

# Local Communities At Risk

Revisiting the Fiscal Partnership Between  
the Commonwealth and Cities and Towns

**September 2005**  
**Municipal Finance Task Force**

## The Municipal Finance Task Force

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The Municipal Finance Task Force was created by the Metro Mayors Coalition to review trends in municipal finance and local aid, to understand the impact of such trends on municipal budgets and services, to enable municipalities to develop strategies and policies to better navigate these trends, and to provide recommendations to municipal leaders, the Legislature and the Executive Branch.

## The Metro Mayors Coalition

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The Metro Mayors Coalition is an organization of the ten chief executive officers for urban core communities in metropolitan Boston, who are committed to working together across geographic and political lines to solve the region's problems. Current members of the Coalition are Mayor Thomas Menino of Boston, City Manager Robert Healy of Cambridge, City Manager Jay Ash of Chelsea, Mayor David Ragucci of Everett, Mayor Richard Howard of Malden, Mayor Robert Dolan of Melrose, Mayor Michael McGlynn of Medford, Mayor Thomas Ambrosino of Revere, Mayor William Phelan of Quincy, and Mayor Joseph Curtatone of Somerville. The Metro Mayors Coalition is facilitated by the staff members of the Metropolitan Area Planning Council (MAPC).

## For More Information

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## Acknowledgements

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We also want to thank Joel Barrera, Project Director for the Metro Mayors Coalition, for his assistance in facilitating the work of the Task Force. In addition, we appreciate the contributions of Dina Siegal, Deputy Director, Mayor's Office of Intergovernmental Relations, City of Boston and Lindsay Toghill, Assistant Director of State Relations, Mayor's Office of Intergovernmental Relations, City of Boston.

The Municipal Finance Task Force would like to thank the Metropolitan Area Planning Council for hosting our meetings and helping to produce this document. In particular, we would like to thank Marc Draisen, Executive Director; Stephen McGoldrick, Deputy Director; Amy Panek, Planner; Benny Meshoulam, Assistant Project Director; Andrea Hurwitz, Communications Manager; Mara Callahan, Graphic Designer; Allan Bishop, GIS Manager; Elizabeth Murray, GIS Consultant; and interns Deanna Maranto and Michael Landon.

Finally, the Task Force recognizes the staff members of the Massachusetts Taxpayers Foundation, the Massachusetts Department of Revenue and the Massachusetts Municipal Association for their assistance with this project.

Note: Task Force member Kathleen Kelley, President of the Massachusetts Federation of Teachers, endorses this report, but wishes to reserve her rights in relation to the discussion of potential municipal health insurance reforms.

## Message from the Chairman

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Fifteen years ago I chaired a Commission which studied the partnership between state and local government in Massachusetts and the need for a better way to fund the governmental responsibilities undertaken by each. The complexities of the system then had created significant difficulties in making that partnership effective.

Over the last several months, I once again have chaired a Commission to study the same fundamental issue. The complexities of our system now have become even greater due to a number of factors spelled out in our Report: an increasing share of state and local revenue going to the very worthwhile cause of education, a decreasing share of state and local revenue going to all other local services, a growing reliance on property taxes by cities and towns – notwithstanding Proposition 2½ – and an increasingly frustrated citizenry who are unable to find coherency in a situation where property values have gone up but fundamental governmental services at the local level are threatened or have deteriorated.

There are some fundamental principles that form the basis for the recommendations in the Report: Revenue sharing from the state to local governments must be even-handed, favoring neither state nor local interests or programs; that sharing of revenue should be based upon a substantially enhanced needs-based approach; non-educational governmental services at a local level must be adequately funded or we will have a growing crisis about the fundamental ability of governments to deliver basic services; local government officials should be given the tools to raise local municipal receipts and control costs, in some cases by reducing the constraints of state law.

We have a system that has been cobbled together over many years in an attempt to solve multiple problems. The Commission members, drawn from many different disciplines, have spent many hours poring over the technicalities of our system in order to explain it and suggest improvements. This effort has brought home to me, once again, how difficult a job our state and local officials have in attempting to address a diverse society's issues while dealing with laws and regulations that have been enacted at different times over many decades.

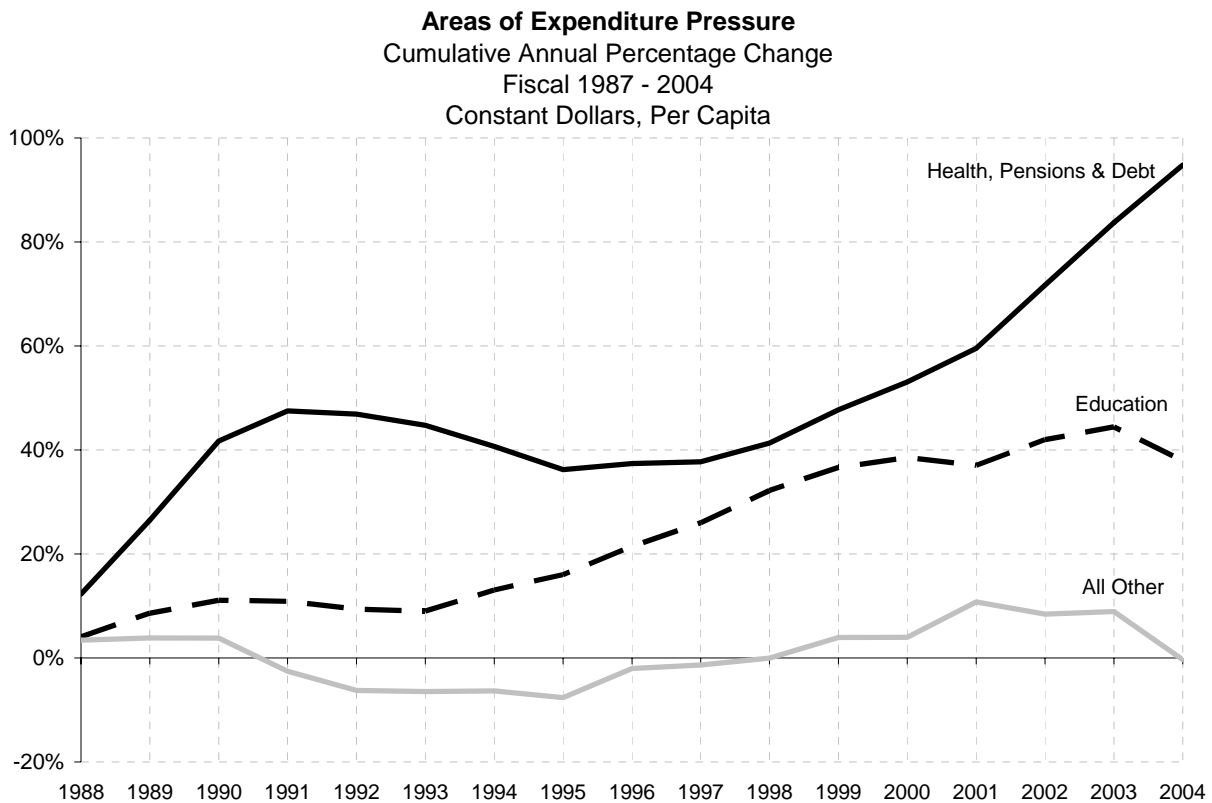
I want to thank all the Commission members and those mentioned in the following pages who served as ex-officio members and technical advisors. They are an outstanding group of dedicated and hardworking individuals. I hope the Report will contribute to a thoughtful dialogue among officials and citizens attempting to find the right balance for this great Commonwealth.



John P. Hamill  
September 6, 2005

# Executive Summary

Massachusetts cities and towns are facing a long-term financial crunch caused by increasingly restricted and unpredictable local aid levels, constraints on ways to raise local revenue, and specific costs that are growing at rates far higher than the growth in municipal revenues. Although there were significant increases in public education funding during the 1990s, general local aid has been stagnant for more than a decade and non-school expenditures have been flat. These long-term structural issues are already squeezing the finances of municipalities – both large urban communities and small rural towns – and Massachusetts has begun to see a decline in municipal services across the Commonwealth. This situation has created a serious strain on municipal budgets that, without changes to state and local policies, will evolve to crisis proportions.



Massachusetts cities and towns are partners with the Commonwealth in delivering public services, such as local and state police protection, educational services from preschool through graduate school, and a transportation system that runs from neighborhood cul-de-sacs to Interstate highways.

Municipalities and the state must work together to solve the short-term fiscal challenges as well as the long-term structural issues that are threatening the viability of local government.

## Maintaining a Critical Partnership

For much of the decade, the Administration and Legislature have had to work in an enormously difficult fiscal environment. In 2002, revenues plunged a staggering 15% due to the combined impact of a collapsing stock market, an economic recession, and a major income tax break that took effect just as the recession began; the resulting financial crisis was made significantly worse by a surge in the largely unavoidable costs of Medicaid, employee pensions, and other major programs.

To deal with the crisis, state policymakers were forced to make difficult and unpopular decisions, including cutting programs across the board and increasing taxes by approximately \$1 billion. For municipalities, it meant cuts to local aid accounts and a “cap” on lottery revenue payouts to cities and towns. It is critical to understand the fiscal context in which those decisions had to be made, and to applaud the positive actions taken in what the Massachusetts Taxpayers Foundation described as the worst state fiscal crisis in a half century.

- Legislative leaders and Administration officials had the foresight to build an enormous “rainy day fund” through the good times of the 1990s, which had reached \$2.3 billion by 2001. Without that rainy day fund, the impact of the fiscal crisis on all state programs, including local aid to municipalities, would have been much worse.
- In 2004, legislators, Administration officials and the Massachusetts State Treasurer created a system to provide a long-term partnership between the state and municipalities to jointly fund the building of public schools in Massachusetts, including a dedicated revenue stream to ensure stability of finances. In addition, after years of wrangling, all the key stakeholders came together in that same year to pass a construction reform package intended to make it easier to build schools and other public buildings.
- Special education (SPED) costs, which can sometimes reach more than a \$100,000 per child, have provided enormous fiscal challenges to municipalities trying to educate children with special needs. State policymakers have created a special SPED “circuit breaker” to share costs with municipalities once a certain threshold of costs is reached with individual students, a change that was enacted in 2000 and implemented in 2004. This has been extremely helpful to municipal budgets.

Clearly, even in the most challenging fiscal times, the Legislature and Administration have tried to maintain a partnership with city and town governments.

Fifteen years ago, a Governor’s Task Force on Local Finance, informally known as the “Hamill Commission,” was asked to review issues related to municipal finance and make recommendations to the Legislature and the Governor. The Hamill Commission brought together many of the state’s leading citizens and municipal finance experts and provided an in-depth analysis of municipal

finances in the 1980s. The Hamill Commission made comprehensive recommendations, many of which became law and helped Massachusetts municipalities navigate through the recent recessions.

This Municipal Finance Task Force report expands on the work of the Hamill Commission to update the story of municipal finances in Massachusetts through the present. The purpose of the Task Force was to review the trends of municipal finances since 1981 in order to highlight important lessons and facts, and to make recommendations about how local governments can continue to provide the kind of public services – quality schools, adequate police and fire protection, accessible libraries, key public health services – that are required in any well-functioning society.

The Task Force held the following principles as core to their review:

- Adequate municipal services – good schools, safe streets, quality human services, roads in good condition – are important to our common quality of life.
- Local government services require sufficient and predictable sources of revenue.
- Revenues through local aid should be provided fairly and the distribution of those resources should be readily understandable.

Plunging state tax receipts during the latest recession forced significant cutbacks in local aid accounts and resulted in a diversion of Lottery proceeds intended for municipalities, undermining the already fragile financial situation of many, if not most, municipalities. The impact of the recession would have been much worse without the foresight of legislative leaders in building a rainy day fund, which helped enormously in managing the fiscal fallout.

However, the problems with municipal finance are not short-term issues. The recent recession reflected long-term municipal finance problems including: dependence on local aid that is both unpredictable and increasingly dedicated to school accounts; the lack of adequate financing structures to give municipalities fiscal flexibility; and insufficient authority to control some municipal costs.

One striking feature of the last several years is the severity of public sector layoffs at the municipal level. The Massachusetts Taxpayers Foundation reported in 2004 that Massachusetts municipal workforces lost 14,200 jobs, or 5.2% of all municipal employees, between February 2002 and August 2004. According to Economy.com, a Pennsylvania research firm, municipalities in Massachusetts cut their workforces more steeply than in any other state in the nation between 2001 and 2005. That reduction in staff often has translated directly into service cuts, such as shortened library hours, fewer health and human services offered to residents, closed fire houses, or fewer police patrols in neighborhoods.



## The Situation in Cities and Towns

Across the Commonwealth, all types of municipalities are facing difficult, long-term fiscal issues. Urban centers, affluent suburbs and rural communities are struggling with tough budget choices and grappling with the beginnings of a municipal finance crisis.

### **Somerville**

As a culturally, economically and socially diverse urban community of about 76,000 people, Somerville's municipal leaders had to take aggressive measures to balance their budget in the midst of steeply declining state aid. Between FY02-FY05, the city endured state aid cuts of more than \$11 million, including a \$4.1 million reduction in Additional Assistance.

The following steps are examples of how the City of Somerville has been working to raise revenues, cut costs and seek efficiencies:

- Laid off a total of 65 municipal employees and eliminated 85 vacant positions. The reductions included: Police (16); Fire (13); and DPW (34).
- Tapped all available excess capacity and raised the property tax levy to the maximum allowable under Proposition 2½.
- Raised virtually all fees, fines and permit rates, and aggressively pursued outstanding taxes from prior years.

### **Lincoln**

An affluent community with a rural and historical ambiance, the Town of Lincoln is facing significant fiscal pressures from cuts to state aid and rising fixed costs. Voters in Lincoln have considered six override elections in the past six years just to maintain basic services.

Growing fixed costs – largely due to personnel expenses such as health insurance premiums, contractually required salary increases, and pension obligations – have forced Lincoln officials to reduce budgets, draw down reserves, and pursue all allowable fee and property tax increases. Six override votes since FY02, and two different votes in FY02 alone, have raised \$1.93 million for the community to use mainly for general operating costs.

### **Hampden**

A rural town of under 5,000 residents in Western Massachusetts, Hampden recently took severe actions to cut town costs. After a failed override vote, the town closed the town library, shut down the senior center and recreation department, laid off two highway department employees, increased transfer station fees, and reduced hours in a number of town departments. Town officials even decided to turn off all 150 of its streetlights.

These steps were taken after voters rejected an override measure to increase property taxes.

## Categories of Local Aid

Across the Commonwealth, all types of municipalities are facing difficult, long-term fiscal issues. Urban centers, affluent suburbs and rural communities are struggling with tough budget choices and grappling with the beginnings of a municipal finance crisis.

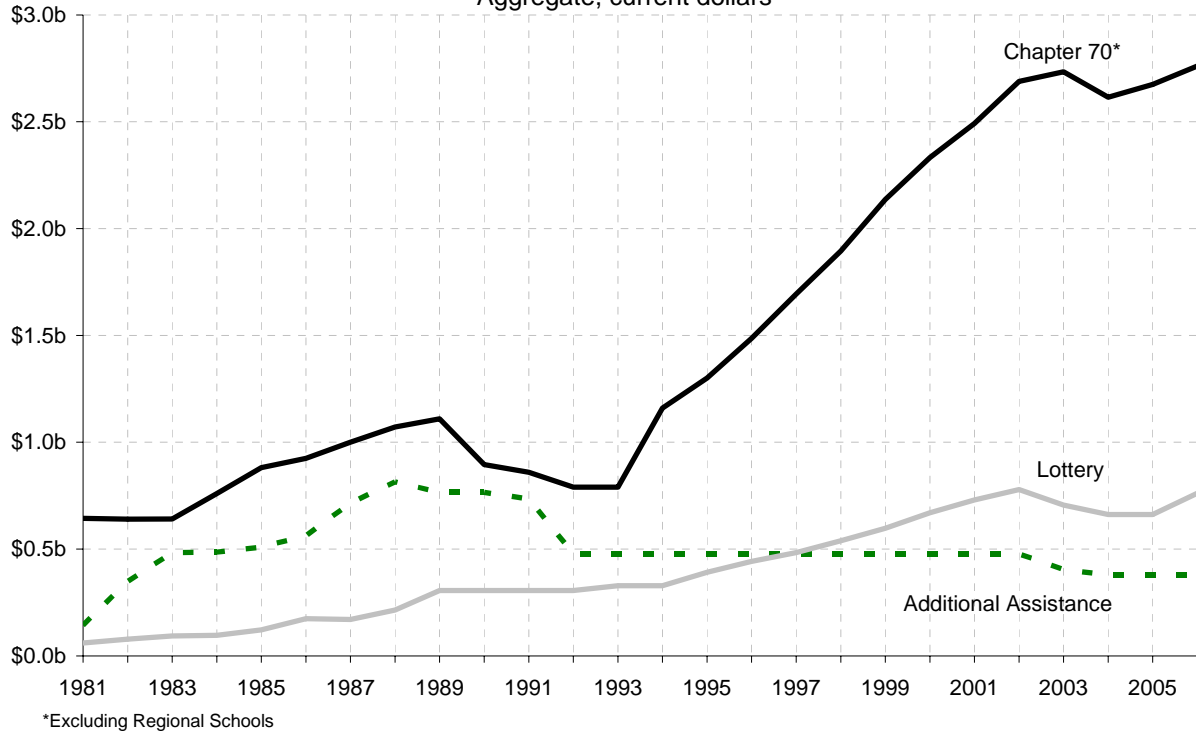
The Commonwealth's partnership with local government is characterized by three main categories of direct local aid, known as "Section Three accounts" because of their placement in the budget:

- **Chapter 70 Aid** provides direct and dedicated funding for public schools in Massachusetts. After the Massachusetts Supreme Judicial Court ruled that the Commonwealth was responsible for providing adequate education to all school-age residents, the state dramatically increased funding for schools, particularly for property-poor communities, through the 1990s.
- **Lottery Aid** is generated by revenues from the Massachusetts State Lottery and is allocated to cities and towns for general support of municipal government. There has been steady growth in Lottery revenues, but the Legislature has twice "capped" payments to cities and towns to divert revenues to state budget line items.
- **Additional Assistance** began as an attempt to recognize disparities in municipal costs and resources, and provides support for general government services. Originally all municipalities received Additional Assistance, but this category of local aid has been cut significantly since 1988, and now only 159 of the state's 351 communities receive this type of general government aid.

There are other ways that state government provides resources to local government, such as school building assistance, Chapter 90 assistance for local roads, and grants for programs such as kindergarten expansion. However, the overwhelming amount of local aid passes through these three budget accounts and most of the discussion in this report focuses on those accounts.

The Municipal Finance Task Force is primarily concerned with *net* local aid, which refers to the state's financial assistance to municipalities after taking into account the state's deductions from cities and towns for services such as charter schools, regional transportation and county governments. The concept of net local aid best reflects the actual dollars being sent to municipal governments.

**Components of "Section Three" Local Aid**  
 Fiscal 1981 - 2006  
 Aggregate, current dollars



## Report Highlights

- Despite stereotypes to the contrary, municipal budgets have seen only modest real increases over the past 24 years. Since 1981, per capita annual growth for municipal budgets has averaged only 1.1% after adjusting for inflation.
- After Proposition 2½ capped growth in local property tax revenues, local aid became increasingly important to municipalities. However, the percentage of state expenditures for local aid has never returned to its fiscal 1988 peak of 20% of total state expenditures. After dropping to 13.4% in 1993, direct local aid accounted for 16.4% of total state expenditures in 2004.
- The advent of Education Reform has meant that almost all real increases in local aid since 1993 have gone to Chapter 70, the state’s education local aid account. Massachusetts has a constitutional duty to provide adequate education opportunities to all children, and under the 1993 *McDuffy v. Robertson* decision, Massachusetts was required to boost state support to public

education to equalize resources among property-poor and property-rich school districts. Over the past 12 years, the Commonwealth has more than doubled its financial support for public schools, with much of this additional aid going to poorer school districts. This increased funding has been a boon for many communities, but Chapter 70 aid also requires all municipalities to increase their budget commitments to schools by a fixed percentage each year.

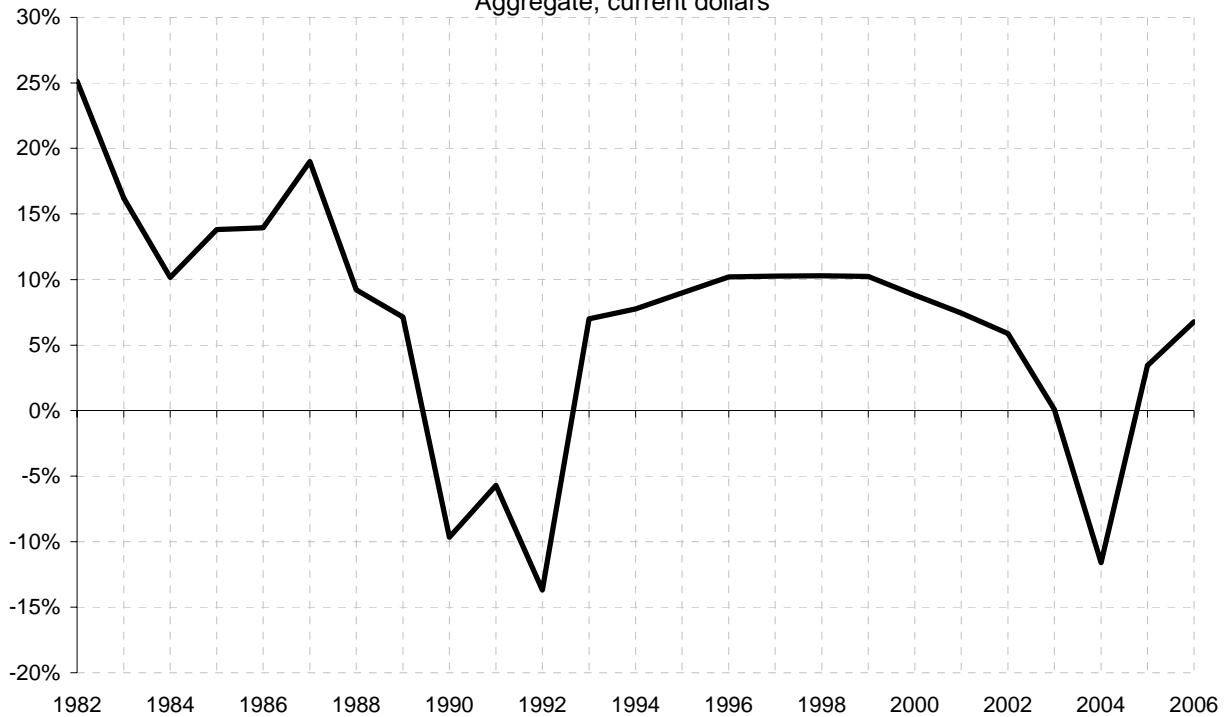
- Although the major increases in school aid to many school systems have been welcome and helped to improve public school education, particularly in poorer school districts, the emphasis on school aid and school spending has meant that other parts of the municipal budget – including such core municipal services as libraries, public health, public works, community development and planning, and police and fire protection – have faced ongoing challenges. Since 1987, annual municipal expenditures for core municipal services (excluding school spending, health care insurance, and some “fixed costs” like pension obligations) have been stagnant in real terms, with -0.3% average growth in per capita expenditures.

### Potholes in Public Works Spending

The decline in public works spending is one indicator of the tough budget choices that municipal governments have been making. Cities and towns have gone from spending 15% of their municipal budgets in 1987 on public works, such as street maintenance and trash pickup, to 9% in 2004. As an example, in Northampton, Mayor Clare Higgins was forced not to fill 10 public works employee positions, or 19% of her public works staff. Likewise, in Somerville, Mayor Joseph Curtatone now has 34 fewer public works employees as a result of the recent recession.

- The concept behind the Additional Assistance local aid account – providing aid in proportion to costs and inverse to resources – is a sound one. However, over the past sixteen years this account has either been level funded or cut. Communities’ specific dollar amounts were frozen, reduced proportionately or eliminated altogether. Since 1988, 192 municipalities have stopped receiving general government support through Additional Assistance. Moreover, even those communities that still receive Additional Assistance have seen that category of local aid fall by \$436 million since 1988.
- Overall, local aid has proven extraordinarily unreliable during periods of economic recession. The two recessions in the late 1980s and the early 2000s reveal a clear pattern of significant reductions to local aid accounts when the Commonwealth’s budget is strained, disrupting municipal finances. As the largest “discretionary program” in the state budget, aid to municipalities has been extremely vulnerable to fluctuations in the state’s revenues.

**Annual Percent Change in Net Local Aid**  
 Fiscal 1981 - 2006  
 Aggregate, current dollars



- Massachusetts communities are seriously limited in the ways they can raise their own revenues, resulting in a return to reliance on the property tax. In 1990, property taxes represented 48% of total municipal revenues. By 2004, property taxes represented 53% of total municipal revenues, meaning that local homeowners and business owners have shouldered an increasing burden. This trend contrasts starkly with the long-term nationwide trend away from reliance on the property tax and toward state aid, local option taxes and user fees to fund local services.
  
- Homeowners also bear an increasing tax burden because home values have continued to rise while commercial property values have stagnated or declined since 2000. Under the rules of Proposition 2½, municipalities do not receive less property tax revenue when one class of property declines and the other increases: instead, the tax burden shifts to the growing class of property. Consequently, residential taxpayers have seen tax increases of hundreds or thousands of dollars, despite temporary legislation to smooth the tax shift in communities with different tax rates for commercial and residential properties. The Massachusetts Department of Revenue reports that residential property taxes now represent 72% of all property taxes paid, up from 68% in 2000. Excluding communities with residential tax exemptions, the Department of Revenue reports that the average family tax bill on residential properties has increased \$910 from

FY2000 to FY2005. In communities that classify properties, commercial property taxpayers pay significantly higher rates than residential taxpayers.

- Municipalities are experiencing tremendous pressure from health insurance costs, which are growing many times faster than general inflation. Municipalities have faced double-digit increases in health insurance costs since the late 1990s, and that one line item has grown by more than 60% since 2001. Indeed, many communities now spend more than 10% of their total budget on health insurance. These trends in health insurance costs are not sustainable and have put enormous pressure on municipal budgets.

## The State Revenue Context

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Revenues from state taxes and fees directly and dramatically affect the ability of the Commonwealth to assist municipal governments through local aid, and many of the state revenue questions currently being debated are relevant to municipal government finances. This report does not go into detail on these state-level debates, but they cannot be ignored because of their potential impact.

During the boom times of the 1990s, the Legislature cut state taxes more than 40 different times. The unprecedented growth in the economy allowed the state to expand local aid, build up state programs, and still cut taxes to individuals and businesses. Taxes were lowered on individual income, capital gains, and corporations, and special tax deductions were given to senior citizens and newly-graduated students with college debts. Many of these tax policies achieved important policy objectives.

Massachusetts has shed its earlier "Taxachusetts" label. According to an analysis of U.S. Census data by the Massachusetts Taxpayers Foundation, the Commonwealth ranked 47th nationwide in 2002 for state and local taxes and fees as a percentage of personal income. At the same time, the Foundation reported that Massachusetts property taxes were 9.1 percent above the national average, and that the state ranked 17<sup>th</sup> in terms of property tax burden.

The Legislature is currently and continually debating income tax rates. A proposal to reduce the income tax has been contentious for many years. In 2000, citizens voted to lower the income tax rate to 5%; however, the state's financial situation has changed considerably since the vote occurred prior to the most recent recession. The fact remains that cutting the state income tax rate to 5% would diminish annual state revenues by approximately \$575 million at a time when municipalities need growth in local aid accounts simply to return to the level of support they received in FY2002.

For local officials in many struggling communities, increases in the state's two broad-based taxes – the income and sales taxes – are appealing because of their potential for generating significant additional revenues that could help ease the pressure on municipal finances. For example, a one-half percent increase to the income tax rate would bring in approximately \$950 million and a one cent increase in the sales tax rate would raise about \$800 million in revenue. Historically, however, the Commonwealth has financed expanded spending from growth in the existing tax base, and turned to tax increases only in times of fiscal crisis.

## Recommendations

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In order for municipalities to survive and thrive over the next two decades, the Commonwealth should pursue local aid and policy strategies that can fulfill three goals:

- **Ensure that state assistance to local governments is sufficient and predictable,**
- **Provide cities and towns with flexibility to control local revenues, particularly those revenues that do not depend on the property tax, and**
- **Give communities the tools to control costs as much as possible and require sound financial management at the local level.**

### 1. Ensure State Assistance is Sufficient and Predictable

**The Commonwealth of Massachusetts should formalize its partnership with cities and towns by adopting a revenue sharing policy that allocates a fixed percentage of state tax receipts for the primary local aid accounts that support municipal government, with this percentage based on the prior year's actual state revenue.** Even though such a policy cannot prevent fluctuations caused by economic factors and changes in state revenues, it can protect local aid accounts so that they will not bear a disproportionate share of cutbacks, and it will provide certainty to local budget writers.

In the years following the adoption of Proposition 2½, the state followed an informal revenue-sharing policy that made it possible for cities and towns to meet the requirements of that measure to reduce or stabilize property taxes, while continuing to support schools, public safety and provide other services. The policy resulted in the allocation of an increasing share of state revenues to local support. Two recessions and increased state expenditures on health care and

other services have upset that informal arrangement, and the Commonwealth's percentage commitment to local aid has been reduced over the last fifteen years.

As Massachusetts policymakers make annual decisions on local aid, they should recognize the state's critical responsibility to support local government generally, in addition to their support for public education. The viability of municipal government is at stake. Additional Assistance and Lottery proceeds now account for only about 20% of total local aid. More importantly, correcting for inflation, the state's support for the non-school side of municipal government has suffered decreases since the early 1990s.

**Massachusetts should support general municipal government by returning to a formula-based approach of distributing local aid that captures and responds to the disparities in the cost of providing services compared to available municipal resources.** To succeed, this reform effort should hold current Additional Assistance communities harmless, but use additional funding as a base to broaden non-school aid. Such a reform will take time, research and resources to implement.

The previous Hamill Commission made a strong statement that local aid should be done using a "needs based" formula: "This formula has general acceptance among local governments. This acceptance reflects its utility. It should continue to be the vehicle for allocating the annual increase in all revenue sharing support, with the exception of regional school aid." The present Task Force concurs that one of the rationales of state assistance must be to even out disparities in resources available to municipalities, and that this distribution should be done in a transparent manner.

**The Legislature may want to consider whether certain categories of municipal expenses that are prone to uncontrollable increases should be treated as special cases and whether it makes sense to create a "circuit breaker" mechanism to help municipalities deal with these costs.**

Municipalities face certain especially volatile and difficult to control costs, such as snow and ice removal. One way to provide relief would be to provide direct, partial state reimbursement for such cost spikes, modeled on the existing special education (SPED) "circuit breaker," which provides a state contribution once SPED costs reach a threshold amount for an individual student. This "circuit breaker" model developed by the Legislature has proven to be an exceptionally welcome solution for municipalities to help them handle SPED costs.



**The Commonwealth should fulfill its commitment to use Lottery proceeds to benefit local government by lifting the current cap, which diverts Lottery income from cities and towns.** The Municipal Finance Task Force endorses an accelerated schedule to uncap distributions, and urges the Legislature to honor its commitment to use Lottery proceeds to benefit local communities exclusively. Massachusetts adopted the State Lottery in 1971 for the explicit purpose of generating local aid to cities and towns: MGL Chapter 35 §10 has as its goal: “provide local property tax relief and continue services at the local level.” By statute, Lottery revenues are intended to be used only for payment of prizes, administrative expenses, and local aid to municipalities.

**The Municipal Finance Task Force believes it is time to review and revise funding for public education through Chapter 70 local aid. The Task Force urges a re-examination of the municipal revenue growth factor and the minimum local contribution, and is open to considering the idea of adding an income element to Chapter 70. However, any reforms must be fully understood to avoid creating new inequities in such a complex funding system.** There is now active discussion in the Legislature and Administration about potential changes to the Chapter 70 formula, which represents two thirds of all direct local aid funding. Chapter 70 has not been significantly modified since the reform law was adopted in 1993. Specific attention should be given to regional school districts, which present unique issues.

## **2. Provide Communities with Additional Ability to Control Non-Property Tax Local Revenues**

**Municipalities should be granted additional flexibility in developing local option revenue sources.** Special excise taxes, such as local option meals taxes, parking excise taxes or rental car surcharges, would give municipalities help with their financial bottom lines and diversify municipal revenue streams.

Because these special excise taxes will have varying relevance to different communities and large disparities in tax rates across communities may distort economic location decisions, this strategy of broadening local revenue options should be part of a comprehensive strategy to stabilize municipal finances.

**The Municipal Finance Task Force believes it is time to consider changes to update the motor vehicle excise tax. In particular, the valuation schedule should be brought into line with actual vehicle values, and Massachusetts must aggressively tackle widespread fraud in vehicle registrations that cost municipalities revenue.**

The Commonwealth should consider changes to the motor vehicle excise tax (MVE) to better reflect the value of the automobile, as well as to aggressively tackle the issue of tax evasion caused by misrepresentation on car and truck registrations. The MVE is an underappreciated component of municipal finance, which generated more than \$600 million for municipal budgets in FY2004. A more realistic depreciation schedule would require only a slight modification to current law while generating significant new revenues for municipalities.

Widespread fraud in automobile registrations costs municipalities significant revenue every year. The Commonwealth could correct issues with fraud by making registration and MVE tax collection dependent on the primary residence of the owner, rather than where the car is reported to be garaged.

**There are several tax issues currently being debated at the State House that have a direct impact on municipal revenues. Although these are certainly contentious matters and arguments can be made on either side, the questions of telecommunications taxation and hotel/motel taxes deserve serious review.**

One particularly controversial issue involves the way Massachusetts taxes or does not tax property owned by telecommunications companies. One side, led by Boston Mayor Thomas Menino and other municipal leaders, argues that a 1913 statute and recent court cases unfairly exempt telecommunications companies from personal property taxes that they feel should be paid to cities and towns at a time when residential property taxes are already going up. Estimates of the potential loss in tax revenue to municipalities vary widely; however, the Massachusetts Municipal Association estimates it to be as much as \$140 million.

The other side, led by telecommunications companies and organizations like the Massachusetts Taxpayers Foundation, argues that current tax laws provide an important incentive for telephone companies to invest in Massachusetts and that a tax increase would raise consumer phone and cable rates and send a poor signal to employers as the economy is just emerging from a recession.

Whatever the merits of these arguments, it is an important public debate that deserves careful consideration because of its serious impact on private investment and municipal budgets across the state.

Also, Governor Mitt Romney last year put forward a proposal to close a tax loophole caused by confusion over what the rate of hotel/motel taxes should be for reservations made through the Internet: Should the tax be calculated on the amount the person actually paid for the room or on

the discounted rate given to the Internet company that resold the room? For municipalities, this issue is important because the hotel/motel tax is one of the few local option taxes available to cities and towns. According to estimates from the Massachusetts Department of Revenue, this loophole will cost cities and towns between \$5 million and \$7.3 million in FY2006, and slightly more in FY2007. The Legislature is again considering the reform, which directly affects local budgets.

### **3. Give Municipalities the Tools to Control Costs**

**Massachusetts policymakers must make the municipal health care crisis a top priority because current cost trends are unsustainable for municipal budgets and these health insurance increases are crowding out other public benefits. This is a very contentious issue, but Massachusetts must find a way to mitigate spiraling municipal health care costs while also protecting employees and retirees.**

Fortunately, the Governor and leaders from the House of Representatives and State Senate are focused on major statewide reforms to the health care system because of its continuing high cost impact on employees and employers. While recognizing that the health care crisis is a systemic problem not easily resolved, dealing with municipal health insurance must be high on state policymakers' agenda.

A recent Massachusetts Taxpayers Foundation report underlined the crisis in municipal health insurance costs. Their survey of 32 cities and towns, undertaken in cooperation with the Massachusetts Municipal Association, found that employee health care appropriations had risen 63% since 2001, at the same time that total municipal budgets had only grown 14%. Eighty percent of all Proposition 2½ allowed growth on property tax revenue from existing properties went to one line item – health insurance for employees – and one-fifth of communities responded that health insurance costs ate up *all* the revenue growth allowed by Proposition 2½.

There are competing ideas for how to deal with the municipal health care crisis. Municipal leaders propose the following strategies to help them better manage health care costs:

- Massachusetts cities and towns could be required to enroll retirees in Medicare within the next three years since they already pay to belong to the Medicare system and enrollment can save municipalities millions of dollars in premiums. State employees are already automatically enrolled in Medicare once they turn 65. The City of Springfield will save \$3 to \$5 million in 2006 because it recently adopted the local option to enroll retirees in Medicare.

Chapter 32B § 18 mandates that the benefits in the Medicare plan offered to the employees must be comparable to those in their municipal plan.

- Municipalities could be given additional flexibility under Chapter 32B to bargain individually with unions on contribution rates for indemnity plans, rather than requiring unanimous consent by potentially dozens of unions. These ideas are already part of the public debate through both the Governor's and the Senate President's health care proposals.
- The Administration and the Massachusetts Taxpayers Foundation have proposed creating individual municipal Group Insurance Commissions to govern local health insurance plans, a proposal that will be debated in the Legislature.
- The Commonwealth could make it easier for municipalities to jointly purchase health insurance plans, particularly for urban communities that do not have the same history as smaller towns of collaborating on the procurement of health insurance.

Public employee unions argue that some of these strategies represent cost-shifting to employees rather than real solutions to the health care crisis and that any proposal to change collective bargaining is an assault on employee rights. Moreover, some union supporters argue that municipal employee benefits were negotiated by public employee unions, that those employees may have given up other benefits or pay during the negotiation process, and that any changes in health insurance should be negotiated directly between union and municipal leaders.

This is an important and controversial debate, and these diverse perspectives should be heard to find solutions that alleviate this budget-busting line item while protecting employees and retirees.

**The Commonwealth should do everything possible to encourage regional service delivery and cost sharing in order to promote efficient government.** One simple way to boost regional service delivery is to make inter-local agreements easier to negotiate and sign. The Massachusetts Municipal Association has sponsored legislation that would allow boards of selectmen to authorize these agreements, rather than requiring a vote of town meeting. Beyond that, the Legislature and Administration should look for opportunities to create incentives for municipalities to work together. For example, state grant programs could favor applications submitted jointly and that demonstrate a willingness to share costs and resources. There are a number of areas where joint provision of services may make sense, particularly for smaller communities. Examples of potential areas for collaboration include joint delivery of veterans' services, building inspections and public health departments.

**The Legislature, Governor and municipal representatives should look for ways to clarify the roles of municipal and state governments, and develop a plan to let the state take responsibility for what are properly state functions.** In particular, there are unresolved questions about improving the way that regional transit authorities, including the MBTA, are funded so that they can be stand-alone organizations with dedicated funding, rather than being subsidized through complex assessment systems on local governments. In addition, county government is still being supported by municipal assessments in some parts of the Commonwealth. It would make more sense – if the Legislature chooses to continue with any form of county government – to organize them without requiring a financial drain on cities on towns.