



**City Manager's Budget Transmittal Letter**

July 1, 2013

THE HONORABLE MAYOR  
AND  
MEMBERS OF CITY COMMISSION

This is the eighth budget I have prepared as either Finance Director or City Manager for Royal Oak. It's the first that doesn't rely on use of fund balance in the general fund. This is mostly due to the voters' decision in November to authorize the new public safety tax. Over twenty thousand voters approved a 3.975 mill levy by a two to one margin. We actually levied only 3.475 of that in December of 2012 and will levy the same amount this year.

This budget includes a new fund, the public safety fund. It was created when the budget was amended following the election and levy of the new tax. The public safety fund is a special revenue fund. All of the revenue from the new public safety tax is deposited into this fund. Revenue from police, fire and emergency medical related fees is deposited here as well. We have also budgeted a "contribution from general fund" which is needed because the public safety tax is not enough to cover all public safety expenditures. All police, fire and emergency medical services expenditures are now budgeted in this fund instead of the general fund.

The Oakland County Equalization Department has officially advised us that they will defer to an opinion of the Royal Oak City Attorney regarding the timing of the public safety levy. This will enable us to keep this levy on the winter (December) tax bill. It is the administration's preference that the public safety levy remains on the winter bill as long as we continue to bill taxes twice per year. We feel moving this levy to the summer bill may be a significant hardship for taxpayers and offer little advantage for the city.

The public safety millage vote, and the tax revenue it authorized, allowed us to change the focus of this year's budget discussions. We now have adequate funding for police, fire and emergency medical services. We have a plan in place for hiring police officers and improving the police department. We are able to maintain fire and emergency medical services.

The new millage actually indirectly helps some remaining general fund activities as well. Because there is less need for the general fund to subsidize police, fire and emergency medical services, we have already restored positions in the clerk's office, code enforcement and the city attorney's office. We have also been able to help fund the senior services programs with a general fund contribution.

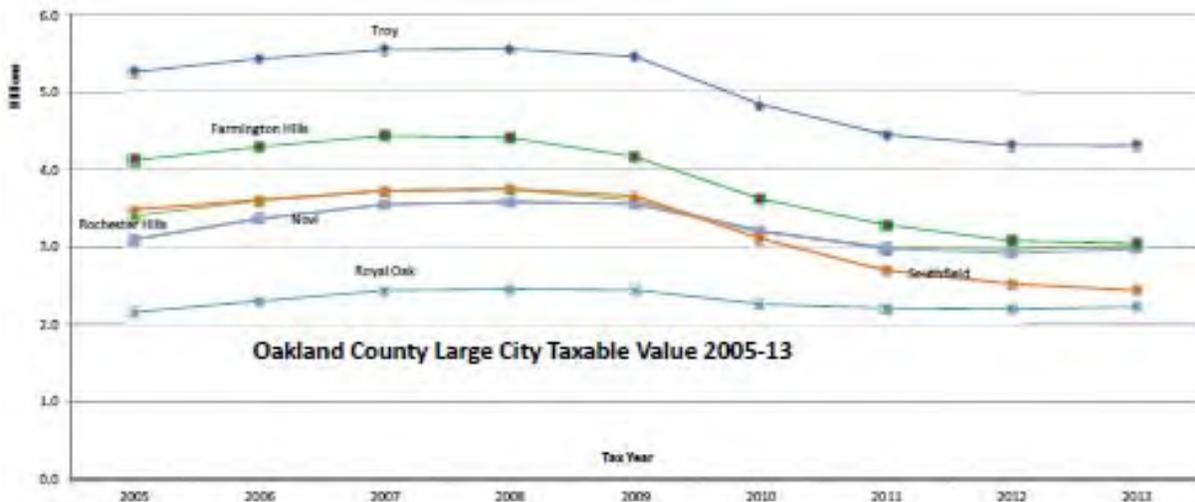
We have been focused on public safety for some time. I think our focus should now shift to recreation, roads and unfunded liabilities.

**Taxable Value**

Taxable value increased by 1.2% this year. Residential taxable value was up 2.7% while industrial fell 10% and commercial fell 2.9%. This overall increase follows four straight years of decline. It is safe to say the slump is over and we should see further increases in the future. This conclusion is also supported by an increase in building permit activity.

However, thanks to Proposition A, increasing property values do not directly translate to the same level of increase in property tax revenue. The taxable value on any particular parcel can only increase by the rate of inflation or 5%, whichever is less, in any one year regardless of the actual increase in property value.

Royal Oak property values have held up much better than most communities. The graph below, of the five cities with the largest taxable value in Oakland County was prepared by the City of Novi. It shows that Royal Oak retained its property value much better than Troy, Farmington Hills, Southfield, Rochester Hills and Novi.



**Personal Property Tax**

The state legislature has passed a very confusing package of bills related to the personal tax. If they stand, we can expect to eventually lose most or all of this revenue. However, this package has to be affirmed by the voters in August 2014. I cannot foresee the voters supporting a proposal that gives a tax break to businesses at the cost of reduced services or higher taxes for those who get to vote on the issue. I think this issue will fail unless the legislature attaches a sweetener to make it attractive to voters.

However, even if it fails, it will cause a loss of revenue to Royal Oak and most cities unless we take precautions. The law, as written, exempts any business with less than \$40,000 worth of personal property taxable value from paying any personal property tax as of Dec 31, 2013. This is eight months and one tax bill before the August 2014 election! Even if the voters reject the personal property tax changes, this provision is in effect for taxes levied between January and August. I have asked the City Attorney to explore a charter amendment, to go to the voters this November, which would allow the City Commission to levy personal property taxes on the winter tax bill.

### State Revenue Sharing

We have \$4.8 million of State Shared Revenue budgeted. This budget assumes that the City will receive all of its entitled EVIP monies, slightly over \$600,000. The EVIP program took the place of the statutory portion of State Shared Revenue in 2011-12. In FY2000-01, at the peak of Statutory distributions, the City received nearly \$3.4 million in Statutory State Revenue Sharing.

### Labor Contracts

We were very successful in negotiating labor contracts with significant concessions which have greatly improved our financial position. All ten contracts expire June 30, 2013 and we have already settled new two year agreements with AFSCME and SEIU. These call for no wage increase in 2013-14 and a 1.5% increase in 2014-15. The other eight contracts are still open. It is our objective to settle the remaining contracts with these wage rates.

### Parks and Recreation

It has been our recent practice to minimally fund park maintenance in the general fund and to require recreation programs to be completely self sustaining in various enterprise funds. During my entire tenure in Royal Oak, the only significant improvement I can recall making to any of our parks was the transfer of play equipment from former school sites. This budget provides for the purchase of two new play structures for city parks and the resurfacing of one set of tennis courts. This is a big change from the recent past, when our general fund contributions to parks was pretty much limited to mowing them, but it is nowhere near enough.

We have not yet determined which tennis location should be done this year. The play structures are for Optimist Park and Huntington Woods Park. Both have old wood structures that are in very poor condition. The one at Optimist Park is so bad as to be dangerous, and will likely have been removed by the time you read this.

While this is a step in the right direction, it is only a baby step. Royal Oak has fifty two parks and, following many years of benign neglect, we are budgeting capital improvements for only three of them. I do not expect to be able to do much more in the near future with general fund money and much more needs to be done.

I am proposing that we complete a thorough review of every city park. This will examine the park's amenities, condition, usage and potential. I know any such analysis will identify several parks that are rarely used and have very little potential use as a park. There are several that we are all already aware of. Right now, they are more of a liability than an asset. However, they could be an important asset in our quest to improve our system of parks. The department staff and I would like to see an initiative that would allow us to sell some of these low use/low potential parks with all proceeds of such sale being put into a parks and recreation trust fund that can only be used to acquire or improve other parks.

One of the Commission's objectives for 2013-14 is to explore the development of a downtown park. This budget does not provide any funds for that specifically, but however we may amend the budget during the year for a downtown study which would include such a park. That study may or may not be commissioned depending on the recommendations of the downtown plan task force.

The department and the Parks and Recreation Advisory Board have been very active in getting community support for our parks. This year, 43 groups participated in park cleanup on April 27 and 28. This represented an increase of 19 groups over 2012. The Board has also implemented an "adopt a park" program to encourage community involvement in park maintenance and improvement. The Optimist Club was the first to step up with a \$2,510 contribution for improvements at Optimist Park.

We would like to explore the possibility of selling naming rights to some of our larger parks. While this is often suggested, nothing has really been done so far. We think it is most feasible for facilities that have a significant presence on major roadways. Memorial Park and Pioneer Park, both located on Woodward Avenue, would be the most attractive candidates. I would also recommend that any revenue derived in this manner also be placed in the proposed parks and recreation trust fund and used for capital improvements at city parks.

### **Roads**

Royal Oak spends no local property tax revenue on maintaining or improving roadways. We rely entirely on our share of the Michigan tax on fuel and vehicle registrations and various grants. This is unusual. Most cities contribute to street maintenance from their general fund. Royal Oak, however, has had an exceptionally low authorized tax rate and has not had the resources available to use for roads.

This has resulted in many roadways that are in deplorable condition. The last time significant funds were spent on local streets was in the late 1980s. The money for that project came from a voter approved bond issue.

Forestdale, between Farnum and Catalpa, for example, is a composite pavement street that was determined to be in acceptable condition at the time of the road bond and not improved at that time. Now, 25 years later, this section of roadway is in such bad condition that the residents of this already paved road have petitioned the city to special assess road improvements. A recent analysis of this section of roadway rated it as a 1 on a scale of 1-10 which is the lowest possible ranking and indicates total failure of the pavement.

We have presented the Commission with a pavement management program to address the condition of our major and local roads. This program incorporates an evaluation and ranking of every section of roadway in the City and utilizes software specifically developed for road agencies to run improvement scenarios to maximize the impact of available funding. It is the ideal tool for planning pavement improvements. The program will produce generalized improvement options for different types of roadways based on their composition and ranking, from which staff and management will develop proposed recommendations with regards to specifics and implementation. However, this tool does not help the City find the necessary money to pay for improvements.

Road financing is a major priority for Governor Snyder. He has proposed raising an additional \$1.2 billion annually for roads state-wide. To achieve this, he has called on legislators to bring forth proposals focused on changes in the fee structures of licenses and registrations, as well as changes in fuel taxes, and how road funds are distributed. There are a number of proposals at the state level currently being debated; however no proposal is close to a vote, let alone

enactment. It is not clear from any of the current proposals that the increases in funding will find their way to the local level.

While the proposed changes will help major roadways, if enacted, I do not expect the state to swoop in and solve Royal Oak's local street problems. In fact, it may even make our local street situation worse. I recently talked with the Michigan Director of Transportation who is against using any fuel tax revenue for local streets. I think we are going to have to look to our own citizens for a solution. Basically, we have three options.

The first is a road millage. This would be an ad valorem tax to support road maintenance and replacement. The city could use the funds generated from such a tax on a pay-as-you-go basis to repair and replace roadways. It could also use these funds to pay debt service on a capital improvement bond, if there is a desire to do more work sooner than a millage alone would allow. Such a levy is more flexible than the second option, as we only need to define work to be performed year by year, unless a bond issue is involved.

The second option is a voter approved general obligation full faith and credit unlimited tax road bond which would be repaid with an ad valorem tax. The annual tax levy would be calculated to generate just enough revenue to pay the current year's debt service. In this case, the voters would be asked for authorization to issue bonds. Issuing bonds requires the road projects to be performed are defined in advance, before the issue goes to the voters, so they know exactly what they are voting for.

The third option is to special assess all road improvements. It has been Royal Oak policy to use special assessments to finance the initial improvement (paving) of unimproved roads. However, we have long told our citizens that once they paid for that initial improvement, the city would take care of all future maintenance. We may have to break that promise.

Special assessing is a significantly different way to pay for roads. It greatly changes who pays and how much they pay. Instead of the cost being levied on all taxpayers on an ad valorem basis, special assessments are typically levied based on property front footage or square footage. Only property owners who receive a direct benefit from the project pay for the project. This usually means only those on the street being repaired are assessed. The amount they pay has no relationship to their ability to pay.

Royal Oak has generally only special assessed projects in response to a petition from affected residents. This makes for good politics and greatly reduces dissent, but it is not mandatory. Subject to the rights of a property owner to appeal to the Michigan Tax Tribunal, the City Commission has the power to determine necessity and levy a special assessment without such support from the affected residents.

We need to start a discussion on how we will pay for roads. I am not necessarily looking to have a question on the ballot this November, but I am convinced it will eventually need to go to the voters to decide. It will cost our citizens far less to fix our roads than it will cost them to continually repair their cars.

### Legacy Costs

Legacy costs, pension contributions and retiree health care are an ever increasing portion of our budget. In this budget, we are planning to spend \$6.7 million for pension contributions and \$7.9 million for retiree health care (OPEB). That is equal to 95% of our general operating tax levy! It would be far more if we actually budgeted OPEB at the amount "suggested" by our actuary. As it is, we are making OPEB contributions at nearly 72% of the actuarially required contribution (ARC) because we cannot afford to contribute any more than that. In fact, we are just barely covering the current actual cost of healthcare for retirees. We are not pre-funding future costs as we should.

City-wide, pension and OPEB contributions are budgeted to increase \$1,004,860. We have unfunded liabilities, according to our actuary, of \$66.6 million for pension and \$113.2 million for healthcare. That's what makes the ARC so high. Only 31% of budgeted pension contributions and 10% of budgeted OPEB contributions are paying benefits that will be earned in 2013-14. The rest, actually more than the rest since we aren't properly funding OPEB, is paying for benefits earned but not paid for in the past.

How do we fix this problem? I've come to the conclusion that there is no fair way to deal with it. It is not fair to reduce pensions or retiree benefits. The retiree came to work for us in exchange for a mutually agreed upon wage and benefit package. For us to renege on our part of that bargain now would be totally unethical. However, it's also not fair to expect current taxpayers to pay benefits for former workers who provide no services to them.

The core problem is City Commissions of the past put off paying the bill for services they provided to their taxpayers. Those huge unfunded liabilities we face today are nothing more than an IOU left for us by our predecessors. The fair solution would be to go back and collect actuarially appropriate amounts from the taxpayers of the past. Of course, that's impossible. Our possible choices are to be unfair to the retirees and employees, be unfair to the current taxpayers, or be unfair to everyone. There is no fair solution to this vexing problem. Yet, a solution must be found.

I didn't have a solution when I wrote about this last year and I don't have a solution for this problem now. I do have some ideas, but they all require changes in state law and some may require constitutional changes. I don't think we can solve this by ourselves, nor should we. This is more than a Royal Oak problem. It impacts the vast majority of cities, states and even the federal government.

There are some things we should consider now, however. The Finance Director has assigned a portion of fund balance for "OPEB discussion." Specifically, for the past two years in order to prevent police and fire lay-offs, we underfunded OPEB for police officers and firefighters by even more than we underfunded OPEB for other employees. We are in a position where we could pay the OPEB trust for the "extra" underfunding of the past two years and we should consider doing so.

It is now possible under Michigan law for local governments with AA or higher bond ratings to issue debt to fund pension and OPEB obligations. We need to carefully examine this option. With interest rates at historic lows, we may have a unique opportunity. It is an opportunity that is not without risk, however. The stock market has been extremely volatile in recent years as can be seen by the performance of our retirement portfolio.

## **Community Development**

We are proceeding with the creation of this combined department which will consist of planning, housing, building, code enforcement, engineering and economic development. We are budgeting to relocate planning, housing and the new economic development divisions to the second floor of City Hall which will require other departments to relocate as well. The money in this year's budget for this purpose will be used for design work. We have provided \$225,000 in the 2013-14 budget for limited renovations and furnishings.

The objective of this change is to improve customer service and promote economic development rather than to save money. The combined number of full-time clerical staff in the three departments is currently two. We used to have three in building alone, plus one in engineering and one in planning. I do not see any more positions being eliminated in this combination.

Rather, I see this as a way to turn our entire development process into a "one stop shop." Instead of sending developers and residents from one counter to another on three different floors where they often get independent (and sometimes conflicting) responses, I want to have all of the services related to construction and development in a single location with one person responsible for all of it. This will also require some ordinance amendments and removing all functions related to business licensing from the City Clerk's Office and consolidating them within this department.

This budget adds an economic development position as is called for in the Commission's Goals and the DDA's goals. I'm hoping to get DDA buy in to co-fund this position but there is resistance to sharing a position. I will also be asking for the Chamber of Commerce to provide some assistance in funding this position.

The economic development position currently has the title of Economic Development Coordinator. This position would work under the supervision of the Director of Community Development. It will provide assistance to businesses contemplating investment and/or growth in the City of Royal Oak and actively recruit new business to Royal Oak.

## **Building Department (State Construction Code Fund)**

The Building Department is a self funded operation. Fees charged for permits pay for the staff and related charges, including rent on the offices they occupy. You will recall that this department/fund was hit very hard by the recession and lack of building activity. We had to transfer \$582,000 to it from the general fund in FY2009-10 to keep it solvent. We also laid off five employees and started using contractors to perform all trade inspections. That immediately ended the financial hemorrhaging, and with construction activity on the rise, enabled us to repay the general fund in FY2012-13.

We need to recognize that building activity will always be cyclical and prepare for it. To that end, we are not returning to the practice of employing full-time trade inspectors even though it would make a great deal of sense right now. Also, we will be recommending a change to our fund balance policy that incorporates this fund. It will call for maintaining a high fund balance in order to provide for periods of low building activity without the need to further reduce the core group of employees.

To further increase flexibility, a building inspector position and a code enforcement officer position will be replaced with two building inspector/code enforcement officer positions. That gives him the ability to devote greater resources to building or to code enforcement, as needed.

We are restoring a full-time clerical position in building. This will move the existing shared Clerk/Steno III to the State Construction Code Fund and put a new Municipal Clerk I in the General Fund (Code Enforcement). The net cost of this to the general fund is negligible and the State Construction Code Fund can easily afford the increase. This will greatly reduce the all too frequent times when we have a certified Building Official working the front counter.

### **Police and Fire**

Thanks to the voters who supported our millage request, these departments will be in excellent shape. We are in the process of implementing the ICMA recommendations as modified by the Chiefs and the Commission.

Our biggest problem in these departments is hiring and retaining talent. It takes time to hire and train new personnel, as we are only able to train three or four officers at a time. While we are hiring to get to the goal of 79 sworn officers, we have existing officers retiring or leaving and some of the trainees not completing the program. This will be a long process.

### **Strategic Plan**

The Commission's 2013-2014 goals and objectives drive many of the changes for the 2013-2014 budget including the new economic development position, and the focus on roads, recreation and unfunded liabilities. Some other objectives also require budget action. An expenditure of \$30,000 is budgeted to create a program to manage the rodent population which residents recently identified as the most serious problem facing the City. There are several options for how we could tackle this problem, but we have not yet determined a specific solution. However, we do expect there will be an educational component to the program. We have also budgeted \$15,000 for a targeted talent and retention study.

This year's budget includes an objective to improve the City's measurement of outputs and outcomes. A potential means of achieving this objective is to join the ICMA's Center for Performance Measurement. The 2013-2014 budget includes a \$1,200 allocation in the event we decide that joining would help to realize the objective, and improve services. More analysis is needed before we can make that determination.

### **Water and Sewer**

We have stabilized the water and sewer costs we control, however those only represent 25 percent of the total. We are facing increases paid to third parties for water and sewer service and for debt service. SOCWA will be increasing our water purchase rates by 1.1% percent. The Oakland County Drain Commission will be increasing sanitary sewage disposal rates by 4.9% percent and decreasing flat rate storm water charges by 2.7% percent. Both are ultimately customers of the City of Detroit and must pass on any rate increases they receive to us. By the same token, we have no choice but to pass these changes on to our water and sewer customers. This fund must remain solvent as we cannot return to the position we found ourselves in eight years ago with the water and sewer fund in debt to the general fund. While

the general fund is much stronger today than it was in 2005, it still can not be the "bank" for other funds. We are increasing the water and sewer rate by 1% percent.

### **Automobile Parking System**

We are not making the budgeted transfer from Auto Parking to the General fund for 2012-13. Because the millage increase for public safety came at the half way point of our fiscal year and it was impossible to ramp up spending to the recommended level in that time period, the general fund does not need the budgeted transfer. Since we have an extraordinary cost planned for the Automobile Parking System in 2013-14, the demolition of 225 S. Troy and the construction of a parking lot, we are leaving this money in APS and use it for that purpose in 2013-14. We are budgeting a \$900,000 transfer from APS to the general fund for 2013-14.

### **Tax Rates**

We have a slight decrease in the property tax rate for 2013-14 of 0.036 mill. We are keeping the new public safety rate at 3.475 mills which is .5 mill less than authorized by the voters. This is consistent with my original recommendation for this tax which called for the full amount not be levied until 2013-14. We are also keeping the public safety tax on the winter tax bill. This is the only city tax on the winter bill.

Respectfully submitted,



Donald E. Johnson  
City Manager