

Frequently Asked Questions:

The City of Detroit's New Revenue Forecasting Process and Multi-Year Budget

The stability agreement refers to multi-year budgeting, what is that and why is it important?

A multi-year budget is simply a presentation of the city's spending priorities and revenue sources over several fiscal years instead of one fiscal year. The general perception is that a multi-year budget will be a tool that assists the city in achieving short- and long-term financial sustainability.

How many local governments in the United States use multi-year budgeting?

According to information prepared by the Government Finance Officers Association, approximately 10 percent of local governments in the United States use a multi-year budgeting approach.

Is there only one type of multi-year budget?

No, in fact there are several types of multi-year budgets. One approach is a one-year budget combined with a longer-term financial plan. The financial plan provides a set of estimates on spending, revenues and reserves but does not break out spending into specific programs or line items. The drawback of this approach is that it does not provide a control level of spending in detail. A second approach is a multi-year detailed budget with spending line items. Using this approach means that a legislative body actually approves a legally binding multi-year budget. The potential drawback is that it involves extensive staff time and may be subject to a great deal of uncertainty regarding spending estimates. Finally, the third approach is a rolling budget where the first year's budget is legally binding but future years contain nonbinding spending plans and must be approved by the legislative body in later fiscal years.

Do all governments that use multi-year budgeting experience success?

No. Research has shown that multi-year budgeting is far from a magic bullet. Proponents of multi-year budgeting generally believe there are several important benefits, including less staff time required in

the budgeting process, a more strategic vision of the future, and the ability to maximize the performance improvement of government operations. The main disadvantages of switching to multi-year budgeting include some significant upfront costs in the transition period and the difficulty of forecasting revenues and some costs such as healthcare insurance.

What is the opinion of external agencies on multi-year budgeting?

There is widespread consensus around the importance of multi-year budgeting. The credit rating agencies, Internal City/County Management Association and National Advisory Council on State and Local Budgeting have all cited the importance of multi-year budgeting in achieving long-term financial sustainability.

What kind of data is needed to complete a multi-year budget?

There is a significant amount of data that must undergird an effective multi-year budget. Preferably, at least three or four years of data are needed to prepare an effective several-year revenue and spending forecast. The more detailed the data, the more useful the forecast. For example, total income tax revenues are somewhat useful but not nearly as useful as income tax withholding, income tax refunds and other information. The reason for this is that each of these components will operate differently and thus need to be projected based on different patterns.

Is the multi-year budget also a deficit-elimination plan?

Yes, according to the agreement reached between the city and the state, the multi-year budget will also serve as the city's official deficit-elimination plan.

What is a deficit-elimination plan?

Any time a city runs a deficit in one of its funds, the state Department of Treasury requires a plan to eliminate that deficit per Public Act 140 of 1971. The Department of Treasury will have approval power over the deficit-elimination plan and thus over the city's multi-year budget.

How is a deficit defined?

A deficit equals total expenditures for a government fund plus any accrued deficit relative to the total revenues available to that fund.

What was the last reported deficit for the city of Detroit?

For FY 2010-11, the city was estimated to have a \$91 million general fund deficit. Combined with previous deficits, the total accumulated deficit was \$148 million. Other governmental funds did not run a deficit.

Is there a state requirement that cities prepare a budget?

Yes, the Michigan Uniform Budget Act requires that all local governments prepare a budget. A budget is a document that lays out the projected spending and revenues across government funds.

How does the city budget now?

Currently, the city of Detroit prepares a one-year budget that includes revenues from all sources and spending across all government and enterprise funds.

Why do governments use multiple funds?

Multiple funds are used because a government must track some monies separately. These monies might have a restricted use. The separate fund tracking allows for the accounting of the use of these monies. In essence, the use of government funds is one tool in ensuring transparency of public activities.

What are the different types of funds?

The city has three types of funds, government funds, enterprise funds and proprietary funds. Government funds, which include the general fund, are designed to track taxes and general spending, while enterprise funds track business-type operations such as the water and sewer system. Finally, propriety and trust funds are those accounts and monies where the city is a fiduciary but it is not the city's money available for spending. The biggest example of this would be pension funds.

Besides a multi-year budget, the stability agreement discusses revenue forecasting. Why is that important?

Revenue forecasting is a process whereby a government estimates how much money will be available to spend in the budget. If this number is overestimated, a government may have to go back and cut spending later or it will run a deficit.

How does revenue forecasting generally operate?

Almost all government revenue forecasting begins with an analysis of past data and trends. In most cases, the upcoming fiscal year revenues will be similar, slightly up or down, from the past year. The state budget law requires at least one year of data to be presented as part of the budget. However, one year of data is rarely adequate to understand trends and patterns in revenues. Most governments look at many years of data to understand these trends and patterns.

Is this data the only source of information used?

No, there is other information used in the forecasting process. One source of information would be local and state legal changes to tax rates or the tax base. A change to the rate or base of a tax might lead to important changes in revenue collections. The past data will not be able to capture this change. Another source of data might be the loss or gain of jobs and businesses. These changes also do not appear in past data if they happened recently.

Are there other pitfalls facing revenue forecasters?

Yes, the biggest challenge in forecasting revenues is what is known as turning points. Turning points occur when the local economy moves up or down in a significant way. Thus, the Michigan recession that started in 2001 was a major turning point. A second turning point occurred when the financial crisis occurred in 2008. These are difficult to predict but have significant consequences regarding revenue collection.

How well has Detroit done recently in forecasting revenues?

In 2010, the city overestimated general fund revenues including the income and property tax by 10 percent. In total this amounted to more than \$60 million that was put in the budget but did not ultimately get collected. In 2011, there was a different trend. Property and income taxes actually came in higher than expected. Thus, in 2010 the city was too optimistic and in 2011 the city was too pessimistic.

The stability agreement speaks of a "revenue consensus." What does that mean?

A revenue consensus is a process where the different government agencies come together to agree on how

much money will be available for spending in the upcoming fiscal years. The state government uses such a process -- the senate fiscal and house fiscal agencies and the state treasury economists come together and agree on a revenue estimate. A consensus is considered important because you can get multiple parties together with different viewpoints and achieve a more accurate view than having only one person or agency derive an estimate.

Who will be part of the revenue consensus process?

In the case of the city of Detroit, the auditor general, chair of the Financial Advisory Board, city council fiscal staff, and finance and budget department directors shall all hold a revenue consensus conference.

When will the revenue consensus conference take place?

The revenue consensus conference will take place in January and June or as agreed to by the board chair of the Financial Advisory Board or the other participants.

What is the role of the Financial Advisory Board in the process?

The board shall review and approve any revenue estimate adopted by consensus.

What if a consensus is not reached?

If a consensus is not reached within 14 days after the start of the conference, the FAB chair will inform the state treasurer. The state treasurer will then set a revenue estimate that shall be binding on the city.

What revenues must be estimated at the conference?

All major revenue sources must be addressed, including income tax, casino wagering tax, property tax, utility users tax, state revenue sharing, state and federal grants, proceeds from sale of city assets, interest income, fees, licenses and permits, operating transfers and any other items.

What is the appropriate way to evaluate the revenue forecast?

There are several factors to consider in assessing a revenue forecast or estimate. One key factor is the assumptions behind the forecast. These assumptions might include inflation estimates, economic trends (such as personal income), employment and sales activity. Often, it is useful to compare a government's

economic assumptions with external estimates from banks, investment firms or other government agencies. Another factor to consider is how the current estimates compare to historical patterns and behavior. If historical patterns are not followed, a strong justification and evidence should be presented for why.

What are the biggest revenue-forecasting challenges facing Detroit?

Detroit has four major revenue sources that are a potential challenge -- the property tax, the income tax, the utility users' tax, and the casino tax.

What are the challenges facing the property tax?

Given the ongoing crisis in the housing market, the property tax will likely continue to decline over the next few years, but the city will face significant challenges in determining the rate of decline. Better assessment and housing data will be necessary to improve the forecasting accuracy with regards to the property tax.

What are the challenges facing the income tax?

Detroit's income tax revenue actually grew in 2011 by a few percent. This fits with an overall national trend and an improving local and state economy. It is not likely given the current high rate of unemployment that the income tax will grow substantially during the next year or two. Also, income tax revenues are still down nearly \$100 million as compared to the early 2000s.

What are the challenges facing other revenue sources?

The city's utility users' tax is based on an antiquated tax base that does not include cell phones, for example. The utility users' tax revenue is stagnant and will not provide a substantial boost to city revenues unless it is dramatically changed. The casino wagering tax has been a major source of revenue growth for the city in the past decade. An increase in efforts to collect taxes owed to the city from nonresidents might also produce some revenue gains.

Are there key criteria that can be used to assess long-term financial improvement?

Yes. The city of Detroit as part of its multi-year budgeting exercise should identify and target several criteria that can be used to target long-term financial

sustainability. One of those criteria might be a fund balance reserve or rainy day fund as a percent of general fund revenues. Another criterion could be revenue and spending measured on a per capita basis which could also include liabilities per capita.

Is a multi-year budget all that is needed?

No. The city will also need to produce, in conjunction with the Financial Advisory Board, a fiscal-improvement plan. This plan would state short- and long-term goals and specific actions that can be taken to achieve the multi-year budget outline. This will include the forms outlined in the financial stability agreement.

What kind of performance measures should be in a fiscal improvement plan?

These measures should be specific, with timelines included and the name of the responsible parties. The measures will need to include specific savings or revenue enhancements and a time period that the numbers will be reached. As these reforms are initiated and completed, this information can be fed into the multi-year budget plan. Presumably, the program management director will be leading these efforts. However, many different city agencies and offices will be involved in making change successful.

For More Information

Eric Scorsone, PhD
 MSU Extension Specialist
 Phone: (517) 353-9460
 Email: scorsone@msu.edu
 Web: www.msue.msu.edu