
Michigan's Local Financial Emergency Manager Law: Considering the Alternatives¹

Working Paper

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With funding from MSU Extension, the Center works directly with communities to improve their fiscal health. The Center brings the experience and expertise of municipal finance professionals in both MSU Extension and MSU's Department of Agricultural, Food, and Resource Economics together to deliver the latest applied research, tools and best practices to Michigan communities.

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Introduction and Purpose of “Considering the Alternatives” Research Forum

Many local governments in Michigan are fiscally troubled due to factors that include long-term economic decline and population loss, cuts to state revenue sharing, depressed property tax values, growing pension and retiree healthcare benefit revenue demands and poor management in some cases. The Local Financial Stability and Choice Act, (PA 436 of 2012), and the concept of the Emergency Financial Manager (“EM”) was created to provide for State intervention and in some cases, complete State receivership of local governance in instances where the State determines a financial emergency exists. Michigan local governments have had uneven experience with local government emergency management. Emergency management and the use of an EM has been the subject of ongoing discussion and whether the EM law needs revision, especially in recent years due in large part, to the Flint Water Crisis.²

The Michigan State University Extension Center for Local Government Finance and Policy published a white paper, “A Review of Michigan’s Local Financial Emergency Law,” (“white paper”) in April 2017 that sought to explore options to PA 436 of 2012. The research strategy of the white paper were two-fold: 1) review the relevant written literature, law and cases, and 2) to gather information for the report hold two small group meetings in Detroit and Lansing in 2016 with relevant stakeholders including experts involved with Michigan local government, county, and/or school district receivership.³

On November 13, 2017, MSU Extension held a follow up research forum, “Michigan’s Local Financial Emergency Law: Considering the Alternatives”, to build on research and findings previously reported in the white paper. The purpose of the research forum was to gather multi-stakeholder feedback on the feasibility of possible alternatives to PA 436 of 2012 and to determine which alternatives have the most support within the group. Specifically, the forum was held to discuss and expand on the white paper’s four alternative options to current EM law, and to develop next steps for implementing policy change. The four options presented in the white paper are:

1. Repeal PA 436 with no replacement;
2. Adopt a model similar to California, allow bankruptcy without state receivership
3. Amend existing law to involve local officials and clarify state administration; and/or
4. Adopt specific legislation on a case-by-case basis.

The following is a summary of the Considering the Alternative forum. It should be kept in mind not all financial problems can be solved with an EM, especially for systemic and long-term difficulties since EMs are most effective addressing specific short-term budgetary problems.

2017 Research Forum Participants

Similar to the 2016 research forums discussed in the white paper, “Considering the Alternatives” participants in the 2017 forum included some participants from the first forums as well as elected or appointed local government officials, local government association representatives, former emergency managers, financial and legal consultants, academics and other policy researchers. The options and alternatives presented in this report are intended to capture the sentiments and ideas expressed by group participants rather than to capture direct quotes and attribute them to particular people. Therefore, no names will be mentioned in connection with any particular option or idea.

Municipal Financial Regulation: The Broader Context

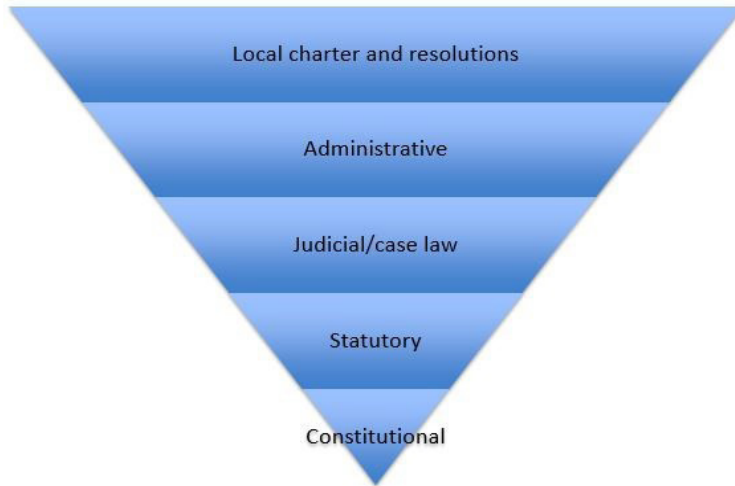
Michigan’s local governments operate within a broad municipal fiscal environment comprised of 1) diverse eco-

² Joint Select Committee on the Flint Water Emergency (Joint Select Committee), Flint Water Crisis: Report of the Joint Select Committee (October 2016), at <https://misenategopcdn.s3.amazonaws.com/99/publications/Final%20Report%20of%20the%20Joint%20Select%20Committee.pdf>.

³ A Review of Michigan’s Local Financial Emergency Law, Michigan State University Extension Center for Local Government Finance and Policy, at http://msue.anr.msu.edu/resources/a_review_of_michigans_local_financial_emergency_law.

conomic and social conditions; 2) state and federal fiscal regulations; and 3) local management and local laws and ordinances (see below diagram). It is in this broader context that any changes to the current EM law needs to be placed and evaluated. It is also noteworthy to remember that not all of Michigan's local governments are endowed with the same financial, economic, or social circumstances.

Municipal Financial Regulation Environment



Numerous constitutional, statutory and State/Federal administrative fiscal regulations influence the local government fiscal context with some having 50-100 years of endurance. Michigan's constitution impacts local fiscal health with policies addressing: 1) constitutionally mandated revenue sharing (as a share of state sales tax revenue), 2) limits to debt issuance based on property assessment; 3) the dedication of a portion the state budget to local governments; 4) requiring local voter approval to increase local taxes; 5) limits on property tax growth.

Some of the statutory state policies designed to promote local fiscal integrity include: 1) statutory determined revenue sharing; 2) standards for budgeting, accounting and local unit debt issuance; and 3) limitations to local tax options.

Some judicial/administrative policies include: 1) limitations to public spending for only public purposes to ensure safety, health, and welfare; 2) lawsuits on unfunded mandate requirement of the "Headlee Amendment".

Local management and local laws impact the environment within which a local unit operates. Some such items include 1) the makeup of the City and county charter; 2) locally imposed property tax limits; 3) a manager verse a strong mayor leadership system; 4) the position and role of the local chief financial officer; 5) local governance and financial management culture

Constraints and Other Impacts

It is well understood that reform of the municipal finance system along with other issues are important and intertwine with Michigan's Local Financial Emergency law. One of the main constraints participants highlighted was the lack of revenue raising tools available to local governments. This is due in large part to Constitutional tax caps, namely the Headlee Amendment and Proposal A.⁴ Revenue plays a critical role in a discussion of local government fiscal distress and, going forward, revenue should be included when dis-

4 See Robert Kleine & Mary Schulz, "Headlee" and "Proposal A" Explained for Michigan Counties, Michigan State University Extension Center for Local Government Finance and Policy, at <http://msue.anr.msu.edu/uploads/235/75790/HeadleeProposalA.pdf>.

cussing local government fiscal distress in conjunction with the EM law.

For an EM to succeed it is necessary that the distressed community “buy in” to the solutions being proposed. This buy in will help inform if and in what ways emergency management is successful. This community buy in could help alleviate the stigma that the local unit takes on once an EM is assigned. Similarly is the very real issue of who would want to be an emergency manager in Michigan today? Given the uneven experience distressed local units have experience under emergency management and the legal ramifications that some former EMs are facing, it was generally agreed that most qualified people may not want the job.

Lack of enforcement of the state policies designed to promote local fiscal integrity are a limitation to more robust state oversight of local unit fiscal health. Currently, there are only five local government finance auditors in the Michigan Department of Treasury who have the responsibility to monitor and audit approximately 5000 local units, which includes municipalities (cities, townships, and villages), counties, school districts, and authorities. Participants suggested that adding more oversight capacity and consequences to existing municipal finance laws would lead to better outcomes.

Some participants noted that there are many differences between school districts and municipalities funding and finances and questioned the appropriateness of addressing fiscal distress for each entity within the same statute. Education is clearly a state function, recognized as such at the federal level, but the state allows local governments to manage education. On the other hand, local governments are creatures of the state and created by the legislature and, at the federal level, there is no similar guarantee for local government. Some participants went so far as to say that EMs are an improper fix for insolvent school districts. The issue is muddled by the dual oversight school districts receive from the state Department of Education and state Department of Treasury. One suggested policy change was to remove school districts from PA 436 and develop tailored and specific legislation to address school district financial distress.

Policy Preferences

Research forum participants broke into small groups to discuss each alternative option described in the white paper. After these small group discussions, each group reported back to the rest of the participants. There was a great deal of consensus among groups. Overall, every small group favored option 3: Amend the existing law to involve local officials and clarify state administration.

Each small group used option 3 as a policy foundation with additional suggestions for policy changes. Policy areas to consider addressing are summarized below.

- Better local input was a popular suggestion. This would include changing the appeals board process to prevent the State having an unfair advantage over local government officials. Extend the timeframe a government has to develop an alternative to the emergency manager’s suggested changes. Currently the timeframe is unreasonably short and lacks true due process, and have local residents vote on options for resolving fiscal crises (ex. raise taxes, cut specific expenditures, request an EM). At the same time, the public needs education on EM law and municipal finance so that when it comes time to vote on proposed plans, they understand what a “no” vote really means.
- Incentivizing or requiring consent agreements. These agreements give local officials an opportunity to discover and acknowledge a problem exists and then begin a recovery process without the intervention of the state and an emergency manager. Consent agreements give local governments a chance to recover on their own terms with their own people and resources.
- As previously mentioned, another policy proposal was to remove school districts from PA 436 and create new legislation to dictate the EM process in school districts.
- Change the structure and role of the Receivership Transition Advisory Board (RTAB), by making the boards less passive and moving away from the “parent-child” model the boards tend to have with recovering municipalities.
- Under the current regime, EMs do not receive technical assistance from the state and best practices

are not shared. EMs are often left to cut expenses without regard for property values. Participants expressed the belief that EMs should protect property values and avoid cutting so much that it creates a death spiral where services deteriorate and people leave. Protecting property values is, arguably, the goal of emergency management and financial recovery.

- Create more flexibility in the consolidation of municipalities. EMs can consolidate or dissolve municipalities according to law. However, there are additional issues regarding consolidation and dissolution. There is a legal process to consolidate Michigan municipalities . One example is the Iron River consolidation . County boards are permitted to merge townships. There is no legal process to dissolve a local government in Michigan; meaning, while an EM can dissolve a local government, there is no uniform process to do it. Dissolution is mentioned in PA 436 but no dissolution process is provided. There are other options besides consolidation and dissolution when it comes to changing the physical make up of a local government. There is a legal process for annexation and even detachment. PA 436 does not mention annexation or detachment. “Dissolve” seems to be a throw away word. One suggestion would be to replace “dissolve” with a term that has a process, such as annexation or detachment.

Thoughts on the Remaining Three Options

Option 1—Repeal PA 436 with no replacement

Participants did not favor repealing PA 436 outright, with no replacement. Complete rejection of this option by all participants, who have different professional backgrounds and experiences and represent different policy interests, was somewhat surprising. Participants were concerned that if the EM law was repealed, then municipalities would be left without the necessary tools to arrest fiscal crises, namely the ability to modify contracts. Both municipal finance laws and the EM law are inadequate to handle the problem of fiscally unsustainable municipalities. Even with the EM’s ability to modify contracts, the law leaves communities without any answer to the problem of bonded debt. Bankruptcy was mentioned as an option that could provide distressed communities the means to amend bonded debt, but that bankruptcy was best avoided. There was also confusion and uncertainty as to when local obligations, debt obligations specifically, become state obligations. For example, much of the debt incurred by school districts is supported by a state guarantee.

Option 2—Adopt a model similar to California

Participants did not favor the California model to allow for municipal and county bankruptcy without state oversight. California takes a very hands-off approach when it comes to municipal financial distress. Most agreed that the State needs to play some oversight role in municipal financial distress. The extent to which the State gets involved, however, is not agreed upon.


Option 4—Adopt specific legislation on a case-by-case basis.

This was not a popular idea and did not evoke much discussion.

Conclusion

Not every situation in a fiscally strapped local government is suited for an Emergency Financial Manager. The work of EMs centers on implementing short-term accounting and financial solutions to personnel, budgeting and accounting problems. However, chronic economic problems are systemic and are not resolved with balance sheet solutions. These long-term difficulties will continue to cause fiscal distress to many local governments.

A local government may find itself in fiscal distress for a number of reasons. An important contributing factor is the limited number of revenue raising tools available to Michigan local governments. An increase in revenue generally leads to a decrease in “failure.” However, failures still happen. Therefore, only fixing



revenue issues and related problems will not resolve local governments' financial troubles, which other laws attempt to resolve. The Local Financial Stability and Choice Act helps resolve some problems, but Act is not perfect and the Emergency Financial Manager concept needs reforming. Research forum participants proposed policy changes to give local governments a better chance of success. Discussions, like "Michigan's Local Financial Emergency Law: Considering the Alternatives" research forum, help generate new ideas and keep the conversation going.

Until the State recognizes the importance of local governments to the state's long-term prosperity, and develops policies to ensure the long-term fiscal stability of local governments, short-term solutions such as the EM law will, in many cases, continue to be an inadequate response to fiscal distress.