MEMORANDUM

DATE: September 22, 2011

TO: All Interested Parties

FROM: Ben Gielczyk, Senior Fiscal Analyst, and Jim Stansell, Economist

RE: Economic Vitality Incentive Program

This memo provides information on constitutional and statutory revenue sharing and the development and enactment of the Economic Vitality Incentive Program (EVIP) for cities, villages, and townships (CVTs) in the FY 2011-12 budget.

Revenue Sharing Background

Historically, CVTs have received revenue sharing payments through constitutionally required revenue sharing payments and legislatively appropriated statutory revenue sharing payments. Constitutional revenue sharing payments are fixed at 15.0% of gross collections of the state sales tax collected at a 4.0% rate and are distributed to CVTs on a per capita basis. Fully-funded statutory revenue sharing payments (including payments to counties) are defined as 21.3% of gross collections of the state sales tax collected at a 4.0% rate. Full-funding for just CVTs would be approximately 15.96% of gross collections of the state sales tax collected at a 4.0% rate.

While constitutional revenue sharing payments are protected under Article IX, Section 10 of the Michigan Constitution, statutory revenue sharing is subject to annual appropriation. Over the last decade, statutory revenue sharing has regularly been appropriated at less than full funding as part of efforts to balance the state budget (See Table 1).

Through FY 2002-03, statutory revenue sharing distributions were determined by the statutory formula developed in PA 532 of 1998.[1] While statutory revenue sharing was initially distributed on a formula basis in FY 2002-03, in December of that fiscal year Executive Order 2002-22 reduced revenue sharing by $53.1 million. Rather than calculate each CVTs share of the reduced statutory revenue sharing amount by running it through the formula, the legislature chose to reduce each CVT's total revenue sharing payment by an equal percentage of 3.5%.

Since FY 2002-03, the formulas developed in PA 532 of 1998 for determining statutory revenue sharing have been abandoned and the act was amended annually such that combined revenue sharing payments (constitutional and statutory) to CVTs have been set as a percentage of the previous fiscal year's combined payment. Since constitutional revenue sharing payments cannot be altered, any changes in annual appropriations for combined revenue sharing have been made in statutory revenue sharing payments.

Statutory revenue sharing payments have been reduced on a regular basis in an effort to balance the state budget. As a result, statutory revenue sharing payments have been steadily declining as a percentage of overall revenue sharing payments (See Table 1). Correspondingly, the number of local units receiving statutory revenue sharing has declined, with a growing number of units receiving only

[1] The statutory formula can be found in PA 140 of 1971. There is also a summary of the formula on the Michigan Department of Treasury website at http://www.michigan.gov/treasury/0,4679,7-121-1751_2197-5658--,00.html. Statutory formulas enacted under PA 532 of 1998 sunsetted on September 30, 2007.

House Fiscal Agency • Anderson House Office Building • P.O. Box 30014 • Lansing, MI 48909
Phone: (517) 373-8080 • **Fax**: (517) 373-5874 • **Website:** www.house.mi.gov/hfa

constitutional payments. Specifically, the number of CVTs that receive a revenue sharing payment has dropped from 1,775 in FY 1997-98 to 755 in FY 2010-11.[2]

FY 2011-12 Program

FY 2011-12 legislative budget negotiations led to the elimination of statutory revenue sharing and the creation of an Economic Vitality Incentive Program (EVIP) in order to restructure the distribution method of unrestricted payments to CVTs. The framework of the program was originally proposed in the Governor's Special Message on Community Development and Local Government Reforms. The stated goal of the program is to reward "best practices" by providing "the incentives and flexibility to engage in serious cost control measures."[3] Details of the EVIP are explained below.

Funding Levels

Legislative budget negotiations resulted in the adoption of a $200.0 million line item appropriation for the EVIP. In addition to the line-item appropriation, the FY 2011-12 budget included $15.0 million in one-time restricted (sales tax) revenue to supplement the line-item appropriation. This appropriation is included in boilerplate (Section 1201) in the General Government article (Article VIII) of PA 63 of 2011.

Under the FY 2010-11 budget, statutory revenue sharing totaled $321.4 million.[4] If combined revenue sharing payments to CVTs were maintained at 100.0% of FY 2010-11 payments, the estimated FY 2011-12 statutory revenue sharing appropriation would have been $311.0 million. Total funding for the EVIP represents a 37.8% reduction from the FY 2010-11 statutory revenue sharing appropriation and a 30.9% reduction from the estimated FY 2011-12 statutory revenue sharing payment.

Of the $215.0 million appropriated for the EVIP, $210.0 million is made available for incentive payments to CVTs. The remaining $5.0 million is placed into a grant program to assist CVTs and counties with the costs associated with service consolidation and cooperation, mergers, and interlocal agreements.[5] The Department of Treasury is tasked with developing a grant application process for local governments wishing to apply for some of the service consolidation and cooperation grant funding. The structure of the incentive payments is outlined below.

Structure of Economic Vitality Incentive Program

The EVIP was created in boilerplate in the FY 2011-12 General Government budget.[6] Because the EVIP is created boilerplate of an annual appropriations act, the EVIP will need to be renewed in subsequent budget bills, or incorporated into a permanent statute, for it to continue in future fiscal years.

In an effort to incentivize certain actions by local governments, the EVIP set up a three-staged qualification process for those CVTs eligible to receive an EVIP incentive payment. For a CVT to be

[2] In FY 2010-11 the number of CVTs receiving a statutory revenue sharing payment increased from 577 to 755 due to the required mid-year Census changes.
[3] See the Governor's Special Message on Community Development and Local Government Reforms at http://www.michigan.gov/documents/snyder/2011Special_Message-1_348148_7.pdf.
[4] FY 2010-11 statutory revenue sharing was supplemented to account for sales tax revenue estimates from the May 2011 Consensus Revenue Estimating Conference and the gains and losses in population due to the 2011 federal decennial census. See PA 83 of 2011.
[5] Compared to the Governor's original proposal, PA 63 of 2011 broadened the acceptable uses of the $5.0 million in grant money available for local governments.
[6] PA 63 of 2011, Article VIII, Section 951.

considered eligible for an incentive payment under the EVIP, the CVT must have received a statutory revenue sharing payment in FY 2009-10 that was greater than $4,500. For FY 2011-12, there are 486 CVTs eligible to receive EVIP payments. Eligible CVTs will be able to qualify for a maximum incentive payment equal to approximately 67.8%[7] of their FY 2009-10 statutory revenue sharing payment. By implementing this threshold, 269 fewer CVTs will receive an EVIP payment in FY 2011-12 than received a statutory revenue sharing payment in FY 2010-11.

Eligible CVTs qualify for one-third of their funding in each of three stages, or categories. CVTs must qualify for each category of funding by the specified due date or they forfeit the remaining incentive payment associated with the category.[8] CVTs may not qualify for partial funding for any of the three categories. Under the EVIP, forfeited funds are designated as work project appropriations and shall be available for the purposes outlined in the EVIP until September 30, 2016. The three categories of funding are described in more detail below.

Category #1: Accountability and Transparency

The first category of funding incentivizes accountability and transparency. Specifically, an eligible CVT must produce, make readily available to the public, and certify with the Department of Treasury a "citizen's guide" and a "performance dashboard" of its local finances, which must include a recognition of its unfunded liabilities. In order to qualify for funding under this category, each eligible CVT must submit its "citizen's guide" and "performance dashboard" to the Department of Treasury no later than October 1, 2011. The Department of Treasury has indicated that CVTs may create the required "citizen's guide" and "performance dashboard" in a manner best suited for the local unit. Nevertheless, in an effort to provide consistency in reporting, the Department of Treasury has developed guidelines and templates that CVTs may follow for both the "citizen's guide" and "performance dashboard."[9]

Category #2: Consolidation of Services

The second category of funding incentivizes cooperation, collaboration, and consolidation among CVTs. However, the category stops short of requiring implementation of the cooperation, collaboration, and consolidation plan to qualify for funding. Rather, the eligible CVT must certify with the Department of Treasury that it has developed and made available to the public a plan with "1 or more proposals to increase its existing level cooperation, collaboration, and consolidation, either within the jurisdiction or with other jurisdictions." The plan must also include past and future service cooperation, collaborations, and consolidations already in place. Additionally, the plan must include savings realized from any past cooperation, collaboration, or consolidation and an estimate of the potential savings from any new service cooperation, collaboration, or consolidation. A copy of the cooperation, collaboration, and consolidation plan must be submitted to the Department of Treasury no later than January 1, 2012 for the CVT to qualify for their incentive payment.

Category #3: Employee Compensation

The third category of funding incentivizes reforming employee compensation. To qualify for an incentive payment under this category, an eligible CVT must certify with the Department of Treasury

[7] The exact figure is 67.837363% of their FY 2009-10 statutory revenue sharing payment.
[8] Payments shall be distributed on the last business day of October 2011, December 2011, February 2012, April 2012, June 2012, and August 2012.
[9] See http://www.michigan.gov/treasury/0,4679,7-121-1751_2197-259606--,00.html.

that it has publicized[10] an employee compensation plan that the CVT "intends to implement with any new, modified, or extended contract or employment agreements for employees not covered under contract or employment agreement." Therefore, while having certified that a plan has been developed and publicized is a requirement for funds under this category, it should be noted that, unlike Category #2 where certification of the plan would be enough, the compensation plan must actually be implemented under any new, modified, or extended contract or employment agreement to fulfill the requirements of the category. To qualify for the incentive payment the employee compensation plan must be submitted to the Department of Treasury no later than May 1, 2012.

In boilerplate, CVTs are provided guidance on what must be included in the employee compensation plan. Each eligible CVT must include, at a minimum, the following:

- Newly hired employees that are eligible for retirement plans must be placed on a retirement plan that caps the employer contribution at 10.0% for those employees eligible for social security benefits. For employees not eligible for social security benefits, the employer contribution must be capped at 16.2%.
- If an employee is a on a defined benefit pension plan, the maximum multiplier shall be 1.5% for those employees eligible for social security benefits. If postemployment health care is not provided, the maximum multiplier shall be 2.25%. For those employees that are not eligible for social security benefits, the maximum multiplier shall be 2.25%. If postemployment health care is not provided, the maximum multiplier shall be 3.0%.
- For those employees on a defined benefit pension plan, the final average compensation shall be calculated using a minimum of three years of compensation and shall not include more than 240 hours of paid leave. Additionally, overtime hours cannot be used in calculating the final average compensation.
- If health care benefits are offered, an employee shall pay a minimum of 20.0% of the premium cost.[11] In the alternative, an employer's share of the local health care plan costs shall be cost competitive with the state's share of the new state preferred provider organization (PPO) health care plan.[12]

The Department of Treasury is not required to specifically review each guide, dashboard, or plan; rather, the Department of Treasury shall develop a certification process for eligible CVTs to follow.

Attachment

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[10] "Publicized" is defined as made available for public viewing in the CVT clerk's office or posted on a publicly accessible Internet site.

[11] Please note the requirements of recently enacted Senate Bill 7. Compliance with the requirements of Senate Bill 7 effectively brings the CVT into compliance with the health care benefits requirement of the EVIP program.

[12] Applies to those employees hired by the state of Michigan after April 1, 2010. For a brief summary of the program, please see http://www.michigan.gov/documents/mdcs/New_Hire_Spotlight_317332_7.pdf.

Table 1: Total Constitutional and Statutory/EVIP Revenue Sharing Payments to CVTs