

**OAKLAND COUNTY, MICHIGAN  
COUNTY EXECUTIVE BUDGET MESSAGE  
FISCAL YEARS 2007 AND 2008 BIENNIAL  
OPERATING AND CAPITAL BUDGETS**

To the Board of Commissioners and Citizens of Oakland County:

I am pleased to present the Fiscal Year 2007-2008 Biennial Budget Recommendation for your review and approval. Promulgated in accordance with the Unified Form of County Government Act, 1973 P.A. 139, and the Uniform Budgeting and Accounting Act for Local Units of Government, 1978 P.A. 621, General Fund/General Purpose Estimated Revenue and Appropriations are balanced at \$490,541,336 for Fiscal Year 2007 and \$424,027,514 for Fiscal Year 2008. The total budget for all funds amounts to \$822,509,809 Fiscal Year 2007 and \$697,814,596 for Fiscal Year 2008.

**INTRODUCTION**

The National Advisory Council on State and Local Budgeting (NACSLB) defines the budget process as a set of activities that encompass the development, implementation, and evaluation of a plan for the provision of services and capital assets. A good budget process consists of far more than the preparation of a legal document appropriating funds for a series of line-items. Instead, a good budget process involves political, managerial, planning, communication, and financial dimensions. Accordingly, Oakland County's nationally recognized budget process is characterized by the following essential features:

- Incorporates a long-term perspective
- Establishes linkages to broad organizational goals
- Focuses budget decisions on results and outcomes
- Involves and promotes effective communication with stakeholders
- Provides incentives to government management and employees

These five features are characteristic of a budget process that moves beyond the traditional concept of line item expenditure control, providing incentives and flexibility to managers that can lead to improved program efficiency and effectiveness.

The Government Finance Officers Association (GFOA) of the United States and Canada has established an Award Program for Distinguished Budget Presentation. The GFOA Award Program recognizes budget publications that adhere to a strict set of criteria leading to exemplary budget documents. Eligible budgets are evaluated by three independent out-of-state practitioners who are members of GFOA's Budget Review Panel. Eligible budgets are evaluated based on four categorical guidelines:

- The budget as a Policy Document
- The budget as a Financial Plan

- The budget as an Operations Guide
- The budget as a Communications Device

Oakland County is proud to be one of only 27 units of Michigan government, out of 1,861 or 1.5%, that have been accorded the Award for Distinguished Budget Presentation by the GFOA. We can all be proud that in 1984 when the GFOA award program was first initiated, Oakland County was the first governmental unit in Michigan, and only the 11<sup>th</sup> in the nation, to achieve this distinction. Oakland County's continuing commitment to budgeting excellence is further demonstrated by the County's support of the GFOA national program for improved budget development practices as evidenced by the involvement of Management & Budget staff as Budget Review Panel members.

## **FINANCIAL OUTLOOK**

### **Oakland County's Economy**

Our nation's economy has experienced growth over the past three years, evidenced by employment increases around the country with the upward trend beginning in September 2003 and continuing unabated since. However, despite steady economic growth nationally, Michigan is unique, because, unlike the rest of the country, our State has not yet pulled out of the recession, which began in 2000. Michigan's economy continues to decline, particularly in terms of jobs lost. Manufacturing represents a significant portion of Michigan's economy and manufacturing job losses adversely impacted Michigan more than any other State. Since the start of the 2000 recession, Michigan has lost over 240,000 manufacturing jobs, about 1/4 of the total manufacturing jobs that existed at the time the State was at its peak level of employment in 1999, just prior to the onset of the 2000 recession. Despite the improvement in the national economy, Michigan's economic condition continues to decline. Unfortunately, economists predict that the number of jobs in Michigan will continue to decline throughout the remainder of 2006 and into 2007.

Within the manufacturing sector, the automotive industry is easily identified as singly having the most significant negative impact on the State's economy. The "Big 3" automotive companies (General Motors, Ford Motor Company, and DaimlerChrysler) as well as their related supplier and service provider companies, constitute a large presence in Michigan's economy. The Big 3 auto companies have been steadily losing significant market share with their light vehicle sales declining by almost 20% since 2000. Loss of market share, coupled with rapidly escalating increases in the cost of manufacturing such as for employee health care and raw materials, has resulted in declining vehicle manufacturing within Michigan. To make matters worse and signaling a long-term economic challenge for Michigan, vehicle production facilities within the U. S. have been shifting from the traditional Midwest area of the country, which is where most of the Big 3 plants still remain, to other areas of the country, primarily the South.

During the decade prior to the onset of the recession in 2000, Oakland County averaged 21,600 additional jobs annually. However, with the onset of the recession in 2000 Oakland County too, experienced employment losses with a reduction of 53,000 jobs between 2000 through 2004, the most severe loss occurring in 2002 when the County lost 17,300 jobs. Approximately 68% of the job loss occurred in the manufacturing and construction sectors, which make up only about 15% of Oakland County's economy. However, in 2005 Oakland County turned the corner, adding 1,900 jobs. The service-providing sector added 5,100 jobs in 2005 while the goods-producing sector continued to decline, however, losing 3,200 jobs. Economists from the Research Seminar in Quantitative Economics, University of Michigan, are projecting

that, in total, jobs will continue to be added over the next several years despite the ongoing difficulties of Michigan's auto industry, most notably the closing of the Ford Wixom plant in the summer of 2007 and the expected downsizing of Delphi headquarters. Even with the anticipated auto-related job losses, the economists are projecting that Oakland County will sustain its economic turnaround with an additional 14,000 jobs during the three-year period of 2006 through 2008. The job growth during this three-year period is expected to occur in the private service-providing sector (7,000 jobs per year on average), partially offset by continued job losses in auto manufacturing and construction. The economists predict that Oakland County's economy will grow more rapidly once the restructuring of the auto industry runs its course.

There are other reasons for optimism. Recognizing that the recently lost manufacturing jobs will likely not be recovered in Oakland County, our efforts to further diversify the County's economy, a primary focus of my administration that has long been supported by the Board of Commissioners, have intensified. To-date, the success of our joint efforts is demonstrated by the County's economic resilience and its continuing recovery from the recent recession. This is especially evident when one compares our successes with the continued struggle for jobs throughout the remainder of Michigan. Now, we have taken Oakland County's economic diversification efforts to another level with the launch of the Emerging Sectors Initiative.

The Emerging Sectors Initiative is intended to insure that Oakland County remains Michigan's epicenter of job creation and business activity. To that end, I directed the Department of Economic Development and Community Affairs to research the top ten emerging business sectors for the 21<sup>st</sup> century, ones Oakland County should target for future job growth, long lasting employment and business stability. I then asked the department to identify and prioritize the top companies within each of those sectors. Our preliminary research revealed that over 60 percent of the emerging sectors companies identified were located overseas and that many had no presence in the United States.

To remedy that situation, in the FY 2005 Budget, I asked the Board of Commissioners to support the establishment of an Emerging Sectors Program and the Board granted my request. To execute the initiative, select "calling teams" were assembled and dispatched to meet with the decision makers of the premier emerging sector corporations. Their mission is to convince the emerging sector companies to bring their businesses and jobs to Oakland County. The membership of a calling team varies from corporation to corporation and country to country, but all include both political officials and private sector corporate leaders from Automation Alley and elsewhere.

Our effort has been an unqualified success. Since the launch of the Emerging Sectors Program, **21** emerging sector companies have committed to **investing an additional \$216 million** in Oakland County, **creating 2,597 new jobs** and **retaining 1,218 jobs**. These jobs are in the emerging sector areas of alternative energy, advanced electronics, advanced materials, homeland security, communications, robotic and automation, and other fast growth sectors such as financial services. Oakland County is well positioned for these sectors with its high concentration of knowledge-based economic activity, 41% of its residents aged 25 or older possessing a bachelors degree or higher, and with the region being the 3<sup>rd</sup> highest producer of graduates with engineering degrees.

Another recent major initiative, which will enhance Oakland County's attractiveness and entice additional business into the County, is the Wireless Oakland project. Wireless Oakland consists of three goals. The first goal is to blanket the County's 910 square miles with wireless Internet service, with a portion of bandwidth available for **free** to every person in Oakland County. The second goal will directly address the "digital-divide" that exists within Oakland County and provide low-cost or no-cost PC's and technology training to vulnerable population groups. Finally, the third goal of the initiative will develop a Telecommunication and Technology Planning Toolkit for Local Governments that

supports continued high-tech investments in local government and promotes the integration of those investments with local community character and quality of life.

The installation of the Wireless Oakland network has begun, and seven community pilot areas should be complete in summer of 2006. The build out of the rest of the County will follow shortly thereafter, and we anticipate the entire County will be blanketed by the end of 2007. Wireless Oakland will prepare Oakland County and its workforce for the jobs and technology of tomorrow. In conjunction with the Emerging Sectors initiative, it will enhance Oakland County's ability to attract and retain high-tech and nanotechnology corporations. Wireless Oakland will also enhance the residential character of our local communities and further distinguish Oakland County as a great place to live, work, and play. It will support a growing mobile workforce and elevate the technical knowledge of its current and future workforces. Finally, Wireless Oakland will play a key role in the transformation of government services throughout Michigan and support the continued provision of Oakland County's eGovernment services well into the future.

Finally, it is important to note that Oakland County's per capita income of \$50,991 is the highest level among Michigan's 83 counties and ranks within the top 1% of the nation. In fact, Oakland County's per capita income is more than 50% greater than both the nation's (\$33,050) and the State's (\$32,079). This wealth is reflected in the County's housing market with the average price of single family homes increasing by 55% from \$159,900 in 1997 to \$247,300 in 2005.

### **Oakland County's Tax Base**

The market value of property in Oakland County is approximately \$153 billion, the highest among all 83 counties in Michigan. The population of Oakland County represents approximately 10% of the State total, while the market value of property in the County represents approximately 18% of the State total. The 2005 to 2006 growth in market value of taxable property in Oakland County was \$6 billion. That growth alone exceeds the total market value of 59 of the 83 Michigan counties for 2005. The majority of Oakland County's property value is found in the residential class, representing approximately 72% of the County total.

### **Oakland County's Financial Condition**

Oakland County employs policies and practices designed to ensure its ability to provide quality services despite economic or budgetary challenges. Oakland County government's strong financial position is primarily a reflection of its adherence to policies and practices that result in strong financial planning, maintenance of healthy fund balances and low debt obligations.

Under Michigan law, the maximum amount of debt that could have been issued by Oakland County in 2005 was \$7.3 billion or 10% of its State Equalized Value. However, operating under the fiscally conservative policies of the County Executive, County Treasurer, and Board of Commissioners, as of the close of Fiscal Year 2005 Oakland County had incurred an outstanding pledged debt of only \$324.5 million, only 4.4% of the permissible level. In fact, with the exception of the annual issuance of limited taxing authority notes related to delinquent tax receivables, Oakland County's practice is to issue debt only for the purchase and/or construction of long-lived assets. Any decision to issue debt, as opposed to using current resources or fund balance, is made only after it is determined to be fiscally advantageous to do so.

The majority of Oakland's pledged debt, approximately \$213.6 million, was issued to finance water, sewer, lake level, and drainage district projects. That debt will be repaid from special assessments levied by the local communities against the users of those systems. Another \$25 million of the total debt represents short-term tax notes issued to purchase delinquent tax receivables from the County's municipalities. That debt is repaid from the interest and penalties associated with those delinquent taxes. Finally, only \$85.9 million of the total outstanding pledged debt is committed for building projects involving facilities utilized directly for daily County operations. The debt for these County-specific projects will be repaid from either resources set aside in the County's Delinquent Tax Revolving Fund (see further discussion below) or from Parks and Recreation funding (for the Lyon Oaks golf course) which has a dedicated millage separate from the County's general operating millage.

Much of Oakland County's financial success has resulted from its focus on long-term financial planning. The County goes beyond the requirement of adopting an annual budget and operates under a two-year rolling budget. This practice requires continuous financial planning that looks at least two fiscal years into the future. That continuous, forward-looking focus enables the County to anticipate problems and to take appropriate action well in advance of major budgetary fluctuations.

The County also maintains a strong position control and position budgeting system, and follows the practice of budgeting for full employment. Should vacancies occur or positions become filled at a level lower than the maximum authorized, the resulting favorable budget variance falls to fund balance.

Maintenance of a favorable fund balance is an indicator of a healthy operating environment. Favorable variances falling to fund balance are created as part of an intentional financial management strategy (for example, budgeting for full employment) and are relied upon to ensure that adequate fund equities are maintained, particularly in the General Fund.

The General Fund is the principal fund used to record the operations of typical government functions. The fund's primary source of revenue is the property tax. For the fiscal year ended on September 30, 2005, the total fund balance in Oakland County's General Fund was \$65.4 million, of which all but \$1.2 million is reserved, designated, or otherwise earmarked for specific purposes. The total fund balance in the General Fund represents approximately 17% of the General Fund/General Purpose Adopted Budget for Fiscal Year 2006.

The Delinquent Tax Revolving Fund (DTRF) is another fund meriting discussion. The DTRF was established in 1974 to help stabilize annual revenues for local taxing units. It does this by paying our local communities 100% of their share of delinquent property taxes in anticipation of the collection of those taxes by the County Treasurer. The County funds the DTRF by borrowing money and issuing revolving fund notes. Payment of the notes is made from the proceeds of delinquent tax collections. Once the notes are paid in full, any surplus in the fund may be transferred to the County General Fund by action of the Board of Commissioners.

Upon recommendation of the County Executive, and with the support of the County Treasurer, in 2001 the Board of Commissioners adopted the DTRF Fiscal Responsibility Plan. The purpose of the Fiscal Responsibility Plan is to guide the prudent use of surplus fund balance in the DTRF without jeopardizing the fund's primary mission of providing a timely, stable revenue stream to the local taxing units. At the close of Fiscal Year 2005, the total DTRF fund balance reported was \$199.1 million.

The foremost rule of the Fiscal Responsibility Plan is that the DTRF must maintain a sufficient corpus in the fund to guarantee timely payment of outstanding notes. Accordingly, \$80 million of the fund balance was designated (set aside) to provide the cash flow necessary for the purchase of the delinquent tax receivables.

Beyond protecting the fund's primary purpose, Oakland County's Fiscal Responsibility Plan includes a strict policy for accessing funds from the DTRF. Any appropriation from unrestricted DTRF funds, except penalties and investment interest, are limited to one-time expenditures. This avoids reliance on the DTRF for the general and recurring operating costs of the County. Instead, the DTRF provides a funding mechanism for major capital projects, which are generally one-time expenditures. Use of DTRF funds for even one-time expenditures requires an affirmative vote by two-thirds of the Board of Commissioners. To date, approximately \$101.1 million of the DTRF fund balance has been restricted to fund debt service payments on bonds issued for Board-approved major capital projects. Projects secured by the DTRF debt service funding program include the Work Release Facility, the Video Conferencing System, the Jail Management System, the Rochester Hills District Court, and the purchase and renovation of the former Oakland Intermediate Schools building.

Oakland County's strong economic base, solid tax base, and responsible financial policies and practices have been acknowledged by the financial investment community. In recognition of Oakland County's financial strength and superior managerial performance, the County has continued to earn the highest bond rating achievable, AAA, from Standard & Poor's and Moody's Investors Service. This AAA bond rating allows the County to borrow at the lowest possible interest rate, saving County taxpayers millions of dollars in future borrowing costs.

## **CURRENT BUDGET ISSUES AND RECOMMENDATIONS**

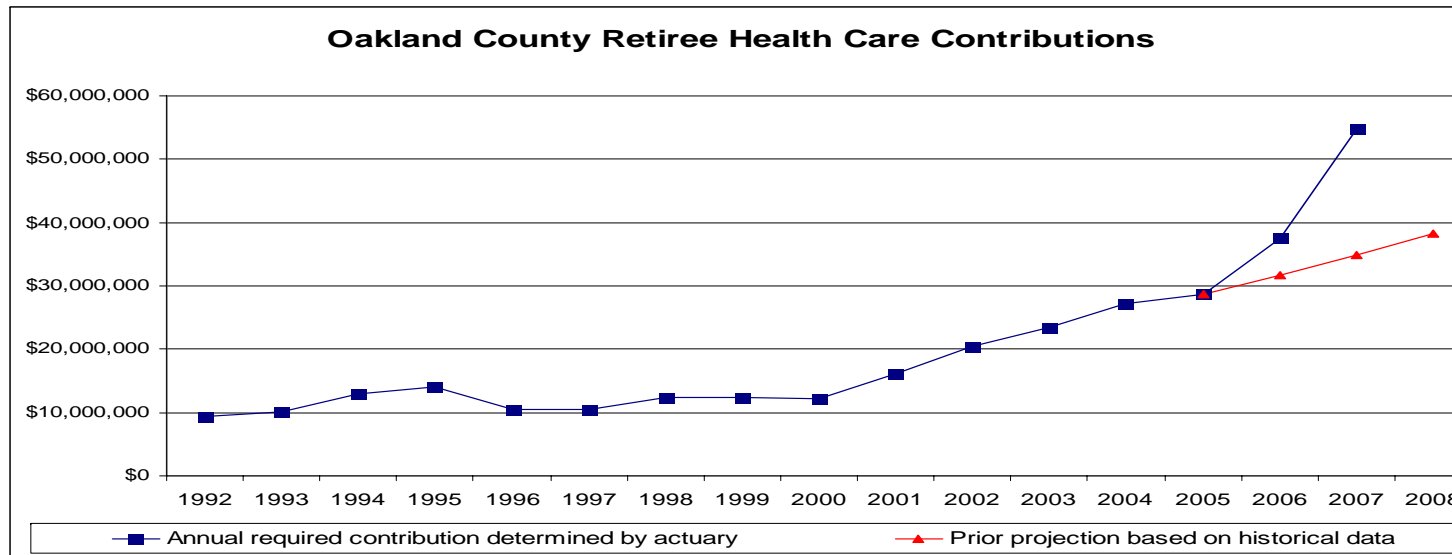
The single largest challenge in developing this budget recommendation concerns the level of funding required for retiree health care. Most governmental entities do not advance-fund future retiree health care benefits. Instead, they fund those health care benefits on a cash basis, with the cost being recognized only when bills for current retirees are presented. Oakland County is different. For the past two decades, Oakland County has funded its retiree health care using figures determined by an annual actuarial analysis. The actuary's recommendation provides an amount that includes not only a projection of annual costs for current retirees, but also funding for costs yet to be incurred for future retirees. Based on the actuary's analysis and recommendation, each year Oakland County pays an annual required contribution (ARC) to the County's Voluntary Employees' Beneficiary Association (VEBA), which is essentially an irrevocable trust to fund health care benefits for retirees.

The two most recent annual actuarial reports resulted in substantially large increases required for the ARC payment. The first large increase occurred during last year's budget process when the ARC increased by \$8.7 million or over 30% from \$28.8 million required in FY 2005 to \$37.5 million in FY 2006. The most recent actuarial report requires an even larger increase from \$37.5 million in FY 2006 to \$54.8 million in FY 2006, an increase of \$17.3 million or over 46%. The total amount of increase for the past two-year period is \$26 million, almost double the required amount in FY 2005. For perspective, \$26 million is equivalent to a 13% increase in compensation.

There are several reasons for the large increases in the retiree health care ARC:

- On the cost side of the actuarial calculation, the fact that inflationary increases for health care continues to significantly outpace general increases for other goods and services is a major issue.
- In addition to the overall cost increase for health care, there was also a required methodology change which affected the cost side of the equation - a mandated change in actuarial guidelines now requires the analysis to be based on different cost assumptions for the different age groups (previously, the actuaries could use a standard assumed amount for each person regardless of age).
- On the revenue side of the calculation, to value the net assets in the VEBA, the actuary uses a technique which “smoothes” fluctuations in the investment market over a three year period (the average of the current market value at the valuation date with adjusted market value from the two prior years). While the market was favorable for investments in 2005, the unfavorable market experienced in 2003 and 2004 suppressed the valuation of the VEBA assets.
- There were recent changes in governmental accounting standards - Governmental Accounting Standards Board (GASB) Statement numbers 43 and 45. Since Oakland County already funds its retiree health ARC based on an actuarial study, the County was already in compliance with these Statements for the past two decades (in contrast to the majority of other governmental units across the country which are not in compliance and will eventually experience a negative impact on their financial Statements if they continue to leave retiree health care funding issues unaddressed). The GASB Statements did impact the County’s actuarial assumptions, however, because the accounting changes mandate that the amortization period for the unfunded accrued liability (UAL) be reduced from 40 to 30 years (shortening the funding period thus increasing the ARC).
- Full-time eligible employees hired on or after January 1, 2006, will have a Retirement Health Savings Account (RHS) plan rather than the traditional employer-paid health, dental, and vision coverage when they retire. The County will contribute \$1,300 per year (\$50 per pay period) of pre-tax dollars to each RHS account (employees may also elect to contribute a portion of their pre-tax pay to their account). This new plan going forward will limit and fix the amount of retiree health care cost in order to maintain the County’s ongoing fiscal stability while still continuing to provide employee benefits. As a result of the benefit change, the traditional plan is considered to be a “closed” plan from an actuarial perspective. Therefore, actuarial guidelines require the traditional plan’s ARC be based on a level dollar payment going forward rather than the methodology that was used previously, which was based on a percent of total payroll. The percent of payroll methodology assumes a gradually increasing payment amount over the 30-year amortization period (similar in concept to an adjustable rate mortgage) while the level dollar payment assumes that the payment remains the same each year over the 30-year amortization period (similar to the concept of a fixed mortgage payment).

Below is a graph, which provides the ARC amounts dating back to 1992, and illustrates the steep rise in the ARC required for FY 2006 and FY 2007 as a result of the two most recent actuarial reports. The graph also illustrates the ARC amounts that were anticipated (based on historical data) prior to receiving the two most recent reports.



As large as the increase is for the required annual retiree health care contribution, it is still substantially less than what would have been required had the County not provided a one-time accelerated \$50.9 million VEBA contribution in FY 2004. The accelerated \$50.9 million contribution has been estimated to save us some \$3 million annually in actuarial payments.

When the actuary report was received last year during the development of the budget recommendation, at that time it presented a major budgetary challenge that required reductions elsewhere in the budget (for details refer to the budget message from the FY 2006/FY 2007 biennial budget, available on the County's web site at [http://www.oakgov.com/fiscal/assets/docs/06-07\\_budget/06-07\\_budget\\_introduction.pdf](http://www.oakgov.com/fiscal/assets/docs/06-07_budget/06-07_budget_introduction.pdf)). Since we prepare a biennial budget and were expecting another substantial increase in the ARC in anticipation of the amortization period being shortened, the FY 2007 initial budget plan approved last year provided for an ARC payment in the amount of \$46.1 million – however, the \$54.8 million required per the most recent actuary report far exceeds the amount budgeted.

Oakland County is in a unique position to take advantage of funding alternatives to close the gap between the amount budgeted versus the amount required for the retiree health care ARC. Since Oakland County has a bond rating of AAA, we enjoy the lowest rates that can be obtained in the government bond market. Further, it is very likely that the Federal funds rate will be on an increasing trend into the foreseeable future in an effort to counter inflationary pressure. Thus, the low interest rates on bonded debt that can be obtained in the market currently are unlikely to remain this low for much longer. There is an opportunity for Oakland County to issue taxable bonds at a low interest rate and then reinvest those funds in permissible long-term investments within the VEBA trust fund. Specifically, the most recent taxable series of bonds issued by Oakland County sold at 5.5% under its AAA rating on behalf of the City of Pontiac for the Phoenix Center. This is in contrast to the 7.5% long-term investment rate assumed in the actuary report for VEBA investments. Oakland County's unfunded accrued liability (UAL) for retiree health care is nearly \$500 million present value. The actuary study requires Oakland County to contribute \$54.8 million annually for the next 30 years in order to fully fund the UAL at the end of that 30-year period. If Oakland County were to issue \$500 million in taxable bonds

at today's market rates to be repaid over 20 years, the annual debt service payment would be approximately \$42 million. By investing that \$500 million through the VEBA trust fund at 7.5% over that same 20-year time frame, the County could realize net gains of approximately \$145 million. This mechanism of funding the retiree health care ARC would reduce the funding period for Oakland County by 10 years (30-year amortization period versus 20-year bond issue). In addition, Oakland County would be one of few governments in the country, if not the only one, to fully fund its retiree health care plan. During a recent conference in April, a delegation of Oakland County officials discussed this funding concept with Wall Street analysts, and their reaction to this plan was very positive. They were impressed that Oakland County has not only been funding its retiree health care ARC based on the actuary recommendations for the past 20 years but also that the County is considering this unique approach to funding the remainder of its long-term liability.

This approach of funding retiree health care costs would help to reduce the interest rate risk in that the cost of financing would be locked in and help to mitigate future potential ARC increases. However, risk still remains as it relates to other variables considered in the annual actuary study, with cost being one of the biggest remaining risk factors. The rapid rise in the cost of health care is a major national issue impacting all employment sectors, both public and private. In response to the financial challenges arising in this area, over the past decade Oakland County has made gradual changes to its employee benefit package. Different tiers of benefit packages, depending on hire date and employee selections, are provided employees. This year, Oakland County continued on its course of making minor adjustments to curb cost increases with the Board of Commissioners approving slight increases in co-pays and deductibles for both the active employee and retiree health plans which will take effect in 2007. In addition, we are exploring wellness program initiatives that could be implemented to further contain costs.

Based on the above discussion, this budget recommendation includes the plan to issue bonds for a 20-year period to fund the remaining retiree health care UAL. The goal is to bring a resolution to the Board of Commissioners shortly after the new fiscal year begins on October 1 to authorize the issuance of the bonds. The budget recommendation provides for debt service payments of \$43 million annually. The projected difference of \$3 million between the original budgeted amount for the ARC and the \$43 million for debt service is recommended to remain as an appropriation annually to the Fringe Benefit fund, to be built up over time until needed as a contingency in the event that the ARC requirement as determined by the actuary should increase in the future. This plan not only provides full funding for the balance of the unfunded accrued liability for retiree health care but also minimizes the impact on the budget plan – otherwise, significant budget reductions across County programs would be required to balance the budget, negatively impacting our ability to provide citizen services.

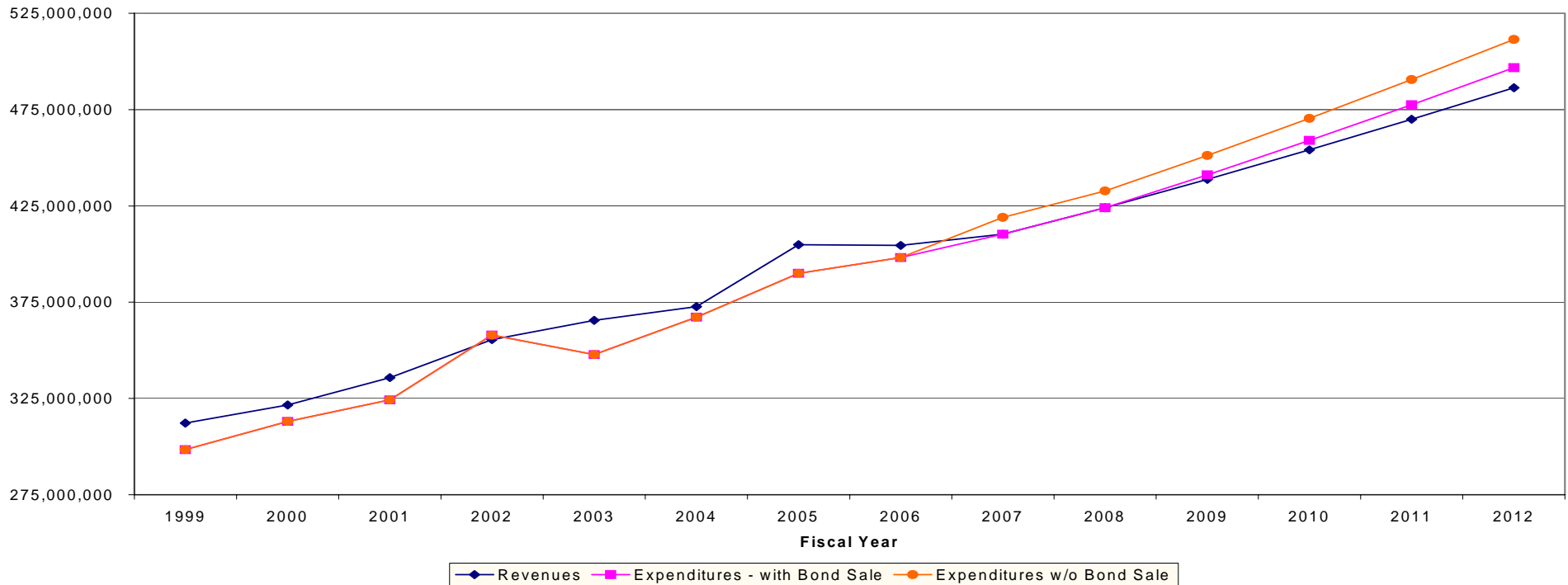
Beyond the challenge of adequately funding retiree health care, the FY 2007 and FY 2008 Recommended Budget reflects the Amended FY 2007 plan (first adopted in September 2005) with some minor adjustments. One of the adjustments relates to the continuing increase in the cost of care for wards of the Circuit Court/Family Division. These increases reflect expanded lengths of stays in residential facilities as well as the shifting of juveniles from federal Title IV-E funding to the County Child Care Fund.

In addition, only new full time eligible General Fund/General Purpose positions included in this recommendation are the Law Enforcement, Administration of Justice and Public Health; *and* are supported by new sources of revenue or verified expenditure reductions. An additional General Fund/General Purpose appropriation is recommended to increase the hours of several part-time non-eligible positions. The County believes this is an effective way to handle increasing workloads without adding the additional fringe benefit cost associated with full time positions.

## FUTURE BUDGET OUTLOOK AND CONSIDERATIONS

As noted, Oakland County goes beyond the legal requirement of adopting an annual budget by operating under a two-year rolling budget process, a mechanism that requires planning at least two fiscal years into the future. Beyond developing the two-year budget plan, Oakland County looks for potential future budgetary issues by projecting future revenue and expenditure trends. Given our existing revenue structure and current programs, it is clear that if preemptive action is not taken, Oakland County will have serious budget shortfalls both in the near-term and long-term, as illustrated in the below projection:

**Oakland County General Fund/General Purpose Revenue & Expenditure Growth  
(Actual 1999-2005 Projected 2006-2012)**



- Notes:
1. Amounts from FY 1999 through FY 2005 reflect actual revenues and expenditures for General Fund/ General Purpose operations as reported for each year-end in the Comprehensive Annual Financial Report.
  2. Figures for FY 2006 reflect the projection included in the FY 2006 Second Quarter Financial Forecast.
  3. The FY 2007 and FY 2008 figures reflect the County Executive's Recommended Budget for those respective years.
  4. FY 2009-FY 2012 reflects a growth rate equal to the percentage growth experienced for revenue and expenditures from FY 1999 to FY 2007.
  5. The revenue for FY 2001 has been adjusted, however, to eliminate the effect from the recognition of \$41,755,923 in one-time revenue due to a mandated accounting change regarding the accounting period when deferred property tax revenue should be recorded.
  6. Revenue and expenditures for FY 2005-FY 2007 have been adjusted to remove the effect of the shift and acceleration of the County's annual property tax levy from December to July. This three-year process increases revenues and expenditures above the on-going operating amounts.
  7. The significant operating surplus in FY 2003 is due to the early implementation of budget reductions in anticipation of a budget shortfall for FY 2004.

The above graph illustrates some important, unfavorable financial trends (gaps between anticipated revenues and expenditures *assuming* historical growth patterns) that must be addressed before they become reality. In particular, the cost for retiree health care could have a significant impact on the County's ability to provide citizen services. As previously stated the FY 2007 and FY 2008 County Executive Recommended Budget assumes the sale of \$500 million in bonds to cover the cost of retiree health care. Should the sale of these bonds not be approved, anticipated County revenues will fall short of anticipated expenditures by \$8.7 million in FY 2007. Should no further action be taken, the shortfall will increase to \$25.2 million by FY 2012.

As the graph shows, the sale of retiree health care bonds will substantially reduce the potential shortfall between anticipated revenues and expenditures. However, even with the bond sale, and the proactive steps take by the County over the past several years to realign expenditures to remain within the amount of limited revenue, potential shortfalls still exist in out years. On the revenue side, the State's overall economic and budget difficulties could mean a reduction in State payments and property tax income. On the expenditure side, inflationary adjustments and potential increased demands for services would cause additional budgetary pressure. The current rate of growth should lead to a \$2.3 million shortfall in FY 2009, which could grow to \$10.4 million by FY 2012. The sooner we make corrections to avoid these potential negative outcomes, the less severe the impact will be on our operations. If action is delayed, as time progresses, any necessary cuts will have to be much deeper and their impact more severe.

Over the past 7 years, the State's financial condition has worsened. This has resulted in the depletion of its Budget Stabilization Fund, which at one point was a healthy \$1.3 billion. The State also used "one-time" fixes, taking fund equity from the General Fund in the amount of approximately \$2.5 billion and taking approximately another \$1 billion from the School Aid Fund equity.

Within the next year or so, the State will be faced with an additional significant financial challenge because it will be required to implement GASB Statement numbers 43 and 45 which changes the accounting standard for retiree health care as discussed previously. According to GASB Statement No. 45, effective for fiscal periods beginning after December 15, 2006, the State of Michigan must recognize the financial impact of its future retiree health care obligations in its financial statements for the fiscal year that begins on October 1, 2007. In order to quantify the financial obligation, the State will be required to conduct an actuarial study based on the valuation as of September 30, 2007 (the State's FY 2006 year end) in order to produce an ARC. Assuming the State does not adopt an advanced-funding policy (as Oakland County has done), the State will have to begin recognizing this obligation on its government wide financial Statements for its fiscal year ending on September 30, 2008. Since it currently accounts for retirees' health care on a "pay as you go" basis, when the ARC is recognized it will reflect an obligation much larger than currently reported using the "pay as you go" method. Disclosure of the level of ARC obligation may cause policy makers to re-prioritize State spending commitments, perhaps leading to further reductions in State spending to local governments.

This situation may be further exacerbated by the fact that the GASB Statement requires governmental units to recognize a liability on their government wide financial Statements if the annual required contribution is not fully funded during the reported fiscal year. In fact, each year governments must recognize that year's unfunded ARC plus all previous years' unfunded ARC from the time GASB 43 and 45 is implemented. Although the Statement does not require governments to fund the obligation, the reporting of such a liability (if one exists) will clearly raise issues of financial stability. Since the State has not made provisions to advance fund retiree health care, it is possible that it may not be in a position to fully fund its ARC, requiring it to report a liability on its government wide financial Statements. Even if the State can

pay its ARC, it will require a significantly increased appropriation, which will put additional pressure on other areas of the budget, including payments to local governments.

The budgetary impact of GASB 45 will have to be addressed by the State, possibly beginning with the FY 2007 budget next year. If the State utilized a biennial budget process, it would be addressing this issue now. However, the State does not utilize a biennial budget process, so it will eventually have to deal with a subsequent potential budget shortfall as a result of GASB 45.

As the State continues to make tough budget decisions, it is likely that there will be a negative impact on Michigan’s local units of government, including Oakland County. Many of the services provided to the public by the local units of government are funded by the State through various funding formulas, reimbursement contracts, and grants. This means the County’s General Fund is vulnerable to State cuts in these areas because our General Fund includes approximately \$29 million of State reimbursements or State contracts for various programs, the majority of which are dedicated for health and children services or for court operations.

Beyond the General Fund, the County has many special revenue fund programs supported by dedicated State and/or Federal grants that are in jeopardy. For example, the drug court programs staff positions funded by State and Federal dollars, including State Court Administrator’s Office (SCAO) grants and Federal Byrne grants. Another large grant funded program in serious jeopardy is the Community Development Block Grant program, which is funded with Federal dollars.

Beyond the issues identified as current budget challenges and beyond the current slow recovery in Michigan’s economy, there remains another potential budget challenge that will impact Oakland County in the next several years: the constitutional limit on the growth in property tax revenue. Property tax revenue is the primary source of funding for Oakland County’s General Fund, accounting for 60% of the General Fund’s total annual resources. Over time, the property tax has provided a stable revenue base and, even after providing several reductions in the levied millage rate since 1992, because of our increasing property values it historically has grown beyond the rate of inflation.

Since adoption of the Headlee Constitutional Tax Limitation Amendment in 1978, Oakland County has been in the enviable position of being able to consistently levy a millage rate well within the Maximum Allowable Tax Rate. However, due to the cumulative impact of the Headlee Amendment, the differential between the County’s current levy of 4.19 mills and the maximum allowable rate is diminishing, as illustrated in the following table:

<u>Year</u>	<u>Taxable Value</u>	<u>Maximum Authorized Millage</u>	<u>Millage Levied</u>	<u>Millage Differential</u>	<u>Taxes Saved</u>
1998	\$39,011,931,708	4.4630	4.1900	.2730	\$10,650,257
1999	41,756,021,276	4.4188	4.1900	.2288	9,553,778
2000	44,370,760,909	4.3688	4.1900	.1788	7,933,492
2001	47,656,729,878	4.3259	4.1900	.1359	6,476,550
2002	50,688,809,599	4.2886	4.1900	.0986	4,997,917
2003	53,179,886,010	4.2604	4.1900	.0704	3,743,864
2004	55,986,490,872	4.2359	4.1900	.0459	2,569,780

2005	58,864,093,550	4.2242	4.1900	.0342	2,013,152
2006	62,133,415,235	4.2240	4.1900	.0340	2,112,536

Translated into property tax dollars that otherwise could have been levied during this nine-year period displayed, the chart shows that Oakland County taxpayers saved \$50 million because County government opted to levy a reduced rate rather than the maximum millage rate allowed by law. However, even given our past ability to levy a rate well within the Maximum Allowable Tax Rate, the County is still not immune to millage rollbacks in the future. The calculation of the rollback depends on several factors, including:

- Inflation as measured by the Consumer’s Price Index
- Increase in taxable value of existing property
- Additions and deletions to the County’s assessment roll

Eventually, possibly within the next several years, the Headlee Amendment will require the Maximum Allowable Tax Rate to be rolled back below the current millage rate levied by Oakland County. The millage rollback would essentially limit the growth in property tax revenue from existing properties to the lesser of either the rate of inflation or 5 percent. The only growth in the property tax revenue base beyond this limitation would come from new construction, which is entered onto the tax rolls at its current market value. Since the property tax revenue anticipated in the Fiscal Year 2007 Budget Recommendation represents approximately 60% of the total General Fund/General Purpose budget, the Headlee Amendment limitation may adversely impact the ability of the Board of Commissioners to raise future taxes for a demonstrated need, such as a new jail or courthouse.

Obviously, the budget challenges and revenue constraints discussed herein are not unique to Oakland County. And while Oakland County is managing its financial challenges in a responsible manner, a fact confirmed by Wall Street’s continuation of the County’s AAA bond rating, there are serious financial problems involving major deficits for many municipalities around the State. Unfortunately, many of those troubled local units are concentrated in Southeast Michigan. Coupled with the State’s ongoing issues, these financially troubled units could impact Oakland County’s economy in a negative manner. As the affect of tough budget decisions made at the State level continue to be pushed down to the local level, it is anticipated that the financial situation is going to become even more challenging for local units of government, both within the County’s geographic area and in neighboring counties.

The County offers assistance to its cities, villages, and townships (CVTs) by providing funding for consulting assistance. The goal is to provide specialized expertise as needed to enable the CVTs and County to explore privatization opportunities and other methods of combining services/programs in an effort to generate long-term savings. This program for the CVTs was made possible with the establishment of the Capital & Cooperative Initiatives Revolving Fund (CCIRF) with the adoption of the budget recommendation last year (see prior year’s budget message for further details).

## **CONCLUSION**

While Oakland County's current financial condition remains strong, we recognize that budget challenges exist today that must be resolved if we are to remain strong and competitive. I see these challenges as an invitation to scrutinize what we do and how we do it. They create an incentive and opportunity for change. The challenge is to change for the better in these difficult times by not ignoring the difficulties. We can again prove that Oakland County government enjoys true leadership and vision.

I am confident that under the leadership of the County's elected officials, department heads, and managers, working in tandem with its many fine employees, Oakland County will continue to rank as a premier County, both financially and programmatically. Wall Street shares this confidence, as it recently affirmed the County's AAA bond rating. As a Moody's Investors Service Vice President said in awarding Oakland County the highest bond rating possible: "Everything about them (Oakland County) is stellar. From my perspective, they are not just better than most counties, they are better than all." And, I am confident that with the dedication and effort, we will continue to be "better than all."

L. Brooks Patterson  
Oakland County Executive