

October 7, 2010

Mayor Earl M. Leiken
City of Shaker Heights
3400 Lee Road
Shaker Heights, OH 44120

SUBJECT: Mayor's Financial Task Force

Dear Mayor Leiken,

As Chairman of the Mayor's Financial Task Force, I want to thank you for appointing this committee, and for charging us to evaluate the present financial condition and fiscal outlook for Shaker Heights. We all felt honored to serve on this committee at your request and to participate in such an important and timely initiative. Our city is a unique and prized community with a rich tradition of citizen involvement and proactive, open-minded, accountable leadership. Your action to create this Task Force is yet another example of this strong city leadership.

Attached are the findings and specific recommendations of this committee. We tried to be thorough, objective, reality-based and cognizant of the NE Ohio region at large. I hope this report is helpful to the Community. We stand ready to assist you and to respond to your questions and the questions of the City Council, the Board of Education and the Community.

Respectfully submitted,



Martin R. Kolb

Attachment

Cc: Todd Campbell
Paul Carleton
Matt Lehman
Carolyn Milter

RECOMMENDATIONS OF THE MAYOR'S FINANCIAL TASK FORCE

Submitted: **Martin R. Kolb, Chair**
Todd Campbell
Paul Carleton
Matt Lehman
Carolyn Milter

October 2, 2010

I. Introduction

Shaker Heights is a community which has enjoyed remarkable success in its near-100 year history in maintaining the quality of its homes, retaining the physical beauty of its parks and walking trails, attracting a highly educated, affluent and diverse population, providing excellent municipal services and maintaining high quality Schools. However, it is clear that the community faces unprecedented challenges as it approaches its centennial in 2012. These include a lack of growth in Cleveland and the regional economy, stiff competition for residents from outer ring suburbs and significant financial challenges in maintaining the quality of community life.

Shaker is a national model of a community that has retained stability in the face of significant challenges. This success has resulted from the willingness of its citizens and its leaders to manage challenges by taking strong action and by changing course where necessary. Shaker's history is filled with examples of the above including its successful experience with racial integration and its successful implementation of a major School reorganization program. Our current circumstances require the same strong leadership that has served us so well in the past.

In October, 2008, Mayor Earl M. Leiken, with the support of the Shaker City Council, the Shaker School Board and Superintendent Mark Freeman, appointed a committee consisting of two School board members, three City Council members, several community leaders, the Superintendent and Treasurer of the School District and the Mayor, Chief Administrative Officer and Chief Financial Officer of the City to review financial challenges facing the Shaker Community.

The group met several times for the purpose of exchanging information and in order to establish a framework for further discussion.

In October, 2009, the Mayor, again with the support and concurrence of the School District and City Council asked a smaller working task force consisting of the undersigned to undertake a further study of the issues that had been raised before the larger group and to make specific recommendations.

The School District and City of Shaker Heights, while mutually supportive, have followed separate financial paths. Each entity has legal responsibility for its own budget and each has taken independent responsibility for its own budgeting and management. The City provides municipal services with 346 full-time and 156 part-time employees with a budget of approximately \$40M and the Schools

provide public educational service with a staff of 802 full-time and 105 part-time employees with a budget of approximately \$90M.

As the Mayor has noted, however, in creating a group to study the community's fiscal problems jointly, there is significant value in taking a more coordinated approach, particularly in times like the present which are extremely economically challenging for both the City and the School District.

- 1) The mutual dependence of the School District and the City has, if anything increased over time. The City's ability to attract and retain residents is dependent on the quality of the Schools and the affordability of the community, both of which are directly impacted by School tax levies. Similarly, the School District depends on the quality of City services and on the City's marketing and economic development efforts to maintain and improve the Schools' tax base.
- 2) The City and Schools share the same taxpayers. Even though the School tax base also includes Cleveland residents, the overwhelming majority of Shaker School taxpayers are Shaker residents who are property owners and all Shaker residents are in the Shaker Schools' tax base. Especially in hard economic times, taxpayers have finite resources to support both entities and there is need for the entities to coordinate financial planning in terms of what is expected from residents.

Each entity's decisions on financial and taxation matters have enormous repercussions for the other.

- 3) Past history which includes a periodic shifting of costs between the City and Schools for recreation and other matters shows clear evidence of their mutual dependence and their need for joint financial planning.
- 4) The financial challenges facing both entities are significant enough that they cannot be solved by either acting individually but will require a concerted effort.

II. City's Financial Circumstances

A. Past.

The City's revenue comes from income taxes, real estate and public utility taxes, the estate tax, local government support from the State and various fees and charges as well as interest payments on City reserve funds. However, income taxes made up 49.5% of all City revenue in 2009 and the income tax, real estate taxes and the estate tax made up over 77% of the City's revenue. Unlike the situation involving the

Schools, City tax revenue, both income and real estate taxes, rises with inflation so that growth in inflation is expected to allow the City to increase its operating costs without additional taxes as long as City revenue rises with inflation. The last City tax increase was 28 years ago in 1982.

A pattern of steady City growth and revenue to offset increases in operating costs continued through the 1990s.

By the current decade, however, City revenues became relatively stagnant. A study done in 2008, after the current mayor took office, showed that City revenue increased only 1.6% per year from 2001 through 2007 excluding extraordinary income and estate tax receipts from one family in 2004 and 2006. By this time, Shaker had felt the impact of:

1. A lack of economic and population growth in the metropolitan area.
2. The impact of the outward movement of much of the population to “outer ring” suburbs.
3. A loss of population and taxpayers as a consequence of the above.

Shaker was shielded from the full impact of these developments by two factors. The first was the existence of a large number of affluent taxpayers who live in Shaker because of the high quality of community life and of the City’s housing stock. The second was the extraordinary tax payments noted above, which actually permitted the City to significantly increase the quality of life through the rebuilding of Thornton Park, the transformation of Horseshoe Lake and the establishment of new walking trails.

However, by 2008, the full impact of the developments outlined above was felt in combination with the national economic collapse in October of that year. By the fall of 2009, the City had gone from healthy annual increases in revenue to relative stagnation with anemic income growth in the first part of this decade to a substantial decline in operating revenue (excluding estate tax which has been devoted exclusively to capital projects) of approximately \$2 million from 2007 to 2009. Not only were there insufficient funds to deal with growth in operating costs – there were insufficient funds to maintain services even if costs had remained static.

B. Current Environment

The City began taking strong measures to deal with the above fiscal problems in 2008 by reducing the size of the 2008 wage increase for non-bargaining unit employees as compared to what had been negotiated for police and fire (a break from tradition), adopting a new health care program for non-bargaining unit employees with higher deductibles and co-pays and negotiating a labor agreement with the Public Works employees which provided for a wage freeze in 2009. In addition, there were reductions in the work force.

More dramatic reductions were undertaken in 2009 which included all of the following:

1. Employee wages were frozen and Director bonuses were eliminated
2. 35 positions (approximately 10% of the work force) were eliminated from the 2007 budget through lay-offs, attrition and a decision not to fill certain positions.
3. A furlough program was adopted from July 1, 2009 through December 31, 2009 whereby City Hall was closed one day every two weeks and non-bargaining unit employee wages were reduced by 10% for the last six months of the year.
4. The renegotiation of labor contracts with police, fire and public works employees to eliminate wage increases for 2010 and to require such employees to join the less expensive non-bargaining unit health care program in exchange for no lay-off provisions.
5. The elimination of certain minor services such as special pick-up and back yard grass pick-up.

All of the above was accomplished with negligible impact on services to residents.

The City is also working very hard to stabilize and increase revenues. The City has been in discussions with key property and building owners to provide assistance in stabilizing revenue. In addition, the City has hired the firm of Robert Charles Lesser to develop an Economic Development Plan with a view to increasing commercial revenues. Further, extensive efforts have been made in marketing to increase the residential tax base. The City is also moving forward with plans to redevelop Warrensville-Van Aken and has raised significant funds to accomplish the reconfiguration of the streets. A new Library Court project has been initiated for senior housing and the City has borrowed funds at low interest rates to double the work in connection with repaving the roads.

As noted below, significant challenges remain but the City's financial picture has been significantly stabilized.

III. School District's Financial Circumstances

Shaker continues to have an outstanding School District. The District regularly produces high numbers of National Merit and National Achievement semi-finalists and students who are accepted into the nation's most competitive colleges as well as providing for the needs of those who are socio-economically disadvantaged and for those who require significant remedial help. The student population is diverse in every sense and the Schools are under significant financial pressure to serve all constituencies.

The Schools receive the bulk of their funding from property taxes and from the State of Ohio. Unlike the City, the Schools have relied on regular property tax increases. House Bill 920 does not allow for inflationary growth in School revenue due to increases in home values (and also does not permit the Schools to realize less money from tax revenues in a deflationary atmosphere with respect to home values like the current one.)

The regular School pattern has been to seek an operating levy every three years and periodic bond issues for capital repairs and improvements.

The community is very supportive of the School District as evidenced by the passage of the most recent School levy with 58% in favor. In the past eleven years, starting with 2000, Shaker voters have approved four school levies for a total increase in millage of 38.80 mills. A study of comparable suburbs shows that Shaker is tied for first with Bay Village in the frequency of levies in this period and is first in the amount of increased millage. The pattern over a 15 year period is not fundamentally different. (See chart attached as Exhibit A)

The Schools have worked hard in recent years to reduce costs as evidenced by the following:

1. Negotiations with the three employee bargaining groups have resulted in wage freezes this year preceded by three years of lower wage increases than those in surrounding Districts. The Plain Dealer reported on Sunday, May 30 that Shaker, which was at one time first in average teacher compensation, has now been surpassed by other Districts.
2. The Schools have reduced the size of the staff by approximately 50 positions since 2007.
3. The Schools have achieved results in negotiations which have reduced the cost of the employee health care program as compared to what it would otherwise have been and increased employees' premium contributions.
4. The Schools have managed to extend the period between the last levy and the one preceding it to four years rather than three years as had been expected earlier.

The District was able to achieve these economies without direct detrimental effect on quality. Nevertheless, the Schools' fiscal situation requires significant attention for the following reasons:

1. The projected pattern of future School levies may impact Shaker's ability to attract and retain residents.

The future of the School District and the community is dependent on our ability to attract and retain residents who have the capacity and willingness to provide

strong financial support to the Schools and the City. Unfortunately, the lack of employment and population growth in Northeastern Ohio has reduced the pool of such individuals. Moreover, outer ring suburbs which also have good Schools provide strong competition for Shaker.

We believe that Shaker has preserved strong advantages in the quality of its housing stock, cost of housing (excluding taxes), proximity to the area's cultural and athletic institutions, neighborhood life and diversity. However, other communities also have attractive features and we are at a distinct disadvantage with respect to the level of taxation. Shaker already has the highest property tax rate in the state. Moreover, Shaker's property taxes are increasing at a rate which exceeds that in most comparable communities. (See Exhibit A) If we are to remain competitive in a very tough market, we must be concerned about the frequency of future School levies.

Further, the commercial and retail market has declined nationally and locally since the Fall of 2008. Owners of commercial and retail property are under intense pressure with respect to rental rates. It will be difficult for them to absorb significant additional taxes in the near term.

In a 2010 Community Survey commissioned by the School District 66% of those surveyed agreed with the statement "If property taxes in Shaker Heights keep going up, it will make homes here unaffordable." The survey found that 51% agreed with the statement that "the schools can tighten their belts and make some cuts and it won't affect the quality of education."

Finally, it is likely that federal and state taxes will increase to overcome an enormous shortfall in revenue as compared to expenses at the State and Federal level. Additional local taxes would exacerbate the burden on residents.

2. The District is subject to continuing unfunded mandates

The State and Federal government continue to impose unfunded mandates on the Shaker Schools requiring a wide variety of student services without any financial support.

3. State of Ohio financial circumstances may result in a significant reduction in School funding.

The State of Ohio is experiencing a very serious structural deficit that has been estimated to be as high as \$8 billion. Since by law the state must balance its budget, it is possible that one means of closing this budget deficit will be a significant reduction in School funding. The District's revenue projections do not take into account any such potential reductions.

IV. Proposed Solutions

A. City

The City brought its projected deficit for 2009 down from over \$2.7 million to \$650,000. A further deficit was projected in 2010 of approximately \$1,000,000 with somewhat increased deficits in future years as employees receive modest wage increases. These are being covered at the present time by a \$6.5M operating reserve.

We believe that the City is essentially on target with its current program but, over the next five years, needs to achieve a combination of cost savings and revenue increases in the range of \$3 million to \$4 million. We think this can be accomplished.

With respect to cost savings, the City is continuing to eliminate positions and costs which will reduce the 2010 deficit to an amount far below the \$1 million that had been projected. The administration plans to work with Council to achieve further savings. In addition, the City hopes to realize the benefit of some upturn in the economy over the next few years as well as realizing benefits from its current economic development effort which seeks to attract new residents to add to the tax base and significantly build the commercial tax base.

The City views a tax increase as a last resort even though there has been no tax increase for twenty-eight years. The City is reluctant to do any tax increase that impacts residents who work outside of Shaker since such residents already pay income taxes in two communities. Those who work in Shaker are currently paying 1.75% in income taxes which is below the 2.0% that appears to be average for this area but the City's strong preference is to resolve its fiscal problems with no further tax increases.

In short, we believe that the City should continue on its current path of reducing costs and seeking to increase revenues, maintaining the quality of services (with minor adjustments if necessary) and seeking to avoid tax increases.

There are certain caveats to all of the above. The first relates to a further economic downturn and/or significant loss of state funding via the local government fund which currently provides approximately \$1.5 million of annual revenue. The second is the potential loss of the Estate Tax which produces an average of \$3 million a year in Shaker and which is the subject of continual discussion in the legislature as to its reduction and/or elimination. Finally, while the City's expectations for inflationary revenue growth coming out of the recession are modest, the failure to achieve that level of growth would present a challenge. In the event of any of these negative developments, the City would face a more difficult scenario.

B. Schools

The Schools' financial circumstances are more complex and challenging than the City's. We give full credit to the Schools for everything that has been accomplished financially and which is outlined above. Despite these accomplishments, we feel that the Schools will be overwhelmed by various forces unless stronger action is taken in the future.

In the first place, continuing on a path which relies on the passage of a new tax levy every three years for operating expenses is undesirable in our opinion. We recommend that the District set a clear goal of achieving a levy cycle with substantially longer intervals between levies but still limited to not more than 10.0 mills for each levy. We believe this would put the District and community in a much better posture to attract and retain the residents and businesses needed for Shaker's future. For the reasons noted, we recommend that no capital issue be put on the ballot in 2011 as had been contemplated.

Secondly, we call upon the District to adopt a "resource-driven" approach which focuses on the level of resources available in the community and creates the best possible educational system for the resources that exist and for those that can reasonably be expected in the future. The community cannot succeed in maintaining a first-rate educational program without first recognizing that resources are limited and that priorities must be set. Making difficult decisions to conserve resources now and to exercise fiscal discipline is essential to succeed in the long term. Many school districts are now facing a choice between enormous emergency reductions and huge tax increases. We need to avoid this scenario in Shaker by careful financial planning well in advance of any emergency.

Finally, in order to accomplish these goals, we believe it will be essential for the District to restructure and reduce staff and exercise great restraint with respect to labor agreements and other compensation and benefit issues. This should be done now in order to maximize savings. In the past, citizen review committees have been assembled and asked to assess School District needs at the end of a levy cycle. We believe it is critical to deal with the changes that are needed at the beginning of the cycle to maximize savings.

C. City/Schools

Finally, we would encourage the City and the Schools to work together and to develop a joint community financial plan to meet the need for quality City operations and the maintenance of a first-class School system in Shaker Heights with a committee to provide oversight in achieving this goal.

The Schools have a unique and strong relationship with young families with School-age children and serves these families every day. The City serves all residents and works with every constituency. All of the groups that are served by the City and the Schools should be represented in the process of determining taxation levels in Shaker Heights and the financial future of each entity. Further, the City and the Schools are now much too interdependent to have one group make major financial and taxation decisions without considering the interests of the other. The interests of every resident – City and School District alike – are best served by a joint financial planning process leading to a community-wide financial program.¹

Shaker must attract and retain income and property tax-producing residents and businesses to assure a funding level which supports quality Schools and City services. The community's ability to attract and hold these taxpayers is dependent on their perception that the Schools and community have much to offer them without unduly burdening them financially. The strategic decisions that are necessary to attract and hold these residents in the community can best be made jointly by the Schools and the City. Moreover, a joint financial plan supported by the Schools and City is also the best vehicle for increasing confidence among these taxpayers that they have a strong and secure future in Shaker.

Shaker has done a remarkable job of maintaining high quality City operations and Schools in the face of significant economic challenges. This is a testament to our citizens and to the quality of people who have served in office in Shaker over a period of many years. The community has unique assets which make us optimistic about its future – the remarkable quality of its housing stock, the physical beauty of its parks and walking trails, its attractive neighborhoods and a highly educated, very supportive population. These assets continue to make us attractive and give promise of a very bright future for Shaker. The best way to assure that future is by adjusting to our changing economic circumstances and by following a sound and disciplined financial approach.

V. Summary of Recommendations

This report is being written in the context of the greatest budget crisis the State of Ohio has ever experienced with the possible exception of the Great Depression of the 1930's. At this point, Ohio has a 6-8 billion dollar structural deficit which the Governor and Legislature will have to address in 2011. The recommendations set forth below are subject to any local financial crisis that may occur if the state budget process results in a dramatic decline in state funding for cities or for K-12 public school education or the major cut-off of any critical funding source for cities or schools.

A. City

1. The City is on track with its program of cost reductions and its efforts to increase revenue through economic development and needs to continue on its course to achieve a combination of cost savings and revenue increases in the next five years in the range of \$3M-\$4M based on current projections.
2. Although the City has not been on the ballot for a tax increase in the last 28 years, it should continue to do its best to avoid tax increases and most especially any tax increase that impacts residents who work outside Shaker who are already paying taxes in two communities.

B. School District

1. While we give the School District full credit for the cost savings that have been achieved, it is nevertheless clear that the District needs to change its financial model. The current model relies on the passage of a new tax levy every three years for operating expenses but that is projected to result in an increase of a further 25-30% of property taxes over 10 years. We view this as highly undesirable.
2. The School District should work with the Joint Committee described in Paragraph C below to develop a financial plan with clear goals which extend the period between levies well beyond three years with millage under 10.0 mills for each levy.
3. The School District's strategic plan and ongoing programs need to be "resource-based" so that priorities are established and expenses are based on available resources and those that can reasonably be expected in the future.
4. The School District needs to exercise restraint in labor negotiations and compensation matters so that employee compensation and benefit costs are consistent with the District's financial goals as outlined above.
5. The School District needs to begin now at the beginning of a levy cycle to reduce expenses by restructuring and reducing staff to accomplish the above goals.

EXHIBIT A

DISTRICT		# OF LEVIES SINCE 2000	TOTAL NEW MILLAGE	# OF LEVIES SINCE 1995	TOTAL NEW MILLAGE
Bay Village	*	4	22.25	5	30.00
Beachwood		2	13.90	2	13.90
Bexely	**	3	17.90	4	20.60
Chagrin Falls		2	15.80	3	20.00
CH/UH		3	25.10	4	34.00
Hudson	***	2	11.00	3	17.70
Lakewood		2	13.80	3	22.90
Orange		2	14.50	3	20.05
Rocky River		3	15.70	5	23.10
Shaker		4	38.80 ¹	5	47.50 ¹
Solon		3	20.70	3	20.70
Upper Arlington		3	17.90	4	24.10
Westlake		2	12.40	3	15.30

* 6.9 mills on 11/10/10 ballot

** 6.85 mills on 11/10/10 ballot – passed .75% school income tax in 2004 and removed 3.5 mills

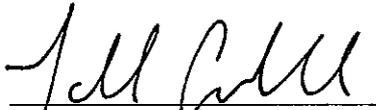
*** Levies failed in May 2003 and 2006 before passing in November of each year

¹ Note that Shaker’s higher increase in millage may produce no more revenue than the lower increases in other communities due to their stronger commercial tax base and other factors.

C. Joint City Schools

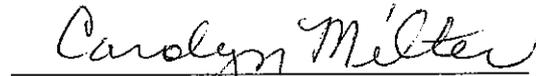
The Schools and City should work together in developing a joint financial plan that seeks to retain excellent municipal services and a first class educational program with oversight to be provided by a committee of individuals who are committed to quality and the achievement of the financial goals outlined above.


Martin R. Kolb, Chair


Todd Campbell


Matt Lehman


Paul Carleton


Carolyn Milter

The committee decided not to include the Shaker Heights Public Library in its analysis. The library, at \$5M, represents a small percentage of the community's financial budget which includes \$90M for the Schools and \$40M for the City. Any changes affecting the library are likely to have only a modest impact on residents. Moreover, the members of the Committee felt a concern that a detailed analysis of the complexities of the library's operations would dilute the effort to adequately address the major financial challenges impacting the community - the School and City financial costs in relation to available resources. However, a decision can be made at some future time to include the library in financial planning.

THE TASK FORCE

Martin R. Kolb, Chair:

- General Manager - Automotive Lighting, General Electric Company
- Past member, Shaker Heights Board of Education and Board President
- Member, City Council Finance Committee
- Three adult sons, all Shaker City School graduates

Todd Campbell:

- Portfolio Administration Group Manager, KeyBank
- Past Board member, Fund for the Future of Shaker Heights
- Member, City Council Finance Committee
- Two children in Shaker City Schools

Paul Carleton:

- Managing Director, Carleton McKenna & Co., LLC, strategic & financial consulting firm
- Member, Business Advisory Council of Baldwin Wallace College
- Member, Finance & Audit Committee Shaker Heights City School District
- Four adult children attended and/or graduated from Shaker City Schools

Matt Lehman:

- Mobile Business Leader, Progressive Insurance
- Past Member, City Council Finance Committee
- Member, Board of Trustees, Shaker Schools Foundation
- Member, Board of Trustees, Shaker Youth Center
- Member, Board of Trustees, Shaker Youth Hockey Association
- Shaker City Schools graduate
- Two children in Shaker City Schools

Carolyn Milner:

- Retired Manager, Communications & Public Affairs, Cuyahoga County Department of Health and Nutrition
- Past member, Shaker Heights Board of Education and Board Vice President
- District Administrator for Cong. Dennis Eckart when he represented the Heights area
- 30-year Ludlow resident, former Ludlow PTA President, Board member Ludlow Community Association
- Three adult children, all Shaker City School graduates
- Now resides in Cleveland portion of Shaker School District