

Commission Letter #36-10
Commission Meeting: 2/01/2010
RE: **Economic & Budget Update**

January 28, 2010

The Honorable Mayor
and
Members of City Commission

Attached is an Economic & Budget Update Report for January 2010. There will be a PowerPoint presentation of this information during the Commission Meeting on Feb. 1.

This is presented to provide some perspective for the report on the Strategic Plan which will follow. No action by the Commission is needed.

Respectfully Submitted,



Julie Rudd
Director of Finance

Approved,



Donald E. Johnson
City Manager

Economic and Budget Update

January 2010

Economic Outlook

This report hopes to serve as a budget and economic update, as the City Commission begins its strategic planning for the 2010/2012 fiscal years.

Nationally unemployment plunged by 7.3 million jobs over the last two years, doubling the unemployment percentage rate, as the national unemployment rate is currently 10%. As of November, Michigan recorded the highest unemployment rate among states, losing more than 240,000 jobs last year. Job losses were broad based, with the most significant declines in manufacturing, construction, retail trade, government, leisure/hospitality and education/health services. A recent forecast published by RSQE Michigan, reports that there may be some job gains beginning in the second half of 2011, hopefully ending an eleven year decline resulting in a total loss of 937,000 jobs in the state.

The federal deficit nearly doubled in fiscal 2009, exceeding one trillion dollars and many expect it to rise to \$1.5 trillion in fiscal 2010. The expected deficit will be nearly 10% of GDP (gross domestic product).

Although the fed fund rate has been hovering in the 0 to ¼ percent range, credit constraints are continuing to be reported as a major problem that is hindering advancements for many U.S. businesses, as banks are holding cash. Some forecast that the Fed will start nudging rates up off the floor in early 2011. Raising the federal funds rate will deter banks from taking out inter-bank loans, which in turn will make cash more difficult to acquire.

The backlog of unsold homes is to blame for keeping downward pressure on new construction and housing values. Oakland County is estimating a county-wide decrease in taxable value for 2010 and 2011 to be 13% and 12.5% respectively. The County is estimating a total "true cash value" decline of 37% / \$58 billion between 2007 and 2011.

The Michigan Senate Fiscal Agency reports that nearly 37% of mortgages in Michigan exceeded the value of their homes as of the third quarter 2009. Home equity no longer provides the support to consumption as it had in the recent past.

On a positive note, the NASDAQ has rallied over the last year, gaining 44% in market capitalization, and the NYSE gained 28.5%. The City's pension plan's actuary report is currently being completed by the City's contracted actuarial firm, and results are anticipated soon.

City's General Fund Budget Update

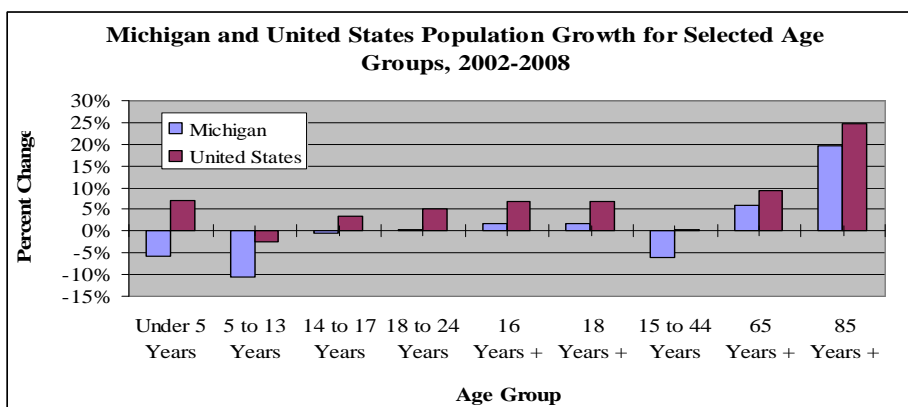
Revenues

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 approximately 10% for the next fiscal year (2010/2011); a more precise value will be available after the March Board of Reviews. A 10% decrease will result in a loss of \$1.7 million to the General Fund and \$2.5 million across all funds. Based on current sales studies, it does not appear that the decline has ceased, resulting in a continued decline for fiscal year 2011/2012 revenues of perhaps another 9% (slightly better numbers than the county-wide projection).

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 State's Sales and Use Tax collections are down nearly 12% from one year ago. The City of Royal Oak's State Shared revenue (generated by the State sales tax) is projected decline by possibly \$600,000 to \$4.7million for (the States) FY2010. Should the State legislature decide to eliminate the statutory payment due to budget short-falls in the future, it will result in an annual loss of over \$1 million for the City. As the State's population (or in other words - tax revenue source) continues to decline and the State's poor economic factors continue, it is likely that this funding source will be jeopardized unless significant changes occur.

Michigan is Missing Population Growth in Key Age Groups



Source: Census
Center for Economic Analysis

Act 51 Revenues from the State gas tax and vehicle registrations are on pace to be slightly less (\$100,000 +) than originally budgeted for FY09/10, as population continues to decline and less fuel is purchased due to fewer miles being driven by the unemployed. Especially as more fuel economical vehicles are utilized an additional source of funding for maintaining the roads and bridges within the state will need to be developed.

The State has not provided fiscal stability for the subordinate governmental units and a mere shell game (such as advancing the timing of a tax collection as done in the past etc) is not the type of solution needed to solve the state's numerous deep-seated problems.

The City's Interest Income has decreased significantly over the last three years due to extremely low interest rates on its investments. In 07/08, the City's General Fund benefited from the \$1.5 million in interest income to support operating costs; this year the City is on pace to receive only \$330,000, due to meager investment rates.

Expenditures

The City's General Fund expenditures at the 6 month point are tracking higher than budgeted, mostly due to retirements not occurring as budgeted. Currently, expenditures are projected to exceed revenues this fiscal year by \$5 million, utilizing nearly \$2.5 million of fund balance. Should costs not be cut, \$5 million will be needed from fund balance to balance a 2010/2011 budget and a deficit in the fund balance would occur in 2011/2012 and each year thereafter. See chart below. Needless to say, should revenues not be enhanced, significant cuts will need to be made very soon.

General Fund Summary	2009-2010 Estimated Year End	2010-2011 Projected Budget	2011-2012 Projected Budget	2012-2013 Projected Budget	2013-2014 Projected Budget	2014-2015 Projected Budget
Beginning Fund Balance	9,806,898	7,360,160	2,273,550	(4,470,301)	(11,422,803)	(18,194,106)
Revenues	32,221,251	30,788,955	29,491,715	29,283,063	29,464,262	29,655,109
Expenditures	37,360,565	37,360,565	37,360,565	37,360,565	37,360,565	37,360,565
Net	(5,139,314)	(6,571,610)	(7,868,850)	(8,077,502)	(7,896,303)	(7,705,456)
Transfers from other funds	2,692,576	1,485,000	1,125,000	1,125,000	1,125,000	1,125,000
Net Change in Fund Balance	(2,446,738)	(5,086,610)	(6,743,850)	(6,952,502)	(6,771,303)	(6,580,456)
Ending Fund Balance	7,360,160	2,273,550	(4,470,301)	(11,422,803)	(18,194,106)	(24,774,562)
Fund Balance as a percentage of Expenditures	19.70%	6.09%	-11.97%	-30.57%	-48.70%	-66.31%
Net Change in Fund Balance	(2,446,738)	(5,086,610)	(6,743,850)	(6,952,502)	(6,771,303)	(6,580,456)

Assumptions used in the projections: Property tax revenues decline by 10%, 9% and 2.5% the next three years. There are no significant gains to the tax roll. State Shared Revenues stay constant. Interest income is low/moderate. Expenditures remain flat (others cuts are made if wages, healthcare, pension & OPEB contributions, fuel etc increase)

As the Finance Department begins to dive into the detailed preparation of the 2010/2012 budget, the FY2009/2010 year-end estimates will be more closely projected and communicated to the City Manager and City Commission.