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CITY COUNCIL REPORT & COMMUNICATION

September 18, 2009

TO:	John Szerlag, City Manager
FROM:	Nino Licari, City Assessor
SUBJECT:	Explanation of Projected Revenue Loss Due to Reduction in Taxable Value
Cc:	John Lamerato, Assistant City Manager – Finance/Administration

Background:

The major factor necessitating the actions you must consider based upon the 6 year projection submitted by the City Manager is the unexpected loss of revenue set to occur in the next 2 fiscal years, caused by the reductions in Taxable Value. Bearing in mind that this would have occurred, eventually, albeit in a more gradual manner (in either 2 or 3 years), the fact is, it will occur next year, and must be dealt with.

Many questions we have received since the release of the 6 year reorganization memo have to do with the disbelief in the revenue projections. Hopefully, this memo will give you a zone of comfort with the veracity of the estimates, and help you to understand the need for immediate action.

This memo will address the loss in revenue due to the reduction in taxes, the major source of income for the General Fund.

Residential Value Projections:

The Residential Sales Study that the Assessor is mandated to use to set Assessments has been on a 12 month cycle for the past 3 years, and will continue to be for the foreseeable future. A 12 month study is mandated in a declining market to give the taxpayer the advantage of using the most current data feasible. This allows the assessment to more accurately reflect the present market, and show a lower value, and hence, lower taxes.

{In the 24 month study, which has been used since the early 1970's, the most recent sale occurs in the study 9 months before the date assessments are set. The oldest sale in the study occurs 33 months prior to the assessment date. This is done to buffer the impact of an increasing market, for the taxpayer}

The 12 month sales study uses the newest sales 6 months later in the cycle, or only 3 months prior to the assessment date. The oldest sale occurs 15 months prior to the assessment date.
For the past 2 years, residential assessments have dropped approximately 8% per year. Taxable values for the first year still increased, based on the Consumer Price Index (CPI). However, Taxable value may never be higher than the Assessed Value. Last year, so many Taxable Values were equal to the Assessed Value, that the reduction in Assessed Value caused 43% of residential properties to have a reduction in Taxable Value, and thus, a reduction in taxes.

While the remaining 57% of residential properties had an increase in Taxable Value of between 0.01% and 4.40% (the CPI was 4.4%), the reduction in Taxable Value on the aforementioned residential properties, plus the drop in Taxable Value on Commercial/Industrial (C/I) properties caused a net loss in Taxable Value of slightly less than 2% for all classes of property.

On average, residential assessments are set to drop 16% for the 2010/2011 fiscal year, or the 2010 Assessment Year. This reduction will eliminate any remaining differences between Assessed and Taxable Values on the residential class of property in the City. While there may be the very rare subdivision that experiences a slight increase in value, due to sales of homes there, this will be a major exception, and not the rule, and most likely, not a measurable percent of homes.

This 16% average reduction in residential values will equate to a Taxable Value reduction of just less than 13% on this class of property.

Additionally, the CPI for 2010 is projected to be 1.00, or less. This means that even if there remains a very few residential parcels with a slight gap between Assessed and Taxable Value, the Taxable Value cannot increase, and may have to decrease slightly.

This 16% reduction is higher than previous projections due to the large number of Bank Sales, and the effects of the economy, and employment outlook for the region.

Many people assume that foreclosure sales are causing the dramatic decreases in Assessments. This is not the case based just on those sales. Before foreclosures can be used in a 12 or 24 month study, they must be the common method of sale in the taxing unit (read entire City). That has not been the case.

{For last year's sales study, there were slightly less than 300 foreclosure sales. This worked out to approximately 1 in 3.4 sales (nowhere close to the most common method of sale). So far, for this study period, we have 135 foreclosures. This is approximately 1 in 8 sales, and far less than we have had in the past. This part of the market of sales seems to have peaked last year, and should be a non-factor within another year (2011 Assessments).}

However, foreclosure sales do have an effect on conventional sales, or non forced sales, and they have contributed to the reduction in value on non forced sales.

One other major contributor to the drop in residential assessments is now Bank Owned Sales. These are properties that were foreclosed upon, and then sold off by the banking industry. Banks must sell these properties, and get them off of their books within 18 months of foreclosure, by Federal Law.

Barring physical damage to the property, either by neglect, or on purpose by the previous owner, many of these sales approximate conventional sales prices, albeit lower, and must be used in the 12 month sales study. They, too, affect the price the public is willing to pay for the non forced sales of homes.

There are 254 Bank Sales for this year, about 1 in 4.2 sales. Many of these will be used in the 12 month study. Based on the Federal time frame for the banks to rid themselves of these properties, these sales may affect Assessments into the 2012 Assessment Year.

Commercial / Industrial Value Projections:

This is a critical component in the projected revenue loss for the next 2 years.

For the first time, a 12 month sales study has been mandated by the State for Commercial/Industrial (C/I) sales, instead of the conventional 24 month study that is charted below.

Previous 24 Month Commercial Industrial Sales Study Time Frame for 2010

2007				**April**	**May**	**June**
	July	**August**	**September**	**October**	**November**	**December**
2008	**January**	**February**	**March**	**April**	**May**	**June**
	July	**August**	**September**	**October**	**November**	**December**
2009	**January**	**February**	**March**			

As the chart below shows, the 12 month study eliminates 18 months worth of higher valued sales, and includes 6 months worth of lower valued sales.

Newly Mandated 12 Month Commercial Industrial Sales Study for 2010

2007				~~April~~	~~May~~	~~June~~
	~~July~~	~~August~~	~~September~~	~~October~~	~~November~~	~~December~~
2008	~~January~~	~~February~~	~~March~~	~~April~~	~~May~~	~~June~~
	~~July~~	~~August~~	~~September~~	**October**	**November**	**December**
2009	**January**	**February**	**March**	***April***	***May***	***June***
	July	***August***	***September***			

This one factor is the major difference between the earlier projection of a 5% reduction in Taxable Value, and the current overall 12% projected loss.

This new sales study forces a 17.5% reduction in C/I assessments for the 2010 year.

This reduction eliminates any difference in Taxable and Assessed Value for all C/I parcels. There is no longer any spread for the CPI to move Taxable Values by the rate of inflation. Any reduction in Assessed Value now means a corresponding decrease in Taxable Value, and thus, revenue.

{The reason that the 17.5% reduction in Assessed Value does not equate to a corresponding 17.5% reduction in Taxable Value is that there currently is a difference, overall, between Assessed and Taxable Values in the C/I class.}

While this drop in market value would still have occurred using a 24 month study, and while it would not have been as drastic in any one year, the fact is, this value loss would have occurred within the next 2-5 years in any case.

Residential and Commercial/Industrial Overall Change:

Using what little difference there is between Assessed and Taxable Values for both Residential and Commercial/Industrial properties limits the overall decrease in Taxable Value to 12%. This is where the bulk of the initial 2010/2011 revenue reduction occurs.

The Second Year of the Revenue Estimates:

While the market is expected to rebound slightly for the 2011/2012 year, we can be certain that the rest of the C/I value drop will occur in the second year.

Estimating the overall market value loss at 10% for 2011/2012, means an actual loss in revenue of the same amount, as there is no longer any difference between Assessed and Taxable Value.

Years 3 through 5 Estimates:

While any estimates past the first two years are given careful thought, and based on all data that is available at that time, they are still estimates, and can change with the times, and are therefore not fixed. However, each year, between August and October, the available market data is looked at, and corrections are made where necessary.

Industrial vacancy rates have continued to rise, and while the vacancy is not increasing as dramatically as before, it remains a problem. Office vacancy has hovered between 18 and 22% for the last 4 years, and shows an inclination of adding tenants, albeit at lower rents.

Oakland County Equalization has slightly more pessimistic forecasts for years 3, 4, and 5. Studying the Troy trends, and comparing them to past County forecasts leads me to a bit more optimistic estimate for Troy in years 3 through 5.

The first two year's projections remain very certain, (barring any unforeseen changes like the one made to the Commercial/Industrial Sales Study) and staff strives to be proactive, rather than reactive.

FROM THE OFFICE OF THE CITY MANAGER

September 9, 2009

TO: Honorable Mayor and City Council Members

FROM: John Szerlag, City Manager

SUBJECT: 6-Year Organizational Restructuring Plan for the City of Troy; Fiscal Year 2009/10 through Fiscal Year 2014/15

Executive Summary

As discussed at previous budget sessions, operating revenues are projected to decline from now through fiscal year 2014/15. As such, the City of Troy is going to have to reduce its full-time workforce by approximately 170 people. This reduction amounts to over 1/3 of all full-time personnel and will necessitate changes to the organizational structure and service delivery venues.

Said another way, we are looking at a declining revenue line every year for the next 5 years; so much so that by fiscal year 2014/15, the aggregate difference between expenditures and revenue will be in the area of $22.6 million. Of course, we cannot let this deficit stand, and thus $22.6 million of cuts in General Fund operations are required to balance this and future budgets. The matrix below will provide insight on cuts required to General Fund expenditures on a year to year basis.

	2009/10 (in Millions)	2010/11 (in Millions)	2011/12 (in Millions)	2012/13 (in Millions)	2013/14 (in Millions)	2014/15 (in Millions)
Revenue	$ 62.0	$ 58.1	$ 54.3	$ 53.1	$ 52.2	$ 51.5
Expenditures	$ 63.6	$ 64.3	$ 60.3	$ 56.3	$ 55.1	$ 54.2
Proposed Cuts	$ (1.6)	$ (6.2)	$ (6.0)	$ (3.2)	$ (2.9)	$ (2.7)
Total	$ 62.0	$ 58.1	$ 54.3	$ 53.1	$ 52.2	$ 51.5
Fund Balance	$ 10.5	$ 10.5	$ 10.5	$ 10.5	$ 10.5	$ 10.5
F/B % of Budget	16.9%	18.1%	19.3%	19.8%	20.1%	20.4%

The desired outcome of this report is twofold:

1. The governing body needs to advise on an organizational restructuring option, and partner with City management and other stakeholders in the community to deliver this option. As such, I propose we meet once a week in a workshop session format until a solution is achieved. Please know that we need to work with a sense of urgency on this matter.

Executive Summary, continued

2. Identification of alternatives to lessen the impact of reduced service delivery and mitigate workforce reduction. These alternatives are delineated later in this memo.

Assumptions

1. General Fund revenues are projected to decrease every year for the next 5 years, primarily due to market conditions impacting assessed valuations, and reductions in state shared revenue. We estimate a decline in revenues from $62.0 million in fiscal year 2009/10 to $51.5 million in fiscal year 2014/15.

2. General Fund costs will increase at 2% per year because of items like insurance, utilities, materials, and other personnel related costs.

3. Personnel related costs constitute about 71% of all General Fund expenditures. However, this report takes all cost-reduction on the personnel side of the ledger. I know this is a conservative approach, but it may allow us to reinstate some positions as we receive more accurate data over time. Now, having made the rule, let me state an exception. General Fund expenditures this fiscal year are going to be greater than revenues to the tune of about $1.6 million. And instead of looking to reduce the workforce this fiscal year, we are first looking to other venues which will be detailed in my next report to you. However, there are no guarantees, and we may reduce the workforce this fiscal year.

4. The restructuring models do not incorporate a millage increase or use of any Fund Balance.

5. Privatization and/or regionalization will save roughly 40% compared to the cost of providing services in-house. As an example, let's say a portion of the Building Department was privatized, and 10 employees were laid off as a result thereof.

   If the savings from these lay-offs came to $1 million, the assumption is that it would cost the City $600,000 (or 60%) to have a private sector firm perform a similar on-demand type of service; hence the 40% savings.

   Please know that I did not include any consolidation efforts in the service delivery options because a result cannot be guaranteed by a certain point in time. That said, it should be considered as a parallel option, and a valid one if consolidation can be achieved within an appropriate time frame.

Methodology

We are a mid-size complex organization delivering an array of life-safety, regulatory, and quality of life services. So when reducing expenditures to match a declining revenue line, the options available to restructure the organization are so numerous as to become cumbersome. Therefore, two general restructuring options have been developed so as to be a manageable starting point for our discussions. Before going there, however, I wish first to provide a definition of terms.

For the sake of this report, privatization means that an outside private sector firm will perform the service on behalf of the municipality. An example would be utilization of outside civil engineers to perform work currently performed in-house by civil engineers.

Regionalization means that another layer of government will perform the service on behalf of the City. An example here is that Oakland County Assessing Department can perform some or all of the Assessing functions for the City of Troy.

Consolidation means that local units of government agree contractually to perform a service so as to achieve an economy of scale. We have examples of consolidation here in Troy like our contract with Clawson for police dispatch and jail services. And although consolidation is not included in any of our models, it should not be discounted and City management will continue to attempt partnerships with our surrounding communities so as to achieve an economy of scale. Again, the models do not include consolidation efforts in the service delivery options because a timeframe cannot be guaranteed for implementation, and our financial crisis mandates a timely resolution.

Our methodology was to look at each department and determine if it could be privatized, regionalized, consolidated, retained in-house, or a combination thereof. Departmental elimination was also viewed as a method to reduce costs.

Outlined below are two options available to us given the above slate of assumptions:

Option 1

The following departments would be eliminated:

- Library
- Community Center
- Museum
- Nature Center
- Community Affairs
- Risk Management (function will still be maintained)

Option 1, continued

The following departments would be privatized to varying degrees:

- Building Inspection
- Engineering
- Public Works
- Parks and Recreation
- Human Resources
- Real Estate and Development

Most of the City Assessor's Office personnel would be regionalized as Oakland County would take over this function.

The following departments would experience reduction of employees:

- City Attorney's Office
- City Clerk's Office
- Purchasing
- Finance

The Fire Department would lose 3 full-time personnel and 1 part-time person.

The impact on the Police Department under this option will be a reduction of 47 full-time personnel. This represents a combination of sworn and non-sworn employees.

Option 2

This option keeps the Library, Community Center and Museum opened on a limited basis. In order to accomplish this, however, lay-offs in the Police Department must increase by 20, bringing the total decrease from 47 personnel to 67 personnel. Please know that 67 personnel in the Police Department represent about 35% of departmental strength. Of course, other departments listed in **Option 1** for elimination, privatization, regionalization, and reduction would still be in place.

Options to Lessen the Impact of Reduced Services and Mitigate Workforce Reduction

1) Seek employee concessions. Please know that I'm currently working with our labor attorney and HR director on this matter. This is subject to contract negotiations, and legal restrictions. However, fiscal year 2014/15 calls for a 32-hour work week for all full-time employees with the possible exception of employees in the Police and Fire Departments. This was the most functional way to balance the 2014/15 budget.

Options to Lessen the Impact of Reduced Services and Mitigate Workforce Reduction, continued

2) City Council can ask the voters if they wish to approve a General Fund millage increase.

3) City Council can ask the voters if they wish to approve a millage increase for a specific use, like a library.

4) City Council may be able to establish an independent library board separate from the City of Troy's General Fund and levy up to one mill for the operation thereof. This could possibly be accomplished without voter approval. Legal counsel is researching this matter.

5) City Council can authorize the use of the Budget Stabilization Fund, Fund Balance, and increase some administrative fees.

6) City Council can transfer some funds from General Capital to General Operating, although I would not recommend any reduction to Capital Funds allocated for road improvements.

Conclusion

This is a complex issue, and I'm sure you have many questions I did not address. I stand ready to answer them. Additionally, a more detailed report is forthcoming on the ramifications of these options in terms of level of service.

c: Department Directors

JS/mr\To M&CC – 6-Year Organizational Restructuring Plan for the City of Troy