Solutions for Declining Municipal Revenue in the City of Royal Oak
Quick Policy Analysis

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Executive Summary

This report analyzes the problem of declining revenue within the City of Royal Oak (henceforth the City). I describe the municipality’s current economic development plan, and I analyze three alternatives to it. Declining revenue in Royal Oak has caused much stress for its residents, elected officials, and public employees. Declining municipal revenue has recently resulted in emergency financial meetings and service cutbacks. Indeed, according to MyFoxDetroit.com, “Facing cuts to the police department, Royal Oak city leaders decided Tuesday to accept a pay cut of their own” (2011).

In a Problem Analysis section, I find that the City’s economic problems result from a failure to encourage entrepreneurs and start-ups and a failure to help facilitate employment opportunities. The City’s financial reports from 2007-2010 show a decrease in total revenue, total grant money, property taxes, court taxes, state sales tax revenues, and criminal traffic division rents. Additionally, the City is reactive to new businesses and entrepreneurs, instead of proactive, and the decreasing rents are compounded by the City’s inaction.

In a Solution Analysis section, I describe and then evaluate three policy options to address the former economic problems. These options include: (1) economic agenda transformation and advertising it on an economic development webpage, (2) enactment and maintenance of an economic gardening program, and (3) a designated incubation facility for small business start-ups and entrepreneurs. The evaluation each of these options is based on the following criteria: (1) expected 15 year return on investment, (2) initial costs, excluding external financial support, (3) time to implementation and functionality, and (4) 10 year potential for job growth creation.

In a Recommendation section, I argue that the City should adopt an economic gardening program, followed by an economic development webpage, and finally, business incubation. All of the policy options, when implemented correctly, will increase municipal revenue.

Problem Analysis

Decline in tax revenue is responsible for the reduction of municipal revenue. This conclusion is based upon interviews with the Royal Oak (RO) City Manager, RO Planning...
Department, RO City Clerk and other community leaders. It is also based upon analysis of available public data, such as RO budgetary reports, RO meeting minutes, RO city Commission meetings, and the RO webpage. The information from these sources also shows that the City fails to encourage entrepreneurs and start-ups and fails to help facilitate employment opportunities.

A review of the City’s financial records from 2007 to 2011 reveals a decrease in revenue. Exact revenue dollars from 2010-2011 data were not yet official at the time this paper was written, so I reference those numbers sparingly. Overall, RO City revenue decreased from $36 million in 2007-2008 to $34 million in 2009-2010 (see Appendix A). Indeed, the adopted budget from 2012-2013 is $30 million. Thus, the City is under substantial financial stress, and the City expects their financial situation to worsen. Residents still expect city services to be delivered, but the City has less and less money to pay for them.

Revenue often decreased categorically. For example, money from grants decreased from 2007 to 2009: $5.5 million, $5.3 million, and $4.7 million, respectively (see Appendix B). The state sales tax revenue was 5.4 million in 2007, $5.2 million in 2008, and $4.6 million in 2009 (see Appendix C). Also, RO revenue from the Criminal Traffic Division was $2.8 Million in 2007, $2.5 million in 2008, and $2.2 million in 2009 (see Appendix D). The City’s financial reports often reveal such decreases in revenue.

The City has not yet experienced many of the disastrous decreases of property taxes experienced by other cities. According to the RO City Treasurer, RO revenue from property taxes was $17.1 million in 2007, $17.1 million in 2008, and $17.0 million in 2009. However, property tax revenue for 2010 is estimated at $15.7 million, which would be about a $1.3 million decrease of City revenue (see appendix E).

The City’s economic problems are compounded by a failure to encourage entrepreneurs and start-ups, and thereby facilitate employment opportunities. For example, RO does have a building available for small business incubation. However, the City lacks a development strategy and does not advertise the availability of space. RO also has a Downtown Development Authority (DDA), which focuses on downtown RO beautification (i.e. planting flowers and trimming trees). The DDA does not provide technical assistance or entrepreneurial development strategies to residents or potential businesses. The DDA’s website is geared toward residents and their leisure activities. The downtowndowntownroyaloak.org’s business section is like the yellow pages
(name, address, phone number, webpage link). However, this format does little to aid economic development. A better format would include statistics useful for entrepreneurs and small businesses.

The City does not have a detailed plan describing how it will facilitate economic growth. The scope of the financial downturn has affected nearly all municipal jobs. Indeed, only the Fire Department was exempt from financial cutbacks, and that was because of a sustained grant (myfoxdetroit, 2011). The RO City Commission and City Manager are aware of the shrinking revenue problem, but may be less aware of potential revenue solutions. I turn now to explore several policy options.

### Solution Analysis

**A. Evaluation Criteria:**

I will evaluate the policy options according to: (1) 15 year return on investment probabilities, (2) initial economic action costs, assuming no external financial support, (3) time to implementation and functionality, and (4) 10 year potential job growth creation. The criteria that I use to assess the policy advise measures financial revenue impacts upon the City.

The first evaluation criterion, return on investment (ROI), measures the actual increase of municipal revenue due to the policy program over 15 years. I assume that the largest total ROI after 15 years would be “Best.” The second criterion, initial economic action costs, is based on removing money from the City Treasury within the first year. I have made clear that the City has no extra money, so the smallest investment would be “Best.” Since the City needs positive rents today, the third criterion, time to implement the policy, assumes that the policy able to start-up immediately would be “Best.” Finally, job growth creation over 10 years is determined by the probability of new net jobs created over 10 years. Clearly, the program that is likely to create the most new net jobs within the City over ten years would be “Best.”

I weight the evaluation criteria according to long-tem financial impacts. So, I weight 15 year ROI and 10 year new net job growth at .30, and I weight start-up time and implementation costs at .20. This is a quick policy analysis, and I am able to provide much more detail to the City regarding evaluation techniques at their request. For example, I could provide the ROI calculator for economic gardening [economic development], statistical website analysis
regarding comparative City’s economic websites, and recent successful business incubation developments.

B. Policy Options:

Three policy alternatives, along with the status quo, will now be described. The options include: (1) maintaining the status quo, (2) economic agenda transformation and advertising it on an economic development webpage, (3) enactment and maintenance of an economic gardening program, and (4) a designated incubation facility for small business start-ups and entrepreneurs.

Option 1: Maintaining the Status Quo

Under this option, the City would continue a reactive economic development plan. No action would be taken by the City.

Option 2: Displaying an Economic Development Plan

Under this option, the City would publicly align itself with state and federal economic growth programs. The RO City Commission and City Manager would actively seek to serve as the test-case for Michigan Economic Development Corporation’s new policy direction. Aligning local public policy to the incentives provided by state and federal programs would increase the probability of obtaining grants and getting job growth. However, transformation to an active and aligned economic agenda is not enough, because residents and non-residents will not perceive that the City enables small business development or entrepreneurs. The City must display its economic agenda.

First, the City would update the official webpage to include an economic development page. The City of Sterling Heights (SH), for example, launched a page entirely dedicated to economic development. SH showcases their involvement in retaining Chrysler Sterling Heights Assembly Plant (SHAP). SH’s economic development webpage also is a vehicle to explain the “Smartzone Corridor” and “Macomb-Oakland University Incubator” (2011). In general, the SH economic development webpage furnishes instant information to possible global, national, or local investors/entrepreneurs.

Second, for this option the City would adopt an economic design, or framework, and make it clear to the community and to entrepreneurs. According to the Small Business
Administration, “An estimated 552,600 new employer firms opened for business in 2009, and 660,900 firms closed. This amounts to an annual turnover of about 10 percent” (2011). Whereas Sterling Heights caters economic development to the Department of Defense, Homeland Security, alternative energy, i.e. manufacturing; Royal Oak would cater to the service industry, i.e. consultants, small business professionals, technology, and the arts. Third, although the City does utilize free media; e.g., Facebook, the City’s webpage is weak regarding adwords, blogging, and web site ad-placement. The DDA website is geared for consumers (downtownroyaloak.org), not entrepreneurs or small business professionals.

Third, for this option the City would encourage community leaders to create a Royal Oak Entrepreneur Foundation and/or a RO Incubation Foundation. With respect to resource utilization, the City itself should not control the foundation, but encourage RO entrepreneurs, venture capitalists, Angels (high net-worth individuals), and second stage managers to do so. Angels are of particular importance, since according to the Kauffman Foundation, Angels “may be responsible for up to 90 percent of the outside equity raised by start-ups after the capital resources of their founders, friends, and family are exhausted,” (IEDC, 2011, 120).

Under this option the City would re-tool its website with an economic development webpage showcasing the City’s economic development plan for small businesses and entrepreneurs. The webpage would link to michiganadvantage.org—the MEDC’s webpage, and maintain many of the MEDC links, such as the “Access to Capital” link, which enables small businesses and entrepreneurs to explore funding sources (www.michiganadvantage.org/Access-to-Capital, 2011). The City would track who uses the economic development web service and actively seek feedback from those sources. The City would publicize who it is recruiting (i.e. service industry, medical technology, artists, small businesses, and entrepreneurs). Finally, the economic development webpage should enable entrepreneurs, venture capitalists, Angels, and second stage managers to foster the previously mentioned Foundations.

The City should be able to complete this under a budget of $30,000.

**Option 3: Economic Gardening**

This option involves the City Manager enacting and maintaining an economic gardening program. Under economic gardening, the City hires an economic development specialist to actively advance first stage growth companies into second stage growth companies and beyond.
According to EdwardLowe.org, second-stage companies are past the startup stage, but not mature. They have an owner/CEO, but not a full-scale professional management team. They approach $1 million in total receipts, but could expand to $50 million (2011). Economic gardening provides “competitive business intelligence” (IEDC, 2011, 52). The City, in preparation for pursuing economic gardening, would review active programs, such as the Economic Gardening Technical Assistance Program for the State of Florida (GrowFL) (http://www.growfl.com, 2011).

GrowFL is an excellent example of how a state may implement economic gardening for local governments. In short, economic gardening provides no incentives, no tax credits, no clawbacks, development from within, business intelligence, GIS, database research, network-building, and web marketing. GrowFL enables local governments to access market research/competitive intelligence for businesses in the financial services industry, internet and social media strategy/search engine optimization, Geographical Information Systems (spatial intelligence for marketing efforts by understanding the competitive environment), Core Strategy Review (transform the company from a niche player to a full-service marketing company), and referrals (IEDC, 2011). Thus, the City would contact the State and incorporate the appropriate activities. It is likely that Michigan Economic Development Commission (MEDC) could service the City much like GrowFL services municipalities in Florida. The City could significantly reduce economic gardening costs if MEDC implements a plan similar to GrowFL, and MEDC appears to be doing so.

Economic gardening requires at least 1 full-time skilled employee. The City of Littleton, for example, hired an (1) Intelligence Specialist, a (2) Geographic Information Systems Analyst, and an (3) Economic Development Specialist. Their economic gardening program costs about $600,000 annually (IEDC, 2011, 52). However, the City of Littleton is a success story because many it its start-up and/or first stage companies quickly became second-stage companies as a result of economic gardening. In fact, the job growth rate, as reported on their website, is about 8 percent a year. Also, The City of Littleton boasts one of the lowest foreclosure rates in the state.

Under the option, the City would hire 1 Economic Development Specialist, who has a background in Geographic Information Systems. The specialist would immediately assess small business development and entrepreneurial development opportunities, and proactively foster
economic development. The specialist would track his or her success in moving first stage businesses into second stage businesses and beyond.

The City should be able to complete this option at a budget of about $100,000 [contract employee].

**Option 4: Business Incubation**

Under this option, the City utilizes any buildings that are currently under-utilized. According to the city manager, the City has a location available for entrepreneur occupancy at 225 Troy Street. About half of this facility is rented, but the other half remains empty. This unused space could be set aside for small business start-ups/entrepreneurs. Incubation facilities are not rent free, but provided at a subsidy. The easiest way to begin incubation in this facility would be to place it under the Downtown Development Authority.

Business incubation has been stringently defined in recent years. Royal Oak, for example, could increase rents from the 225 Troy Street building, but this may not be incubation. Incubators are selective with a focus on high-growth potential businesses and on businesses with highest job-creation/highest-wage potential (IEDC, 2011, 101). Incubation enables wealth creation, focuses on the entrepreneurial spirit, provides value to tenants and stakeholders, operates as a business rather than a nonprofit, *and includes only firms investable/scalable to $XMM* (Italics added, Girdwood 2011). Most importantly, incubation businesses are tracked and, in general, move out of the incubation facility within three years. Business incubation does not guarantee that the growing business will relocate in the same city as the incubation facility. Thus, 225 Troy Street may not qualify as an incubation facility—regardless of positive rents.

Under this plan, the City should expect a robust influx of for-profits and entrepreneurs. Business incubation locates many new businesses under the same roof [50,000 sq. ft.], and they utilize the same copy machine, secretary, custodial services, lunch room, accounting, marketing, legal, and/or internet service (IEDC, 2011, 101). Hence, incubators have earned a reputation as a workplace that rapidly enables new businesses to grasp the tools and knowledge necessary for success. In short, “funding sources like to know they can send top prospects to a nurturing environment” (Girdwood 2011). For example, the U.S. Economic Development Administration (EDA) sponsored the start-up of the City of Sterling Heights incubator (just a few miles away from Royal Oak) with $450,000 (2011). Since RO does have a large hospital and art movement,
for example, it should prima facia pursue medical technology incubators and art/service incubators.

Under this option, the city manager should first complete an incubation feasibility study. This will reveal the incubator’s probable success, and outline which businesses would likely create the most success under the same roof. The feasibility study must: determine potential incubator needs (e.g. broadband internet access, shipping dock access, environmental audit, parking, access for employees, utilities, liability), detail community support networks, and analyze state and federal assistance programs (IEDC, 2011, 91-8). If an incubation facility is feasible, then the City should be prepared to: assist in real estate and service planning, increase community awareness, enable and establish contact relationships, assist in application of federal and state funding, determine the appropriate businesses for the facility, (e.g. manufacturing, service, technology), verify demand for incubation space, determine the minimal rental rates, and project conservative cash-flow projections (IEDC, 2011, 91-4).

Under this option, the City would attempt to secure external funding for a business incubator. About 59% percent of incubators are funded via rent and services, 18% through contracts for services, 15% from ongoing cash subsidies, and 8% of funding arises from other sources (equity stake, royalty agreement, grants, private sector, etc.) (NBIA, 2011, 33). Many incubators, however, are sponsored. Today, roughly 31% of sponsorship comes from economic development organizations, 21% from government entities, 20% via academic institutions, roughly 8% from “Hybrids” (more than one sponsor), approximately 8% from other sources, and only 4% from for-profit industries (NBIA, 2007, 6). Thus, funding for incubators is common, and the City could significantly reduce the costs of business incubation if it is able to obtain such funding.

Developing an incubator requires that the City have the necessary political, social, and financial start-up capital. An attempt should first be made to raise an incubator fund through structured revenue, either internally or externally. Examples include Peoria $3MM (Arch Development) and Cedar Rapids $3MM (First Iowa). Second, the City could link up with an existing fund. For example, the city manager should seek connections to local incubators, such as The Macomb - Oakland University INCubator (http://www.oakland.edu/macombouinc, 2011). Also, the City could try to build a relationship with incubator resource specialists, such as National Association of Seed and Venture Funds (http://www.nasvf.org). Finally, the City can
solicit funding from the National Business Incubator Association (www.nbia.org) and Kauffman Center for Entrepreneurial Leadership (www.entreworld.org). Under this option, without external funding, business incubation would cost at least $250,000.

C. Evaluation:

With respect to Option 1, there would be (1) no 15 year return on investment probabilities, (2) no initial economic action costs, (3) no time to implementation and functionality, and (4) no 10 year potential job growth creation.

With respect to Option 2, economic development website, there would be [evaluation 1-Low] limited 15 year return on investment probabilities. The City would be able to estimate the success of the economic development website program by tracking growth that resulted directly from the activity of the webpage. It is very likely that the website would more than pay for itself, however, the overall revenue generated would be minimal as a policy option. Second, [evaluation 2-Best] initial economic action costs would be very low, likely well under $30,000 from a budget of over $30 million. Excluding Option 1 (i.e. doing nothing), Option 2 is the cheapest option, and the quickest to implement. Third, [evaluation 3-Best] time to implementation and functionality would be under six months. Also, the City could activate this program without difficulty at any time in the future. Finally, [evaluation 4-Low] 10 year potential job growth creation is low because the City’s webpage assists local entrepreneurs and small businesses in finding external sources for development. The greatest potential growth from Option 2 would come from linking entrepreneurs, venture capitalists, Angels, and second stage managers together in order to create economic development.

With respect to Option 3, economic gardening program, there would likely be [evaluation 1-Best] a very high 15 year return on investment probability. The City would be able to estimate the success of the economic development specialist, because the specialist will track his or her economic gardening success and stagnation. It is very likely that the specialist will return immense benefits for the City, because robust economic growth as a result of the trained specialist will result in (1) higher tax revenue due to growth of local businesses from first stage to second stage, (2) lower foreclosure rates, and (3) more stable small business and entrepreneur development. Second, [evaluation 2-Medium] initial economic action costs would be about $100,000. This cost would continue from year to year, since the economic specialist would be a
professional employee. However, Royal Oak property taxes are estimated to decrease City revenue by almost $1.3 million next year, which is equivalent to the economic specialist’s salary over 13 years. Since the specialist would grow businesses and lower foreclosure rates (i.e. keep higher property taxes), I estimate that the return on investment to be very high—millions of dollars over 15 years. Third, [evaluation 3-Medium] time to implementation and functionality would be about 1 year before economic gardening showed significant tracking results from the hired economic specialist. Finally, [evaluation 4-Best] 10 year potential job growth creation is very high because the economic specialist initiates and maintains entrepreneurial and small businesses development from first stage industries to second stage industries. The specialist literally grows local businesses. The greatest potential growth from Option 3 would come from the recorded growth of local businesses—new net jobs.

With respect to Option 4, business incubation, there is very likely [evaluation 1-Medium] a significant 15 year return on investment probability. The City would be able to estimate the success of incubation by tracking growth that resulted directly from the incubation facility. It is very likely that the incubation facility could be funded externally and through the business start-ups, therefore, the tax revenue and rent stream would provide substantial City revenue. Second, [evaluation 2-Low] initial economic action costs could be high, likely over $250,000 without external funding. Third, [evaluation 3-Low] time to implementation and functionality would be the longest of the options, since the incubation facility might need to be built—after securing the feasibility study and contractually organizing small businesses and entrepreneurs. Finally, [evaluation 4-Medium] 10 year potential job growth creation is medium, because once the businesses graduate from the incubation facility (usually 2-3 years), they may relocate in a surrounding city. The greatest potential growth from Option 4 would come from linking entrepreneurs, venture capitalists, Angels, and second stage managers together in real economic development—new jobs.

Table 1 shows how the public policy options score (low, medium, high) according to the evaluation criteria. I find that economic gardening has the highest probability of return on investment over 15 years [evaluation 1]. I find that start-up costs [evaluation 2] and start-up time [evaluation 3] are lowest with the creation of the economic development website. I find that economic gardening has the greatest probability to create jobs in the City over ten years.
[evaluation 4]. I weight all of the variables so that actual positive rents receive more points [.30] over time to implementation and start-up costs [.20].

On the following page, I have organized the policy options according to the evaluation criteria on a Goeller Scorecard.

<table>
<thead>
<tr>
<th>Evaluation</th>
<th>Criteria</th>
<th>Counter-factual</th>
<th>Website</th>
<th>Economic Gardening</th>
<th>Business Incubation</th>
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<td>High (3)</td>
<td>Medium (2)</td>
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</table>

Ranks: 3=Best, 2=2nd Better, 1=Worst
High (bold), Medium, Low (underline)

D. Recommendations

Policy options 2-4 are robust mechanisms that turn negative economic and social externalities into positive ones. These options encourage employment opportunities, attract entrepreneurs and start-ups, and enhance sustainable economic development.

Economic gardening earns 2.6 points, followed by creating an economic development website at 1.8 points, and finally, business incubation scores 1.6 points. Moreover, all policy options are better than the counter-factual, since all policy options actively increase City revenue. Therefore, based on this evaluation, I recommend that the City first institute economic gardening.
References


Appendix A

City of Royal Oak Total Revenue, 2007-2009

Source: City of Royal Oak Treasurer

$37,000,000
$36,500,000
$36,000,000
$35,500,000
$35,000,000
$34,500,000
$34,000,000
$33,500,000
$33,000,000

Appendix B

City of Royal Oak Grant Revenue 2007-2009

Source: City of Royal Oak Treasurer
Appendix C

City of Royal Oak: State Sales Tax, 2007-2010.

Source: City of Royal Oak Treasurer
Appendix D
Property Tax Revenue 2009-2010, Estimated.

Source: City of Royal Oak Treasurer