changes with cities such as Detroit and Flint suffering severe population declines while others such as Grand Rapids have enjoyed mild population increases. Thus, it is reasonable to expect that population changes are mechanically driving increases or decreases of gross income tax revenue, a “population size effect”. Our preliminary analysis confirms that population growth is an important determinant of the responsiveness of city income tax revenues. When explicitly accounting for population growth in the empirical analysis, we find a much stronger association of city income tax revenue with population growth than per capita city income. Lastly, there is descriptive evidence that income tax revenue in cities with a greater proportion of nonresidents, such as Detroit, is more resilient to sudden income changes.

While the short-term outlook is bleak and will depend on how far income tax revenues fall overall, income-tax cities will benefit from having more diversified revenue sources once the economy begins improving. Unfortunately, we do not know when this economic shutdown will end and how far income tax revenues will fall before that happens.

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Will Property Taxes be Immune to the Effects of COVID-19?

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Key Points

- In the past 50 years, Michigan has experienced at least five periods of economic contraction, including the current COVID-19 induced recession.
- The only recessionary period that saw extended, severe drops in property values and their associated tax revenues was the Great Recession (2007-2009). If history repeats itself, Michigan can expect property values and tax revenues to remain fairly stable.
- Although there is plenty of room for improvement in Michigan's broken municipal finance system, the reliability of the local property tax during most economic recessions should not be dismissed and may provide local governments with one stable revenue source during this period.

The COVID-19 pandemic has largely shut down the Michigan economy and sent the state spiraling into an economic recession. Reviewing property value and revenue data from previous recessions can help to understand the potential impact this one might have on local property tax revenues. A quick look at the data illustrate that, for the most part, property values and tax revenues remain fairly stable during economic downturns.

Although past performance is not an indicator of future success, the Citizens Research Council believes the Great Recession was an exception because of the strong ties of the financial crisis to the real estate market. During the COVID-19 recession, the Research Council expects that the property tax system will perform as it did during previous downturns.

Michigan Recessions Since 1970

Looking at economic data over the past 50 years, Michigan has experienced at least four separate periods of fairly severe economic contraction:

The 1973 to 1975 recession, often referred to as the first oil crisis, reflected the convergence of two forces: the postwar recovery of Japan as a competitive threat to Detroit's big three automakers, and the petroleum embargo enacted by the oil cartel nations in the fall of 1973. Oil prices quadrupled overnight and the nation succumbed to a recession lasting 16 months, with U.S. unemployment levels peaking at nine percent.

The 1980s started with a six-month mini-recession from January to June 1980, which was followed by a 16-month recession from July 1981 to November 1982. During this period, U.S. unemployment levels peaked at 10.8 percent while Michigan's were nearly double that. Real personal incomes in Michigan fell 12 percent and by the time the recovery came, Michigan's purchasing power had fallen from 6.6. percent ahead of the national average to 3.7 percent behind.

After a mild eight-month national recession that started in March 2001, Michigan fell into a single-state recession that lasted much of the following decade. It started sometime in mid-2002 and was signaled by a disruption in employment recovery. Employment and job losses in Michigan did not show signs of stabilizing until 2007. Between 2000 and 2009, Michigan ranked last in the nation on population growth, real per capita gross domestic product, and employment. Michigan also became poorer relative to other states during this period, as its per capita personal income national ranking fell from 19th in 2000 to 41st in 2009.

Michigan's recovery from its single-state recession came just in time for the state to succumb to the Great Recession of 2007 to 2009 that embroiled the whole country in its most severe economic downturn since the Great Depression. The nation experienced peak unemployment of 10 percent and a decline of 4.3 percent in overall production. However, the fallout in Michigan was much worse due, at least partially, to the decline of Detroit's big three automakers' share of the market and profits. Both General Motors and Chrysler filed for bankruptcy. The housing market in Michigan and the nation collapsed; total housing permits issued in Michigan fell 88 percent from 2004 to 2009 and the corresponding value of housing starts fell from $7.6 billion to $1.2 billion.

Michigan experienced 15 percent unemployment, bankruptcies across industry lines, net population loss, and a record number of foreclosed properties. The Great Recession was caused, at least in part, by a housing bubble that led to inflated and unsustainable housing prices. The bundling of subprime mortgage securities spread the economic collapse beyond the mortgage-lending industry.

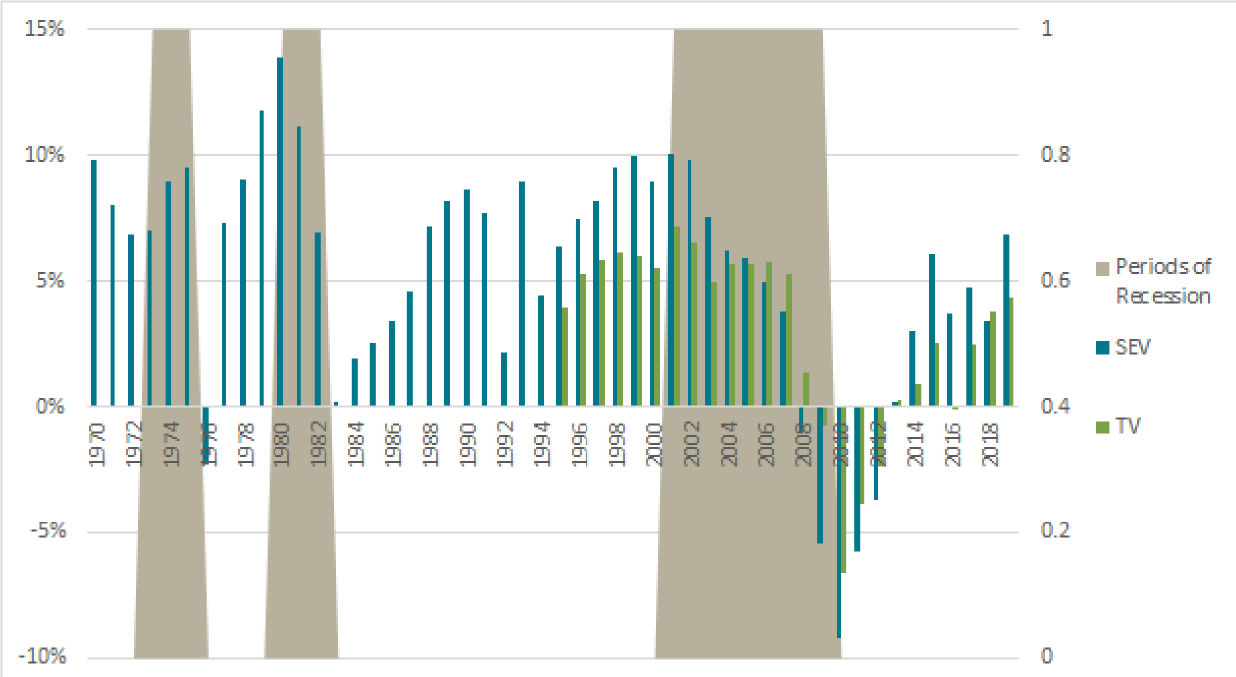
Property Tax Revenues during an Economic Downturn

All local governments in Michigan rely on property tax revenues to some extent, and, for most local units, they make up a majority of local own-source funding. One benefit of a heavy reliance on property taxes is that they tend to be much more stable than other types of taxes, including sales and income.

Chart 1 shows the percentage yearly change in state equalized value (SEV) from 1970 and the percentage yearly change in taxable value (TV) since 1995. This reflects changes in the assessed values that property taxes are levied on. As **Chart 1** shows, property values fell slightly in the mid-1970s due to the recession and were around zero percent growth in 1983 right after the early 1980s recessions (property values do not change immediately and there is usually a lag of a year or two after a recession before changes are evident). They continued to grow during Michigan's single state recession, though at lower percentages than in previous years. The only recession that saw extended, severe drops in property values was the Great Recession, which was precipitated by the housing market crash.

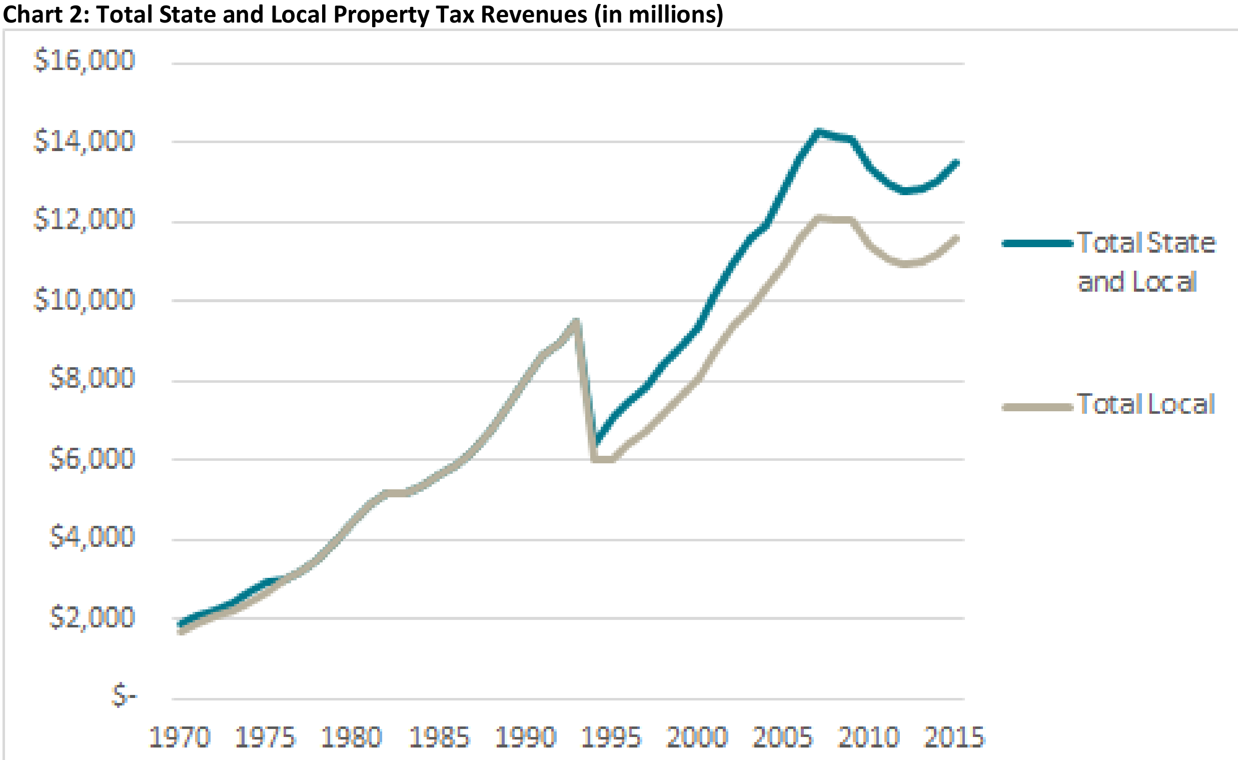
Charts 2-4 highlight what happened with property tax revenues during the recessionary periods. **Chart 2** shows two major declines in total state and local property tax revenues in nominal, or current, dollars: one when Proposal A was enacted in 1994 (no surprise - part of the impetus behind Proposal A was to lower property taxes) and the second was during the Great Recession. **Charts 3 and 4** focus on local property tax revenues disaggregated by jurisdiction type and show largely the same thing - property tax revenues remained fairly stable through all recessions except for the Great Recession.

Chart 1: State Equalized Value and Taxable Value Percent Change from Previous Year



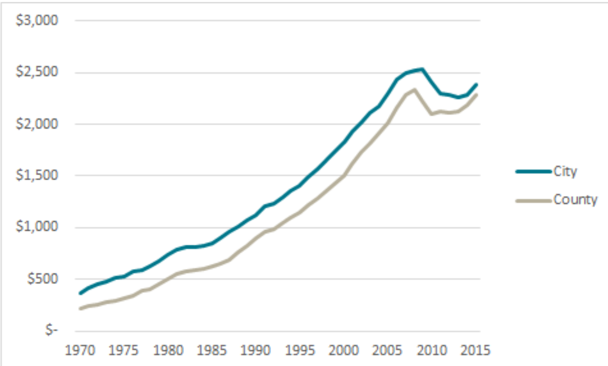
Source: Michigan Department of Treasury

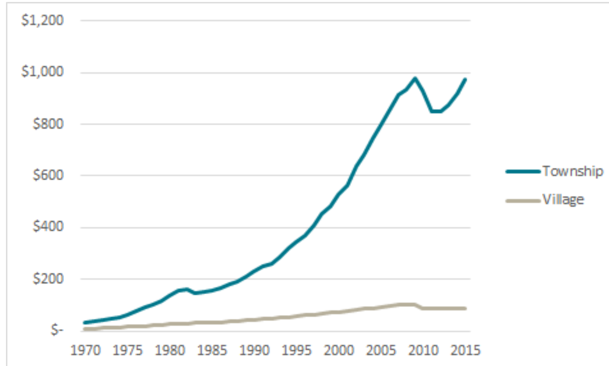
Chart 2: Total State and Local Property Tax Revenues (in millions)



Source: Michigan Department of Treasury

Chart 3 (left): City and County Property Tax Revenues (in millions)
Chart 4 (right): Township and Village Property Tax Revenues (in millions)





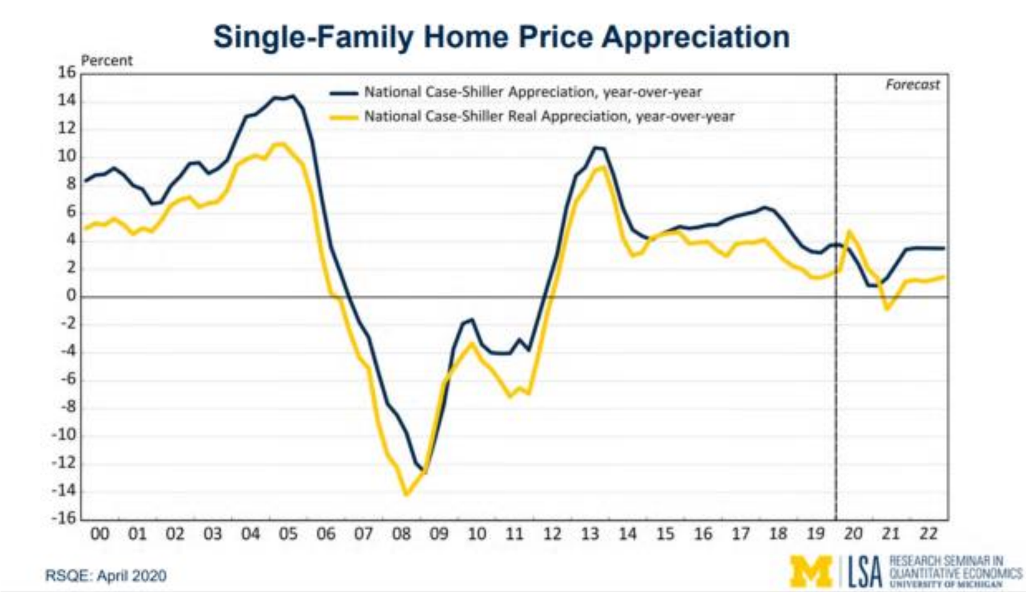
Source: Michigan Department of Treasury

The 2020 COVID Recession

So, what does this historical data tell us to expect moving forward? If history repeats itself with this recession, Michigan local governments can expect property tax values to remain fairly stable, at least initially.

Chart 5 shows the projected single-family home price appreciation at the national level through 2022; it shows that home prices have been stable for the past five years and are projected to remain fairly stable. We do not see large increases creating a bubble like in the early 2000s before the housing market crashed. Prior to the COVID-19 pandemic, low inventory combined with low mortgage costs was contributing to price increases. The forecast shows that appreciation will slow dramatically and the housing market will take a hit as economic fears grow, but these projections do not show large decreases in expected home values. This is partially due to measures in place to suspend home foreclosures and allow for delayed payments in the short run.

Chart 5: Single Family Home Price Appreciation



While past recessions saw high unemployment (though maybe not as high as we are currently experiencing) and sometimes long periods of economic contraction, property values and tax revenues tended to remain stable. Growth may have slowed or stopped, but most recessions did not see large declines in property tax revenue. Unless this pandemic has a long-term impact on real estate markets, it is unlikely to have a great effect on property tax revenues. That said, these revenues could be impacted in the short term, should people and businesses be unable to pay their taxes due to unemployment or business closure.

Proposal A, and the change to basing property taxes on TV instead of SEV, has created something of a bubble that can insulate property tax revenues during periods of decline. Here's how it works: SEV (linked to market value) can be quite a bit higher than TV (linked to inflationary growth or 5 percent, whichever is less). After the housing crash of the Great Recession, SEVs declined but were often still well above TVs. Therefore, TVs still had "room" to grow by inflation and stay below SEV, preventing sharp declines in property tax revenue.

According to the Southeast Michigan Council of Governments (SEMCOG), the ratio of TV to SEV is 78 percent in Southeast Michigan, meaning that 22 percent of property value is untaxed due to the Proposal A cap. This gap may not be 22 percent across the state, but it should provide room in most jurisdictions for property tax revenues to grow even if property values decline. If we experience real declines in property values, the associated revenues will not decline until TV and SEV meet.

Although the Citizens Research Council has long held that the property tax alone is an insufficient revenue source for local governments and there is plenty of room for improvement in Michigan's broken municipal finance system, the ability of local governments to rely on property taxes during recessionary periods should not be overlooked.

The data discussed in this post reflect statewide trends. Data at this level may obscure wider variation at the county or municipal levels. For the most part, we do not expect property values or tax revenues to follow the pattern of the Great Recession, but some individual performances may do worse than others.

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CITIZENS RESEARCH COUNCIL OF MICHIGAN

The Impact of COVID-19 on State Revenue Sharing for Cities, Villages and Townships

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Key Points

- Michigan's unrestricted state revenue sharing programs, both constitutional and statutory, provide cities, villages, and townships (CVTs) funding in place of allowing for broader access to local-option taxes.
- Constitutional revenue sharing will be impacted by the decline in sales tax revenue, but the extent to which the impact is shared over this fiscal year and the next depends on when a local government's fiscal year ends.
- Methods to distribute statutory revenue sharing funds depend on a formula and the criteria to receive funds have been modified over the past decade. These payments are conditioned on state appropriations and may be cut to help balance the state budget, as has been done in past recessions. This expected decrease in statutory payments may be permanent as previous reductions have not been restored.

Michigan's 1,773 cities, villages, and townships (CVTs) rely on unrestricted state revenue sharing payments to supplement locally-raised revenue.[12] The revenue sharing program was adopted after certain local taxes were discontinued or preempted by the state. Today, the program consists of both constitutional payments and statutory payments based on formulas contained in state law and conditioned on annual state appropriations. For some CVTs, revenue sharing comprises a significant portion of their budgets. The economic disruption and state revenue declines caused by COVID-19 will create serious budgetary strain for many local governments.

[12] Counties are treated differently than CVTs; they do not receive constitutional revenue sharing payments and statutory payments are distributed based on population. Full funding for county revenue sharing is 25.06 percent of 21.3 percent of sales tax collected at the 4 percent rate. Like other statutory payments, actual appropriations to counties are routinely below the full funding rate.

Constitutional Revenue Sharing

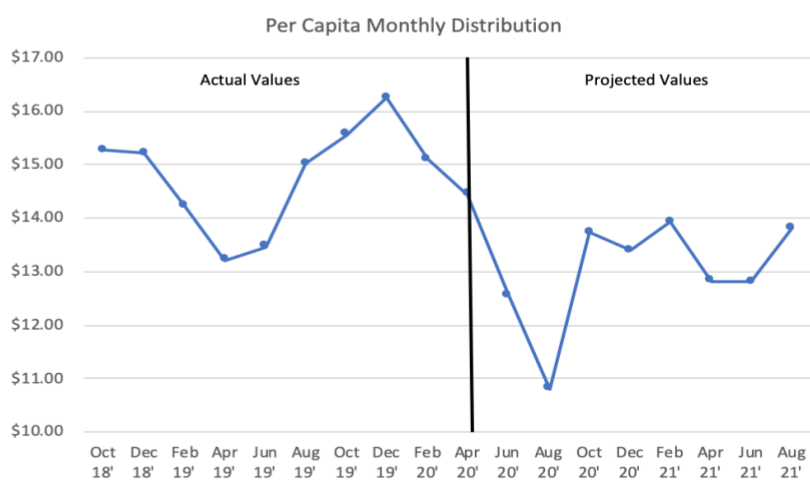
Since a 1946 amendment to the state Constitution, a portion of state sales tax revenue has been dedicated to local governments to utilize as unrestricted general operating revenue. The 1963 Michigan Constitution provides that 15 percent of sales tax revenue collected at the 4 percent rate (the rate at the time) is distributed to local governments on a per-capita basis. The sales tax rate was raised to 6 percent in 1994 by Proposal A, but the revenue from the additional 2 percent is dedicated to the School Aid Fund. Decennial census rates are used to estimate the population of each city, village and township that receives constitutional payments.

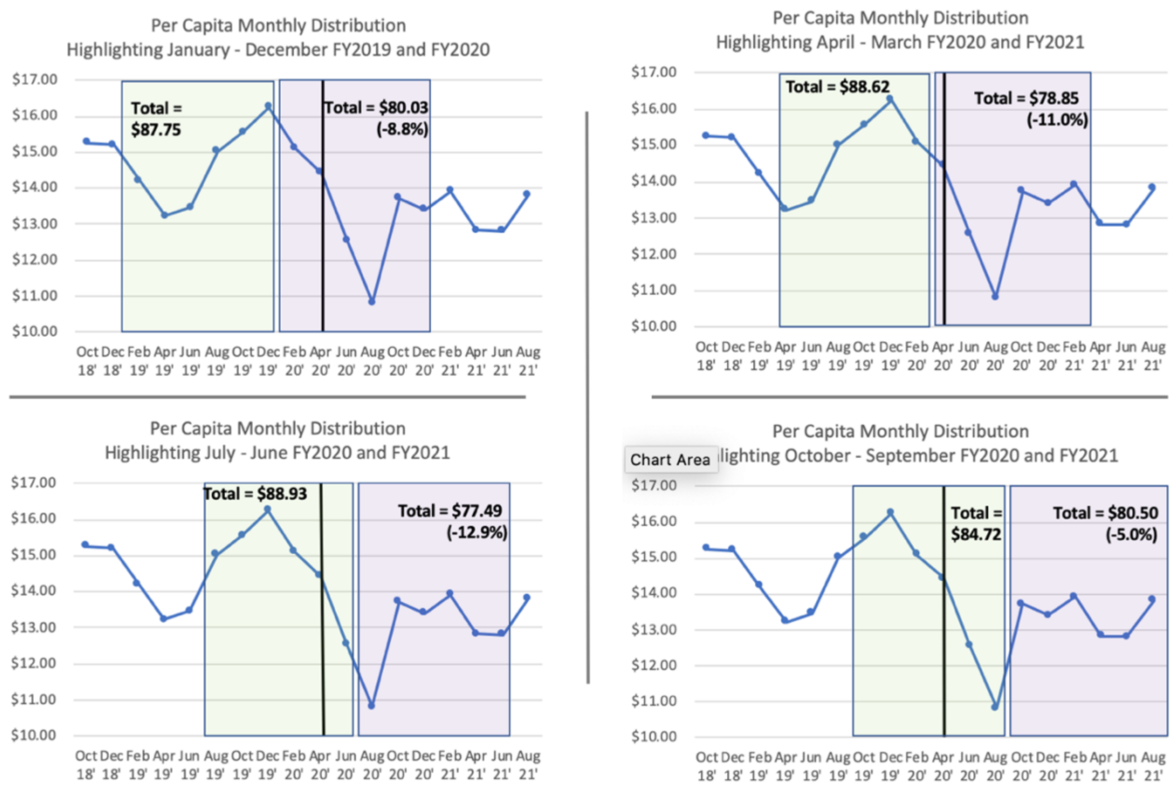
Payments to CVTs are made bimonthly, and the distribution rate is based on sales tax collections from the prior two months. For example, the June 30 payment is based on collections in March and April, the first two months to see major declines in revenue. The total per-capita distribution rate for fiscal year (FY)2019 was approximately $86.40 per resident, based on an October fiscal year. The rates for FY2020 and FY2021 are expected to be less because of the decline in sales tax revenue due to the COVID-19 recession.

COVID-19 Related Impact on Constitutional Payments

Constitutional revenue sharing payment estimates depend on projections of sales tax collections for a given state fiscal year. Current estimates reflect a decrease of 11 percent in sales tax revenue for the state's current fiscal year ending September 30, while total constitutional revenue sharing payments are expected to decrease by 2.2 percent. This difference is caused by the fact that revenue sharing payments lag collections.

Determining how the decrease will affect individual CVTs is complicated by the fact that municipalities have different fiscal years. The total amount an individual CVT receives is dependent on which bi-monthly distributions are included in its fiscal year. Using calculations from SEMCOG, the graph below shows actual per-capita distributions through April 2020 and estimated payments after April based on updated sales tax revenue estimates from the May 15 Consensus Revenue Estimating Conference.





As the graphs illustrate, the decreased payments will affect units' budgets differently depending on when their fiscal year starts. Those starting in July will see the largest decrease in their FY2021 budget compared to FY2020. CVTs with different fiscal years will see a greater decline in FY2020 and less of one in FY2021.

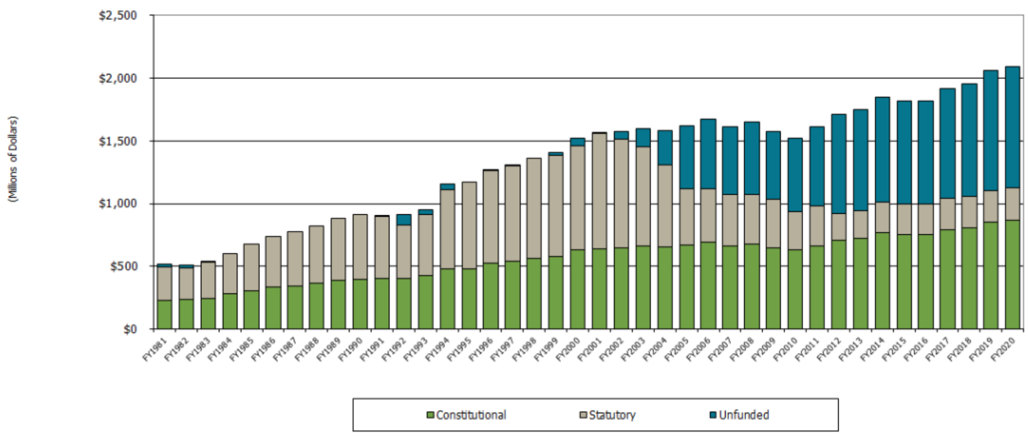
Additionally, because the constitutional revenue sharing is distributed on a per-capita basis, CVTs with large populations will see the largest payment reductions. The decline will impact those units with low taxable values per capita more heavily because they cannot raise as much revenue through property taxes. Also, some CVTs with small populations rely on revenue sharing as a larger percentage of their budget than larger units that may receive a greater dollar amount.

Statutory Revenue Sharing

Statutory revenue sharing payments are based on a formula contained in state law. Less than half of CVTs receive this funding, and because of the way that cuts have been made, Detroit receives more than half of the total distribution. Since inception, statutory revenue sharing has been modified several times. The name itself has changed multiple times and has been referred to as the Economic Vitality Incentive Program (EVIP), and more recently, Cities, Villages, and Townships Revenue Sharing (CVTRS). The statutory distribution formula, as well as sources of funding, have also changed over the years. Today it is funded through sales tax revenues. According to the 1998 statute, full funding would be 75.5 percent of 21.3 percent of the sales tax revenue collected at the 4 percent rate. The formula is designed to take into account the variations in local governments' service delivery needs, infrastructure maintenance requirements, and revenue rising capacity.

However, statutory revenue sharing payments are dependent on annual state appropriations, and the formula described above was never fully implemented. The chart below shows that the state has consistently underfunded statutory payments relative to the full funding level stipulated in law. The revenue has been directed to finance other areas of the state budget. Moreover, since FY2011, payments have been based on a unit's prior year payment. This means that a local government's population, taxable property value per capita, and yield equalization from the early 2000s are still a factor in their current payments.

State Revenue Sharing, FY1981-2020 (budgeted)



Source: Michigan Department of Treasury; Citizens Research Council of Michigan

COVID-19 Related Impact on Statutory Payments

In FY2015, the revenue sharing program was changed in an effort to increase the number of eligible CVTs. The new program, CVTRS, eliminated criteria related to consolidating services and employee compensation as a condition of receiving payments. In FY2020, the criteria were again changed so that CVTs must have received a statutory payment in the previous year and meet requirements related to accountability and transparency in order to be eligible to receive payments. The maximum payment for FY2020 was 102.3 percent of a local unit's combined CVTRS payments (including supplemental payments) from FY2019.

These payments are subject to appropriation risk. They are not guaranteed like constitutional payments. As the chart above illustrates, the state has a history of not providing the fully funded amount, especially during years when its own budget is under strain. The gap is so large that considering the expected decrease in sales tax revenue, even if a local government receives the maximum payment (102.3 percent of its FY2019 payment), it would still not likely reach the fully funded amount.

Given the current pressure on the state budget, legislators may decide to decrease CVTRS payments by an amount disproportionately greater than the decrease in sales tax collections. It is worth noting that implementing a comprehensive negative supplemental bill this late in the fiscal year would be complicated. The state's flexibility is limited because the fiscal year is three-quarters over and making reductions in the budget now may be taking away money that has already been spent. That being said, the state is working on the FY2021 budget, which is more likely to include additional reductions.

While the impact of the current recession is uncertain and state and local lawmakers have not yet made decisions on how to balance the current-year and next year's budgets, previous decisions to balance the budget by cutting revenue sharing have had long lasting impacts. Even with the expansion under the current CVTRS program, payments are still lower than they were in the early 2000s. Methods to distribute statutory revenue sharing funds have been modified several times over the past decade, and more change is likely. Even without major changes, a decision to drastically reduce CVTRS payments this year or next year could potentially have long lasting effects since current payments are dependent on prior year payments.

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CITIZENS RESEARCH COUNCIL OF MICHIGAN

Information Technology

IT Security for Mitigating Fiscal Risk of Remote Work

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Key Points

- As remote work has increased in response to COVID-19, so has risk of cybersecurity breaches. Municipalities face the risk of potentially significant costs in the case of such an incident.
- This fiscal risk can be mitigated through employee education. Working remotely places increased responsibility for cybersecurity on nontechnical employees who need resources to understand cybersecurity best practices.
- Microlearning can be implemented by providing employees with weekly cybersecurity tips. This will promote learning retention and avoid burdening employees with a significant demand on their time.

As employees work away from the office, existing cybersecurity procedures and policies are challenged by these new working arrangements. Also, online scams taking advantage of the situation pose a threat. In this context, it is particularly important that municipalities pay attention to cybersecurity. Cybersecurity breaches can have a significant impact on a municipal budget. This fiscal risk can be mitigated by following cybersecurity best practices. Because employees working remotely are responsible for following security best practices, it is important to educate staff as to what best practices they should be following.

When addressing data security, don’t let perfect be the enemy of good; before you dig a moat around your house, you should lock the front door. There are simple things you can do today to significantly reduce your risk exposure. The following guidance addresses social engineering, use of existing security resources, and data protection, and is designed to be a manageable first pass focused on shoring up municipal cybersecurity without requiring an extensive time or resource commitment.

Fiscal Risk

Theft of personally identifiable information, such as credit card or Social Security numbers, and crypto-ransomware, which encrypts municipal data and demands a ransom in exchange for the decryption key, are two common threats facing municipalities. For example, over the past couple of years dozens of municipalities have experienced theft of credit card information used by residents for online payments. According to the 2019 Cost of a Data Breach report sponsored by IBM, the average cost per record breached in the public and nonprofit sector was $78; with an average of over 16,000 records per breach, the average total cost of a data breach for public and nonprofit organizations in the study was $1.29 million. Furthermore, across all industry sectors the likelihood of a data breach for an organization in the next 24 months involving at least 10,000 records was estimated at 30% in 2019; the risk is now higher as hacking incidents have increased four-fold since the start of the COVID-19 crisis (Checklist, 2020).

Numerous municipalities have also experienced ransomware attacks. While large cities experiencing these attacks often receive a lot of media attention, smaller governments are also suffering from these attacks. For example, the Lansing Board of Water and Light experienced a ransomware attack in April 2016 that cost $2 million for technical support and security upgrades, and the city of Cockrell Hill, TX with a population of 4,200 experienced an attack in December 2016 in which all files in the police department were encrypted; when the city refused to pay the $4,000 ransom, police records back to 2009 were lost (Cliff, 2017). Furthermore, credit rating agencies pay attention to the fiscal impact of such attacks on local governments. Moody's has provided guidance regarding ransomware attacks, including the complex decision as to whether or not a ransom should be paid (Ransomware Attacks, 2019).

Social Engineering

Most municipal staff are not expected to be IT experts. Yet employees have increased technology responsibilities when working outside of a traditional office. While high-tech malicious attacks pose a threat, the weakest link in an organization's cybersecurity is often well-intentioned employees. Social engineering attacks, in which the attacker uses social skills to gain sensitive information or access to the network, are common. For example, numerous organizations have experienced phishing attacks that have tricked employees into emailing W-2 forms directly to attackers.

The following links provide helpful guidance that is understandable to non-technical users.

- Infographic on identifying phishing emails: 5 Signs a Coronavirus Email is a Phish
- Interactive educational quiz: Google Phishing Quiz
- Guidance from the FTC: How to Recognize and Avoid Phishing Scams
- Resource to check whether a website is safe: TrendMicro Site Safety Center
- Infographic explaining how social engineering works: Hacking the Mind: How & Why Social Engineering Works
- Tips for avoiding Social Engineering and Phishing from the Cybersecurity and Infrastructure Security Agency: Avoiding Social Engineering and Phishing Attacks

Use Existing Security

Municipalities may already have access to underutilized security resources. As employees work away from the office and provide more of their own front-line IT support, it is important that existing security measures are followed. Consistently using existing resources can significantly improve cybersecurity without increasing costs.

If your municipality has a VPN (virtual private network), employees should use it when working. A VPN encrypts the connection between the employee computer and the municipal network, preventing employee work from being monitored by third parties. If you do not have a VPN, talk with your IT service provider about selecting and contracting with a VPN service that meets your needs.

Make sure that you trust the VPN employees are using. Avoid free VPN services; those services likely harvest and sell data from users. Likewise, any paid VPN service should be reputable and contracted with the municipality. Employees should not use their own VPN service, paid or free, because doing so would send municipal data to an untrusted third party administering the VPN.

Make sure that software is up to date; updates address known security vulnerabilities. Operating systems and apps on both desktop and mobile devices should be kept updated. Automatic updates should be enabled on all devices to ensure updates are applied. If employees are using their own personal devices for municipal business, it is important to ensure that those devices are properly secured. For this reason, it is best to restrict municipal business to devices that are owned and managed by the municipality when possible.

Protect sensitive data

It is easy for employees to blend home and work during this time. However, it is important to maintain separation between personal life and work when it comes to computers and devices. Municipal work should occur on devices and software accounts secured specifically for municipal work. The following guidance will help secure municipal data.

- Dedicate work devices for work purposes. Family members should not be using these devices, and work computers and devices should not be used for personal access. This practice will help safeguard the security of municipal devices.
- Computers and mobile devices should be set to automatically lock if left unattended.
- Use different passwords for work & personal accounts.
- Avoid using personal data storage and sharing accounts (such as Dropbox or Google Drive) for municipal work. Cloud storage of municipal data should be limited to official municipal accounts.

Because laptops and mobile devices can be lost or stolen, full disk or device encryption should be used on all devices. Encryption will protect data on a device if it is lost or stolen. Also, it is best to avoid storing municipal data on thumb or flash drives because of the risk of losing these small drives. The guidance and links below provide instructions on how to encrypt devices.

- Apple mobile devices: Set to require a passcode. Data encryption is turned on by default.
- Android mobile devices: Set to require a password, PIN, or passcode. Data encryption is turned on by default in Android OS 7.0 and newer. In older devices, go to Settings, then Security, and choose Turn on Encryption.
- Use FileVault to encrypt a Mac
- Use device encryption in Windows 10

Summary of Tips and Resources for Microlearning

Employee education can be implemented through microlearning, where guidance is provided in small pieces. The following tips summarize the guidance contained in this document. These tips can be used to implement microlearning; one of the following resources or topics could be copied and pasted into an email to employees each week. Consider alternating what category the tip comes from each week.

Social Engineering

Tip 1 Infographic on identifying phishing emails: 5 Signs a Coronavirus Email is a Phish

Tip 2 Interactive educational quiz: Google Phishing Quiz

Tip 3 Guidance from the FTC: How to Recognize and Avoid Phishing Scams

Tip 4 Resource to check whether a website is safe: TrendMicro Site Safety Center

Tip 5 Infographic explaining how social engineering works: Hacking the Mind: How & Why Social Engineering Works

Tip 6 Tips for avoiding Social Engineering and Phishing from the Cybersecurity and Infrastructure Security Agency: Avoiding Social Engineering and Phishing Attacks

Using Existing Security

Tip 1 When working remotely, use the municipal VPN (virtual private network). A VPN encrypts the connection between the employee computer and the municipal network, preventing employee work from being monitored by third parties. Also, avoid using free VPN services; those services likely harvest and sell data from users. Likewise, any paid VPN service should be reputable and contracted with the municipality. Employees should not use their own VPN service, paid or free, because doing so would send municipal data to an untrusted third party administering the VPN.

Tip 2 Make sure that software is up to date; updates address known security vulnerabilities. Operating systems and apps on both desktop and mobile devices should be kept updated. Automatic updates should be enabled on all devices to ensure updates are applied. If you are using your own personal devices for municipal business, it is important to ensure that those devices are properly secured. When possible, it is best to restrict municipal business to devices that are owned and managed by the municipality.

Protect Sensitive Data

Tip 1 It is easy for employees to blend home and work during this time. However, it is important maintain separation between personal life and work when it comes to computers and devices. Municipal work should occur on devices and software accounts secured specifically for municipal work. The following guidance will help secure municipal data.

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Tip 2 Because laptops and mobile devices can be lost or stolen, full disk or device encryption should be used on all devices. Encryption will protect data on a device if it is lost or stolen. Also, it is best to avoid storing municipal data on thumb or flash drives because of the risk of losing these small drives. The guidance and links below provide instructions on how to encrypt devices.

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Sources and Additional Information

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This memo is part of a series of memos in the Local Government COVID-19 Fiscal Strategy and Resource Guide, available at closup.umich.edu/COVID-19. CLOSUP has partnered with public finance experts from universities, consulting firms, and research institutions from around the state to provide local governments up-to-date information as well as a set of ideas and tools that will help them strategically navigate the new fiscal landscape.

Have additional questions or issues you think we should address?

Email: localgov-COVID-19@umich.edu

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