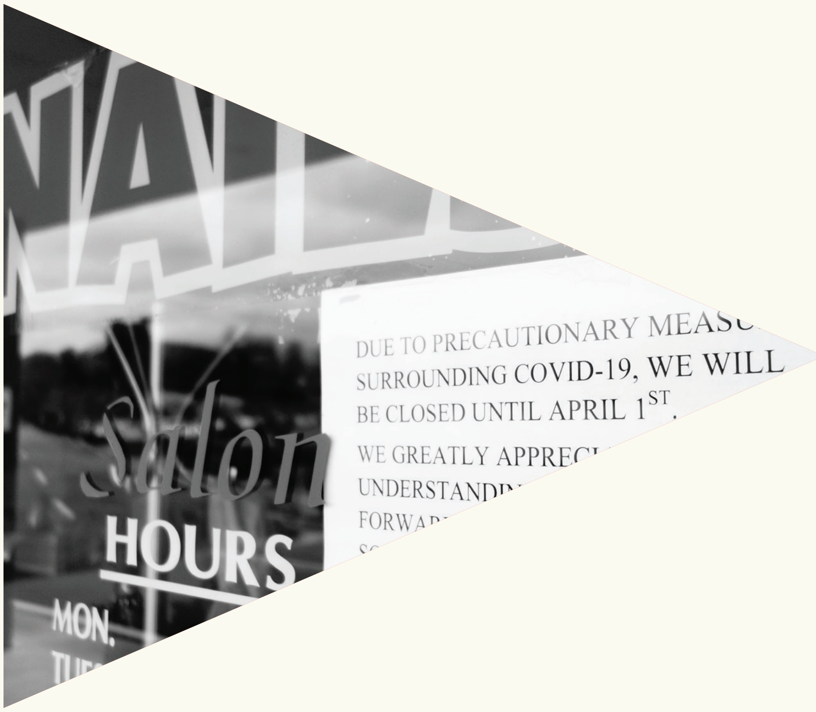
MetroCommon × 2050
Policy Recommendations

Dynamic and Representative Government

Expand and improve the way we finance local and regional government



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MAPC

Recommendation:
Expand and improve the way we finance local and regional government

Strategy 1

Ensure sufficiency & resiliency of revenue to meet local and regional needs.

In spring of 2021, Congress passed the American Rescue Plan Act (ARPA), which included substantial local recovery funding. This money represents a once-in-a-generation opportunity to make investments that can help repair and rebuild our economy and support those individuals and communities that were most deeply impacted by the COVID-19 pandemic. But even with these critical recovery dollars, the state and our municipalities will, over time, face significant gaps in funding needed to reach our region's long-term goals. We must find new, stable sources of revenue that can help meet our operating and capital needs.

As we think about new revenue sources, it is important to remember that the reliability and resiliency of revenue vary depending on the source. Property and income taxes tend to be fairly stable, although climate change and sea-level rise and its impact on coastal development could threaten property taxes over the longer term. The economic fallout from the pandemic dramatically reduced receipts from hotel, meals, and rental car taxes, although we expect these to recover as the pandemic recedes. Moving to steadier and more predictable revenue sources over the long term is necessary to provide stable, efficient, and effective municipal government and municipal services.

- **Action 1.1. Contain rapidly growing fixed costs to enable funding for high quality services.** Municipalities face significant fiscal pressures driven in part by the age of its workforce, the number of retirees, and longer life expectancies, which have increased high-growth fixed costs such as health insurance and pensions. Regular growth in the costs of covering public employees is another driving factors. Taken together, these costs consume an increasing share of local budgets, which in turn decreases the amount of funds available for meeting other local priorities. Further reining in rising healthcare costs, primarily through reforms at the state level, while maintaining high-quality health insurance for all municipal employees, would provide municipal and state budget relief.

Some of the highest costs for cities and towns occur in public safety contracts. Potential reforms, particularly around line-of-duty rules and disability retirements require further research and investigation. Similarly, rules governing binding arbitration through the Joint Labor Management Committee should be considered. The current standard measures a municipality's "ability-to-pay," but it does not take into account other municipal spending pressures and therefore often compels cutbacks in other areas. A municipal legislative body has the ability to reject an arbitrator's award, but this rarely happens. Current law forbids a municipal chief elected official from even recommending against a settlement, a limitation that should also be revised.

Action 1.2. Provide more flexibility to help municipalities weather economic downturns. One-time federal relief payments will help create local budget stability in FY22 and FY23, especially as cities and towns try to address economic downturns that occurred as a result of COVID-19. However, over the long-term, cities and towns need to be able to plan for unmet needs and future economic upheaval. Three actions would provide greater flexibility and resiliency for municipal budgets in future downturns: increased flexibility around Proposition 2½; the establishment of a state aid stabilization fund for Unrestricted General Government Aid (UGGA); and more flexibility for short-term financing.

Proposition 2½ significantly restricts growth in a municipality's ability to raise tax assessments year over year, preventing cities and towns from providing needed services. As discussed above, some costs, such as health insurance and pension liabilities, rise much faster than 2.5% annually. Moving some costs outside the limit of Proposition 2½ would provide much greater flexibility to meet local needs.

Some municipalities rely heavily on state aid as major portions of their budgets. While this is not a problem in a strong economy, this has a disproportionate impact on those communities with greater reliance on state aid during downturns. This generally includes some of the most economically challenged communities in the state, where residents have a high dependence on local services. The state should create a stabilization fund that steers ten percent of any increase in Unrestricted General Government Aid into the fund, to be used to reduce the pain of cuts made to local aid during economic downturns. The Division of Local Services could establish criteria that would automatically direct stabilization funds to municipalities when certain reduction thresholds are triggered. While the state currently has a "rainy day" fund, allocation of those resources is at the discretion of the Legislature and Governor, unlike how this stabilization fund would work.

During economic downturns, such as the 2008 recession and the 2020 COVID-19 lockdowns, municipalities were exposed to fiscal losses they could not plan for and that forced cutbacks in needed services. While the Legislature has granted cities and towns limited powers to borrow additional short-term funds to help manage cash flow challenges, and has also allowed certain mandated payments (e.g., pension payments) to be delayed or spread over longer cycles during a downturn, waiting to legislate such changes until after a crisis has occurred is inefficient and damaging to local finances. The Commonwealth should therefore consider making such powers permanent and should make a range of short-term financing options available to cities and towns if certain economic triggers, such as unemployment increases, are met. The Commonwealth should build upon the relief made available through the American Rescue Plan Act and create tools that give cities and towns assistance immediately after a crisis emerges.

Action 1.3. Diversify local revenue sources. Cities and towns need more options to raise money locally to invest in local economies. Many of Greater Boston's communities have an overwhelming reliance on local property taxes to fund municipal operations. In 2019, property taxes comprised nearly 64 percent of total tax receipts to cities and towns.[1] While generally a fairly stable source of revenue, the property tax is vulnerable to long-term threats posed by the impacts of climate change, particularly in coastal communities. It is also a highly regressive source of revenue. Property taxes can be a significant burden to low-income homeowners and renters – while households with the highest one percent of incomes on average pay about three percent of their total income on property and commercial taxes, those with the lowest incomes tend to pay around five percent of their income on property taxes.[2] This also contributes to wide disparities in public school funding. Taking state aid into account, the wealthiest 20 percent of local school districts on average spent $5,000 more per pupil than the least wealthy 20 percent of districts.[3]

Alternative revenue sources like increasing the income, capital gains, and corporate income taxes are discussed in "Enable wealth creation and intergenerational wealth transfer". The Legislature should pass legislation that would allow cities and towns to create a local option for revenue measures, including some of the following revenue mechanisms: a local option parking tax, district-based taxation, value capture mechanisms, increasing the real estate transfer fee and deeds fee, increasing local vehicle registration fees, and the ability to use regional ballot initiatives to fund a variety of local or regional transportation investments. Across the country, many local projects are funded my locally raised money, but Massachusetts does not have this option, and instead requires individual municipalities to file a home rule petition to raise local taxes and fees, a lengthy and difficult process with a low rate of success. If the Legislature allowed more local option fees and taxes, it would help to diversify revenue sources for cities and towns.

1 https://archive.massbudget.org/report_window.php?loc=MA-Property-Taxes.html#footnote-5.

2 https://www.massbudget.org/reports/pdf/PropTaxes-COVID19-6.30.pdf.

3 https://massbudget.org/reports/pdf/MassBudget%20Chapter%2070%20Reform%20Paper%202018%20Final.pdf.

Strategy 2

Provide new revenue and investment for climate, housing, and transportation capital infrastructure.

To meet our 2030 and 2050 climate goals, significant investments will be needed to modernize, electrify, and protect our public transportation system, as well as to build sufficient and climate-resilient affordable housing. We do not presently have enough dedicated revenue to address these needs.

- **Action 2.1 Create a regional Climate Infrastructure Bank.** Building the electric infrastructure needed to reduce greenhouse gas (GHG) emissions and ensuring that our transportation system, utility infrastructure, and neighborhoods are prepared for the impacts of climate change will require massive investments. A regional Climate Infrastructure Bank that can raise funds and prioritize investments across our region could lead this effort. Governance of such an entity should include state and municipal representatives, along with membership from communities that are most affected by climate change, including communities of color that have been disproportionately and systemically impacted by the effects of climate change. A Climate Infrastructure Bank could raise revenue in a variety of ways, though perhaps the most promising is through a carbon tax, which could be collected as a traditional gasoline tax, or at the wholesale level, as proposed in the Transportation and Climate Initiative.[4] Other sources could include one or more of the following: per-capita municipal assessments, impervious surface fees, or greenfield development fees.

- **Action 2.2 Adopt the HERO (Housing and Environmental Revenue Opportunity) tax.** The Legislature is currently considering a proposal that would increasing the real estate excise tax by doubling the current rate. This proposal, known as the Housing and Environmental Revenue Opportunity (HERO) proposal, would raise the Massachusetts rate to 9.12 percent and could generate $300M per year that would be split between affordable housing and climate investments. A coalition of housing and environmental advocates are supporting this legislation in the 2021-22 session. H.2890 (Representative Nika Elugardo) and S.1853 (Senator Jamie Eldridge) have been filed in the current session.

- **Action 2.3 Create an affordable residential development circuit breaker.** Opponents of residential and mixed-use development often argue that the new local revenues retained by the host municipality do not cover the increased costs of providing municipal services to the development. To answer this question, the Public Policy Center at UMass Dartmouth conducted a study of six mixed-income residential projects, which showed that three out the six projects generated enough municipal tax revenue to cover the costs of their municipal services.[5]

  This work, supported by the Mass Housing Partnership, showed that when the new state receipts – such as from the sales and income taxes generated by the developments – were included, the new developments all generated

4 https://www.transportationand-climate.org/final-mou-122020.

5 The Costs and Hidden Benefits of New Housing Development in Massachusetts." Goodman, Kore-jwa, Wright. March 2016.

positive revenues. In aggregate the study concluded that municipal shortfalls could be covered by less than a third of the new state receipts. Building in a "circuit breaker" that would allow some portion of new state revenues generated from a new affordable or mixed-income development to be retained by the host municipality would ensure that development impacts are fully covered. It would also remove the objection that new development doesn't pay for itself. Another option could be to use one half of the circuit breaker funds to mitigate local impacts and to allocate the other half to a body such as the Climate Infrastructure Bank, which would be better poised to address regional needs.

Strategy 3

Shift revenue generation and investment to provide greater fairness in funding and more equitable outcomes.

Many of our state-level revenue sources, formulas for allocating funding, and grant program criteria do not incorporate equity as a fundamental objective or guiding principle. Our existing revenue-raising mechanisms place greater financial burdens on lower-income households and individuals, causing them to pay a greater share of their incomes as taxes. Some state and federal resource allocations prioritize population size or other factors over demonstrated need. We should rebalance how we raise and invest resources for a more progressive impact and to steer greater resources to communities and populations that could benefit the most from enhanced investments and to those communities and populations that have historic and systemic disinvestment. Additional ideas for creating a more progressive tax code and providing more opportunities for intergenerational wealth transfer are contained in "Enable wealth creation and intergenerational wealth transfer."

- **Action 3.1. Make the sales tax more progressive.** The Massachusetts sales tax is inherently regressive because lower income individuals use a greater share of their income to pay the flat 6.25 percent applied to the goods subject to the sales tax. To reduce the burden on lower-income residents, the sales tax could be broadened to apply to services. The exemptions on certain goods could be expanded and we could simultaneously reduce the tax rate applied to certain goods. These changes could be done in a revenue-neutral way so that the impact on our overall sales tax revenue does not decrease.
- **Action 3.2. Fully fund the Student Opportunity Act (Chapter 132 of the Acts of 2019).** The Student Opportunity Act was passed into law in 2019. It directs additional resources to close the education outcomes found by race, in economically disadvantaged communities compared to higher income communities, for English Language Learners, and for children with disabilities. This landmark legislation has the potential to improve outcomes for K-12 students dramatically, but funding must be identified and allocated each year, and the first year of funding was rolled back due to the COVID pandemic. The Legislature included an additional $220 million in the FY22 budget, fully funding the first year of the law. Advocates, however,

believe because they are using lower enrollment numbers, an additional $90M is needed for full funding. In 2021, the Legislature created a $350 million Student Opportunity Act Investment Fund, designed to function as a reserve fund. The use of American Rescue Plan Act (ARPA) funds could help meet short-term needs, and new funding that might be provided by the Fair Share Amendment, should it pass, could provide the long-term dedicated revenue required to reach the full promise of the Student Opportunity Act. The Commonwealth should pursue additional ideas to promote more equitable educational funding, including increasing investments for English language learners and special education.

- **Action 3.3. Review federal and state funding formulas and grants for ways to improve equity.** Many state and federal funding formulas were established generations ago without a fundamental emphasis on directing resources to where they are most needed or to advance equity. One recent example was the federal allocation of the American Rescue Plan Act funds to municipalities following the Community Development Block Grant (CDBG) formula. This resulted in inadequate allocations to several communities greatly impacted by COVID-19 that are home to high percentages of people of color, low-income residents, and immigrants. In many cases, these communities received much lower funding amounts than relatively higher-income communities. The Baker Administration was able to make these communities "whole" through additional allocation of state-controlled resources. However, reviewing federal formulas like CDBG and state formulas like Unrestricted General Government Aid (UGGA) and grant programs, such as MassWorks, will likely uncover opportunities to prioritize resource allocation in communities that have suffered because of systemic disinvestment and underinvestment.

- **Action 3.4. Research disparities by race and ethnicity in the impact and administration of the property tax.** The property tax has historically been a fairly stable and consistent source of revenue for municipal operations, but there have been long-standing concerns about the disparities in the impact on lower income neighborhoods and on racial and ethnic minorities. Recent research indicates that accessing practices including valuation and the granting of tax abatements may have disparate impacts based on race and ethnicity.[6, 7] Further research is needed to explore potential disparities in assessing practices and to recommend reforms.

6 The Assessment Gap: Racial Inequalities in Property Taxation. Avenancio-Leon and Howard. Opportunity and Inclusive Growth Institute, Federal Reserve Bank of Minneapolis. July 2020.

7 Property Tax Limitations and Racial Inequality in Effective Tax Rates. Martin and Beck. Critical Sociology. 2017 Vol. 43(2)).