

Economic Outlook

February 2011

This report hopes to serve as a brief economic update, as the Royal Oak City Commission begins its planning for the rolling FY2011/13 budget.

The national unemployment rate is currently 9.4%, a 1% improvement from one year ago. As of December, Michigan's unemployment rate was 11.7%, down 2.3% from its December 2009 peak.

The federal budget projects the federal deficit to reach \$1.5 trillion or 10% of GDP (gross domestic product) by the end of the 2011 fiscal year. The idea that the deficit will increase from \$1 trillion and \$1.5 trillion in the third year of recovery is troublesome to many. As output recovers, revenues normally increase and expenses decline thus moving the federal budget towards balance, however there are concerns by many that this is not occurring. The federal debt is rising, although there are reports that President Obama's budget calls for cuts in spending, including a fifty percent cut to the Community Development Block Grant program and the Great Lakes clean-up project is slated to lose a quarter of its funding. We have yet to learn if Royal Oak's CDBG program will be affected.

Two days ago, Michigan Governor Snyder delivered devastating news for local units of government. Governor Snyder is proposing to eliminate statutory revenue sharing payments to cities, townships and villages. This equates to a loss of nearly \$900,000 annually for Royal Oak's General Fund. However, the Governor is establishing an incentive program; for local units that meet specific standards/best practices. It *may* be possible to recover up to two-thirds of the former statutory payment, the exact recovery potential is not known yet. These necessary standards/practices to recover statutory payments are related to a City's demonstration of consolidation/service sharing, long-term planning and a citizens' guide to the city finances. More details are expected to be revealed in March. A 4% increase in Constitutional funding was mentioned by the Governor, however it is unknown how that affects the City at this time.

Governor Snyder also suggested personal property tax reform. Royal Oak currently receives \$1.3 million in personal property tax revenue.

City's General Finances and a General Fund Update

Revenues

The City's tax revenue collection rate is on the same pace as last year - approximately 95%. The County is anticipated to disburse the balance to the City after settlement in a few months. The City Assessor is estimating that taxable values could decrease between 3 and 4% for the next fiscal year (2011/12); a more precise value will be available after the March Board of Reviews. A 3.5% decrease in taxable value will result in a loss of approximately \$550,000 to the General Fund and \$350,000 across all other applicable City millages.

It is vital to keep in mind that when the housing market recovers, the taxable values cannot increase by more than the rate of inflation or 5%, whichever is lower. Reductions in taxable value are permanent until a residence is sold. Therefore, it may not be until after 2020, when the City returns to the same taxable value level as 2005. The county's average Sheriff Deeds-Foreclosures was an 8.67% increase. Royal Oak had 410 Sheriff Deeds-Foreclosures in 2010 compared to 363 for 2009, an 11.5% increase.

The City of Royal Oak's piece of State Shared revenue (generated by the State sales tax) was down from \$1.3 Million in FY08/09 to approximately \$900,000 in FY09/10 to an estimated \$900,000 in FY10/11. And again, the Governor has proposed eliminating potentially \$900,000 of Royal Oaks State Shared Revenue.

Act 51 Revenues are budgeted to decline steadily, unless there are changes to this legislation, as less fuel is purchased due to fewer miles being driven due to high unemployment and more fuel efficient vehicles are manufactured. Currently the General Fund is not supplementing the Major Street Fund and Local Street Fund.

The City's Interest Income has decreased significantly over the last four years due to extremely low interest rates on its investments. In FY07/08, the City's General Fund benefited from nearly \$1.5 million in interest income to support operating costs; this year the City is on pace to receive only \$200,000, due to declining fund balance yet mostly due to meager investment returns due to the market.

We hope to repay the General Fund the monies that were transferred to the State Construction Code in the prior fiscal year. Based on current estimates, the State Construction Fund may be able to repay \$150,000 to the General Fund this fiscal year.

The Use of Fund Balance has been a significant source of revenue for the General Fund, the past two years. In FY09/10 nearly \$3 million in fund balance was used to balance the budget. In FY10/11, nearly \$1.9 million is currently budgeted to be used. It is important to report that bond rating agencies review the City's General Fund fund balance level when evaluating its financial status. In addition the State of Michigan's Fiscal Scorecard grades a City downward when a City's General Fund fund balance declines lower than 13% of expenditures. The State's most recent Fiscal Score gave Royal Oak a five out of ten, indicating fiscal stress. (Ten being the worst score)

Fortunately the \$1.3 million from the short-term SAFER grant and continued ALS revenue in the amount of \$930,000 in FY11/12 helps to offset the declining revenues in the General Fund.

Expenditures

The City’s General Fund expenditures at the six month point are tracking slightly higher than budgeted, due the firefighter positions that are currently budgeted through April only. However, an amendment is forthcoming to account for the SAFER grant for the balance of the year. Should the City experiences a surge of retirements at the end of the year, the current budget is not sufficient to cover the vacation and sick time payouts, therefore a budget amendment would be proposed to cover these costs (possibly in a form of a contingency).

Contributions to the Pension System are anticipated to be nearly 40% of wages and Retiree Healthcare contributions are anticipated to approximately 50% of wages for FY2011/12. These are estimations at this time, until the actuarial valuations are completed. It is important to point-out, that the City will have two retirees to everyone one employee in the upcoming fiscal year.

GENERAL FUND SUMMARY						
General Fund Summary	2010-2011	2011-2012	2012-2013	2013-2014	2014-2015	2015-2016
Beginning Fund Balance	6,721,096	4,827,026	3,426,248	(347,242)	(5,825,592)	(11,741,852)
Revenues	30,232,990	30,460,602	29,528,240	28,193,530	28,362,300	28,553,650
Expenditures	35,072,060	34,012,900	34,771,730	34,966,880	35,433,560	36,056,560
Net	(4,839,070)	(3,552,298)	(5,243,490)	(6,773,350)	(7,071,260)	(7,502,910)
Transfers from other funds	2,945,000	1,455,000	1,295,000	1,295,000	1,155,000	1,055,000
Net Change in Fund Balance	(1,894,070)	(2,097,298)	(3,948,490)	(5,478,350)	(5,916,260)	(6,447,910)
Ending Fund Balance	4,827,026	3,426,248	(347,242)	(5,825,592)	(11,741,852)	(18,189,762)
Fund Balance as a percentage of Expenditures	14%	10%	-1%	-17%	-33%	-50%

TABLE ASSUMPTIONS: \$1.3 M of SAFER Grant Revenue, \$930,000 ALS Revenue, 22 Police Officers Layoff as budgeted in the current budget. and reduced State Shared Revenue.

THE ABOVE PROJECTED BUDGETS AND BALANCES ARE VERY PRELIMINARY. As the Administration begins to dive into the detailed preparation of the rolling FY2011/2013 budget, these projections will be more precise.