MTF
Massachusetts
Taxpayers Foundation

333 Washington Street | Suite 853 | Boston, MA 02108 | 617.720.1000
www.masstaxpayers.com

MTF Session Preview: Municipal Finance

During the last eight years, the Baker administration and the Legislature created a transparent and predictable approach to governing unrestricted local aid increases, while also providing supplemental funds for local transportation projects. However, local aid increases, both unrestricted and transportation-related, have lagged far behind statewide revenue growth and the formulas used to distribute aid remain either out of date or totally unrelated to need.

This local aid preview provides brief background on this issue, summarizes key legislative activities from last session, outlines the larger policy environment and poses several questions policymakers will need to answer in the upcoming legislative session.

Background

Aside from the K-12 funding formula (previewed in this MTF publication), the largest source of state support to cities and towns is Unrestricted General Government Aid (UGGA). UGGA is the combination of two historic aid sources, Lottery Aid and Additional Assistance which were combined in FY 2010.

When Governor Baker was elected in 2014, he committed to tying increases in UGGA to expected tax revenue growth. Beginning in FY 2017, the annual budget increased UGGA by the same percentage that policymakers agreed upon for tax revenue growth during the Consensus Revenue process.[1] Up until FY 2021, estimated tax growth approximated actual tax growth pretty well, but in the last two years, tax collections have far surpassed expectations. This means that in FY 2021 and FY 2022, UGGA funding only increased by 3.5 percent, while tax revenues grew by 39 percent.

The state also provides annual transportation aid to cities and towns through the Chapter 90 program. These funds are not provided through the annual operating budget, but instead come through capital spending bills, which operate on a less predictable timeline making it difficult for cities and towns to plan.

Lastly, the state provides cities and towns with Payment in Lieu of Taxes (PILOT) for state owned land which is not subject to local property taxes. The annual PILOT appropriation provides a prorated share of the assessed value of state-owned lands, but starting with the Great Recession, PILOT funding remained essentially flat for a decade. In December of 2020, the State Auditor

[1] In FY 2021, UGGA was level funded in spite of the Consensus Revenue figure projecting a decline in tax revenue.

published a report which estimated that state pilot obligations were $45.7 million, compared to actual funding of $30 million.

Key Policy Actions, 2021-22

Budget-makers reassess UGGA approach – In FY 2022 (signed into law in July of 2021), UGGA funding grew by 3.5 percent, consistent with the consensus tax revenue agreement made in January of that year. Lawmakers did not adjust UGGA upward when the FY 2022 tax revenue estimate was increased by $4.3 billion between January and July.

In FY 2023, tax revenue estimates were again upgraded by billions between January and June and this time lawmakers did adjust UGGA funding, albeit slightly. The Governor and House budgets boosted local aid by 2.7 percent, the original consensus revenue growth figure. The Senate and final budgets doubled the growth figure by 5.4 percent, an increase of $63.1 million over the prior year.

Local road aid remains flat – Chapter 90 funding was funded at $200 million in the capital budget in both FY 2022 and FY 2023, the same level as in FY 2020. This is a decline from FY 2018 and FY 2019 when local road support was funded at $240 million and $220 million respectively. However, in FY 2022, lawmakers used $100 million from state surplus dollars to provide temporary aid for local winter road repair projects. As yet, that increase has not been carried through to FY 2023.

PILOT support grows – Spending on municipal reimbursements for state owned land remained flat for more than a decade between FY 2008 and FY 2019. In that twelve-year period. PILOT payments ranged from a high of $30.3 million (FY 2009) to a low of $25.3 million (FY 2011). The FY 2019 appropriation was just $178,131 higher than the program's $28.3 million funding in FY 2008.

Since FY 2008, PILOT funding has increased, slowly at first, and more significantly in FY 2022 and FY 2023. Funding for the program has increased in five consecutive budgets, the first time in at least twenty years that has happened. Program funding in FY 2023 is $45 million, a 58 percent increase in just four years, and close to the Auditor's estimation of full funding.

Policy context

The FY 2024 budget and the next legislative session will develop a local aid approach that accounts for several key policy realities:

Disconnect between state tax collections & local aid

The Baker administration ushered in an UGGA funding system designed to provide greater predictability to local leaders and to tie local aid to state tax collections. However, because that system ties expected, and not actual, tax growth to local aid increases, UGGA has not grown in tandem with state taxes over the last two years. While state tax collections grew by 39.9 percent, UGGA aid increased by 3.5 percent.

Local revenue growth has been moderate

While the state has enjoyed 2.5 years of record tax collection growth, local taxes have grown at a much more moderate rate. Limited by Proposition 2 ½, each community's annual property tax rate is constrained by an annual level limit cap of 2.5 percent. Between FY 2020 and FY 2022, while state tax coffers grew by 39.9 percent, local property taxes grew by just under 9 percent. Cities and towns have not had the same ability to use tax revenue growth to rebuild reserves and make one-time investments.

Local required school spending is increasing

The Student Opportunity Act significantly increased school budget assumptions for low-income students, students with limited English proficiency, and special education students. These changes will increase the statewide education budget, and with it both the state and local share of those costs. Much of the new aid will go to districts with the largest shares of low-income students; close to 50 percent of new FY 2023 aid will go to 20 school districts, but all districts will see an impact on their required local spending.

The formula requires that cities and towns contribute 59 percent of the statewide education budget. As that budget grows, so too does the local share and because many of the communities receiving additional aid have limited ability to increase local spending, the contribution for other school districts can rise quickly. In many cases, school districts contribute far in excess of their required level and so will not be immediately affected, but local pressures will grow as SOA implementation continues.

Local Fiscal Recovery Funds remain

The American Rescue Plan provided just under $3 billion in flexible Fiscal Recovery Funds to cities in towns in Massachusetts, and a further $393 million to county governments around the state. While data on local spending is patchy and delayed, as of the most recent federal data, a large share of local FRF funds remain unexpended. The continued availability of these resources, along with the December 2024 deadline for obligating all funds could weigh on state local aid choices.

Key questions for the upcoming session

Will the state adjust the UGGA funding approach?

The last two years illustrate how badly expected tax revenue growth can diverge from actual growth. If the purpose of the original policy is to tie local aid to growth in state tax revenues, it makes sense to reassess the current method. One way to maintain the predictability of the current system, while improving its link to reality would be to make annual local aid growth equal to tax revenue growth in the last calendar year. That figure, which is known when the consensus revenue figure is established would allow each budget proposal to set local aid funding based on the same data and prevent the need for future adjustment.

Is it time to redo the local aid funding formula?

Each community's UGGA aid is based solely on the amount received in the prior year and the distribution of local aid has not been subject to a formula in more than 20 years. Because of this, differences in UGGA funding between communities defy all logic and can exacerbate inequities. UGGA funding ranges from $397 per capita to less than $30 per capita. Somerville receives $360 per resident, while Framingham, which has a similar population and a lower income per capita, gets $159 per resident. The formula has been in dire need of review for years and the time has come to rationalize the distribution.

What is a fair system to fund and distribute local highway funds?

Unlike UGGA, annual state funding for local transportation is neither predictable nor tied to reasonable annual increases. Chapter 90 aid is actually less in FY 2023 than it was five years ago. Lawmakers and the new administration should tie annual Chapter 90 funding to either growth in tax collections, like UGGA, or at least growth in the state's capital budget. Chapter 90 is distributed based on an annual formula, which is based on road mileage, population and employment. However, that formula has not been reviewed in a number of years and should be reassessed to determine if the current system is equitable and best suited to addressing transportation needs.

At the same time, transparency on the use of Chapter 90 funds also needs to be improved. In the past, significant amounts of state transportation aid have gone unexpended from one year to the next. Understanding when and how funds are spent is essential to improving the effectiveness of the investment.

Can the state incentivize smart use of local Fiscal Recovery Funds?

Almost two years after the passage of ARPA, Fiscal Recovery Funds have been critical to balancing local budgets, but there has not been a coordinated attempt to target state and local FRF resources to tackle shared challenges. For example, while Massachusetts has used $215 million in state surplus and federal funds to supplement loans and subsidies for local water infrastructure projects, those funds have not been used to leverage local use of FRF resources to make investments go further. As the clock begins to wind down on FRF, the new administration should prioritize creating state and local match requirements on local infrastructure projects.