

Commission Letter #325-08  
Commission Meeting: 12/15/08  
RE: Update to Long Term Budget Strategy Report

December 12, 2008

THE HONORABLE MAYOR  
AND  
MEMBERS OF CITY COMMISSION

We presented a report at the city commission meeting of July 28, 2008. That report projected our revenues and expenditures five years forward, identified the cutbacks that will be required, how the major departments will likely be organized with fewer employees and how services will suffer.

This update will look at information not available in July and discuss how that information impacts our projections. It does not include an update to the future organization charts or any discussion of how departments will be reorganized or how services will further suffer. It does include an estimate of what would be required, in mills, to maintain current (2007-2008) service levels and what it would take to restore police and fire services to prior levels as recommended by the respective chiefs.

Three things have occurred since July that will be discussed here. We have final 2007-2008 numbers. Oakland County has projected taxable values through 2011-2012. The stock market has lost approximately 30% of its value.

### **2007-2008 Numbers**

We'll start with the good news. Due to continued attrition, the DDA taking over court debt, and many other factors we finished the 2007-2008 fiscal year with a general fund balance of \$8.4 million. This is better than we anticipated in the July report. Think of this as our "rainy day fund." The rain has started and a hurricane is bearing down on us.

### **Taxable Value**

In the 2008-2009 budget and in the July report, we relied on taxable value estimates provided by Oakland County in late 2007 which called for values to decline 3.5% for 2009-2010 and 2.5% for 2010-2011. Oakland County's current projections call for county-wide values to decline 4.5%, 9% and 5% for 2009-2012. I have chosen to temper these numbers by 1% because I think Royal Oak's values will hold up a little better than the county average. I'm assuming taxable value losses of 3.5%, 8% and 4% and hoping the market levels out by 2013. I must admit my basis for doing this has more to do with instinct than empirical evidence.

It is critical that we remember how Proposal A will impact us when the housing market recovers. Even if housing prices return to 2005 levels, our taxable values will not. The current levels become the new Proposal A cap. They can go down and further reduce the cap but they cannot go up by more than the rate of inflation or 5%, whichever is less. Any reductions on taxable value are permanent reductions. We will never fully recover that lost taxable value until a home is sold.

## Stock Market

The Standard and Poor's 500 index stood at \$1,447.16 on Jan 2, 2008. On Dec 11, it was at 873.59, a decline of 39.6%. This will have a significant impact on the City of Royal Oak Retirement System and on our retirement contributions rates.

The full impact will not be felt immediately. Our next actuarial valuation will be based on numbers at June 30, 2008. At that time, the S&P 500 was at \$1,280, down 14.8% since June 30, 2007. Our portfolio does not mirror the S&P 500. Over 40% of it is in fixed income securities and cash equivalents. Also, we use a four year smoothing calculation to lessen the impact of short term changes in market values on contribution rates.

Never-the-less, we can expect to see pension contributions rates increasing significantly if the market does not recover soon. I have attempted to address this but my guess is no better than anyone else's when it comes to forecasting the market. For purposes of this report, I assumed the market has bottomed out, that it will stay at current levels for another year, and will recover gradually to 2007 levels by 2012.

### Estimated Pension Contributions

	2008-09	2009-10	2010-11	2011-12	2012-13
Police & Fire	23.49%	27.34%	31.19%	33.11%	33.11%
Other	17.57%	19.77%	21.98%	23.08%	23.08%

## Auto Industry

As I write this, the future of the American automobile industry is very much in doubt. The bailout plan failed in the U.S. Senate last night and it is unclear what will happen next. It is also very unclear what the impact will be on Royal Oak should one or more of the domestic manufacturers fail. However, it won't be good. We could very well see taxable values decline much faster and much more than we have projected. The numbers that follow do not address this possibility at all.

## Summary Table

The projections in the table that follow represent my best estimate of what will happen **IF** we continue all operations as budgeted in the 2008-2009 budget. Obviously, we cannot continue the current level of services. Absent significant revenue increases, Royal Oak needs to continue cutting staff and reducing services.

**General Fund Projection,**  
Dec 12, 2008

<b>General Fund Summary</b>	<b>ACTUAL 2007-08</b>	<b>BUDGET 2008-09</b>	<b>PROJECTED 2009-10</b>	<b>PROJECTED 2010-11</b>	<b>PROJECTED 2011-12</b>	<b>PROJECTED 2012-13</b>
Beginning Fund Balance	6,683,517	8,413,848	9,109,450	6,808,708	2,025,679	(4,498,422)
Revenues	35,364,126	33,638,938	32,863,545	31,439,412	30,765,877	30,743,396
Expenditures	34,292,505	36,739,378	38,121,040	39,054,804	40,014,179	41,001,036
Net	1,071,621	(3,100,440)	(5,257,495)	(7,615,392)	(9,248,302)	(10,257,640)
Transfers from other funds	658,710	2,796,042	1,382,734	1,389,968	1,397,346	1,404,872
Adjustments (see detail)	0	1,000,000	1,574,019	1,442,395	1,326,854	1,220,161
Net Change in Fund Balance	1,730,331	695,602	(2,300,742)	(4,783,029)	(6,524,102)	(7,632,606)
Ending Fund Balance	8,413,848	9,109,450	6,808,708	2,025,679	(4,498,422)	(12,131,028)
Fund Balance as a % of Exp.	24.54%	24.79%	17.86%	5.19%	-11.24%	-29.59%

**Adjustments**

favorable budget variances	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000
impact of 2008 bond issue			574,019	442,395	326,854	220,161
est. pension contribution increase			(115,138)	(230,276)	(287,845)	(287,845)
	1,000,000	1,574,019	1,442,395	1,326,854	1,326,854	1,220,161

**Cuts Needed**

I haven't yet updated the department by department estimate of cutbacks that will be required, so the departments have not had an opportunity to prepare a new operating plan. However, it's clear that things have gotten much worse since my July 28 report. At that time, we projected that we would have to reduce the number of general fund employees by 17% between now and June 30, 2013. I would now estimate we will need to increase that reduction to 22% or about 55 employees. This would leave us with 195 general fund employees, down from 298 in 2003, a 35% reduction.

**Tax Rate Needed to Maintain and Enhance Public Safety Services**

Administration was directed by the City Commission to calculate the additional taxes that we would need to levy in order to restore public safety services. Before I could do that, I had to first calculate the tax increase that would be necessary just to remain at our current level of operations. The first line in the table that follows represents additional millage that would be needed to maintain the staffing levels in the 2008-2009 budget for all general fund departments. Then I did a rough costing of the additional personnel recommended by the Police Chief and Fire Chief and translated that into mills. We did not even ask other departments for their recommendations. The numbers are scary enough as it is.

The Police Chief would recommend restoring twenty one positions. This would consist of two command officers, three detectives, thirteen police officers, two police service aids and one clerk. The Fire Chief would recommend restoring six firefighters and one fire inspector.

The tax rate numbers in the table that follow do not represent a recommendation from the administration.

### Millage Increase Needed

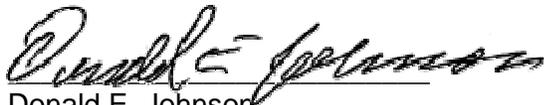
	<u>2009-10</u>	<u>2010-11</u>	<u>2011-12</u>	<u>2012-13</u>
Maintain Current Service Levels	1.02	2.30	3.26	3.82
Restore Fire Services	0.37	0.43	0.48	0.51
Restore Police Service	<u>1.18</u>	<u>1.30</u>	<u>1.44</u>	<u>1.52</u>
Total	2.57	4.03	5.19	5.84

We do recommend that we be allowed time to prepare and present an update to the staffing targets and the organizational changes section of the July report. Before Commissioners and citizens can evaluate the situation, they should understand the impact the necessary cuts will have on city services and public safety services in particular.

Too often, discussions involving taxes are done in the abstract as though taxes and services were not related. The question shouldn't be about increasing taxes. No one wants higher taxes. It would be better to think of the issue as a simple purchasing decision. How much fire protection do we want to buy? How much police protection do we want to buy? What other city services do we want to buy?

Respectfully Submitted,

Approved,



Donald E. Johnson  
Director of Finance



Thomas R. Hoover  
City Manager