

April 11, 2005

Honorable Mayor and City Council
City of Midland, Michigan

Dear Councilmen:

Transmitted herewith is the City Manager's proposed budget for the fiscal year ending June 30, 2006.

The proposed budget provides a balanced financial plan for municipal operations in a format that compares projected revenues and expenditures with those of the current fiscal year and the audited figures for 2003-04. The City Manager and the Director of Fiscal Services have prepared this budget after review of itemized estimates submitted by the City department heads. Such review will continue, but we believe that this preliminary budget affords the basis for discussion of operations to be undertaken in the 2005-06 fiscal year. It is, of course, subject to revisions which, as a result of public hearing and/or the direction of the City Council, may appear advisable.

Budget Objectives

Prior to the preparation of the 2005-06 budget, the City Council retained the services of Kezziah Watkins to facilitate the City of Midland Budget Priorities Community Roundtables, which were conducted in January 2005. On February 7, 2005 the City Council received the Summary Report for the Roundtables and a presentation by Kezziah Watkins summarizing the responses of 185 Midland citizens who invested over three hours of their time to give the City Council valuable feedback on City's finances and level of services.

This comprehensive financial plan was prepared to achieve the following objectives:

- Maintain the current quantity and quality of municipal services as advocated by the Budget Roundtables;
- Fund all of the operating and maintenance expenditures to support the infrastructure, facilities and equipment necessary to provide municipal services today and tomorrow;

- Restore the General Fund Contingency balance to \$1.5 million in compliance with City Council policy;
- Sustain the ongoing defense of the two remaining major tax appeals and provide sufficient annual reserves to cushion taxpayers from significant future tax increases or loss of services consistent with our fiduciary responsibility.

Budget Challenges

In 2005-06 the City of Midland, like most other state and local governments throughout the country, is faced with continuing financial challenges, which include the following:

- Substantial increases in the cost of health care insurance (\$999,000).
- Decrease in the City's total taxable value by 0.13% as a result of:
 - Reduction of the value of Dow Corning as a result of the settlement of their tax appeal;
 - Depreciation tables issued by the State Tax Commission, which accelerate depreciation and provide for faster reductions in the taxable value of personal property;
 - Constitutional limits imposed by Proposal A on annual increases in taxable value of real property.
- Loss of more than \$900,000 in annual state shared revenue compared to levels of five years ago, precipitated by unfavorable economic conditions and the State of Michigan's own budget difficulties.
- Loss of more than \$1.8 million in annual investment earnings compared to four years ago as a direct result of the economy's effect on interest rates.
- Increase of \$534,000 in required employer contributions to defined benefit pension plans as a result of a three-year downturn in securities markets.
- Unanticipated increase in tax appeal defense costs in the current and proposed budget of \$1,976,000.

Highlights of the Proposed 2005-06 Budget

Despite these challenges, the proposed 2005-06 budget provides a balanced financial plan that:

- Reduces the property tax rate for funding the tax appeal reserve by 2.15 mills to return to City taxpayers \$5.33 million which has become available as the result of the negotiated tax appeal settlement with Dow Corning Corporation;

- Further reduces the property tax rate for funding the tax appeal reserve by 0.48 of a mill to reflect a downward adjustment of the litigation risk in the Midland Cogeneration Venture tax appeal case;
- Increases sewer rates by 6%, resulting in an annual increase of \$16 (\$4 per quarter) in the combined water and sewer bill for a typical residential customer;
- Decreases the total property tax rate from 9.87 mills (\$9.87 per \$1,000 of taxable value) to 9.81 mills, resulting in a decrease in City property taxes. The change is comprised of the following:
 - Tax rate for general operations increases from 9.35 to 11.70 mills;
 - Tax rate for storm water management decreases from 0.56 to 0.12 of a mill;
 - Special levy for funding the tax appeal reserves decreases from a negative 0.68 of a mill to a negative 2.63 mills;
 - Tax rate for debt service decreases 0.02 of a mill from 0.64 of a mill to 0.62 of a mill.

GENERAL FUND

Property Tax Appeals. Over the past nine years a significant budget challenge has been the property tax appeals filed by the City's three largest taxpayers:

- Midland Cogeneration Venture (MCV)
- Dow Corning Corporation
- The Dow Chemical Company

Following the process provided by Michigan law, these taxpayers filed appeals with the Michigan Tax Tribunal (MTT) for the tax years 1996 through 2004.

Each fiscal year from 1997 to 2001, the City Council levied a special tax appeal millage at a rate that initially generated 80% of the total potential annual loss of property tax revenue and tax administration fees that could result from these appeals, and ordered the revenue placed in a tax appeal reserve fund. This reserve fund also includes funding for interest that may be added by state statute on any property tax refunds. The amount reserved in each year is based upon an annual assessment of the risk of loss involved in each of the appeals.

Since the inception of the appeals the City Council has maintained a promise to adjust the tax appeal millage rate as necessary to refund any unused or unnecessary funds in the reserve.

2004 saw major developments in the Dow Corning Corporation tax appeal for the years 1996 through 2004 culminating in a negotiated settlement between the City and Dow Corning that was approved by the MTT on October 11, 2004.

This settlement required the City to pay a City tax refund to Dow Corning in the total amount of \$1,914,996 leaving \$5.33 million to be refunded from the tax appeal reserve to property tax payers in the form of a tax appeal reserve millage reduction in the 2005-06 budget.

It is anticipated that the remaining two tax appeals will be extended to the 2005 taxable values and the amounts in contention are illustrated by the following table:

Estimated Appeal for 2005 Tax Year	<u>Taxable Value Per City Assessor</u>	<u>Taxable Value by Petitioner</u>	<u>Taxable Value In Contention</u>
MCV	\$ 617,908,700	\$281,880,322	\$336,028,378
Dow Chemical Company	<u>188,717,000</u>	<u>109,950,940</u>	<u>78,766,060</u>
TOTAL 2005 APPEAL	\$ 806,625,700	\$391,831,262	\$414,794,438

The following table demonstrates the effects of the current amount of each appeal on total taxable value and the corresponding potential revenue loss to the City of Midland and to other area taxing authorities:

<u>Taxpayer</u>	<u>Taxable Value In Contention (In Millions)</u>	<u>Revenue Loss City of Midland (In Millions)</u>	<u>Revenue Loss - All Taxing Authorities (In Millions)</u>
2005 Appeals (Estimated):			
MCV	\$ 336.0	\$ 3.36	\$ 16.13
Dow Chemical Company	<u>78.8</u>	<u>.79</u>	<u>3.78</u>
2005 Total	\$ 414.8	\$ 4.15	\$ 19.91

In December 2004 the final briefs by MCV to the Court of Appeals were filed. After reviewing these documents the City's experts have indicated it is unlikely that a refund for the remaining years 2001 through 2005 would exceed an amount using the MTT methodology for establishing taxable value in its January 2004 decision. Therefore the reserve for MCV has been reduced by an additional \$2.1 million in the proposed 2005-06 budget.

The final large industrial property tax appeal, that of The Dow Chemical Company, is in the litigation stage. The City's legal experts have advised that this reserve be maintained at 80% of the tax in dispute, plus interest.

Based on the developments in the MCV and Dow Corning cases discussed above, the proposed 2005 property tax rate of 9.81 mills reflects a reduction of 1.95 mills (from negative 0.68 of a mill to negative 2.63 mills) in the tax appeal reserve rate, which would reduce reserves by \$6.5 million from the previous year's level. The resulting June 30, 2006 reserve balance of \$30 million has been deemed adequate to cover the City's risk in the two remaining cases.

The following table shows contributions to the tax appeal reserve fund with the proposed 2005-06 adjustments:

<u>Fiscal Year</u>	<u>Tax Year</u>	<u>Contribution to Tax Appeal Reserve</u>	<u>Special Millage</u>
1996-97	1996	\$ -0-	0.00
1997-98	1997	5,029,000	2.30
1998-99	1998	5,834,300	2.49
1999-00	1999	8,063,200	3.24
2000-01	2000	9,226,000	3.64
2001-02	2001	5,457,400	1.94
2002-03	2002	1,255,000	1.44
2003-04	2003	5,235,900	2.13
2004-05	2004	(1,682,300)	(0.68)
2005-06	2005	<u>(6,520,666)</u>	(2.63)
SUBTOTAL		\$ 31,897,834	
Dow Corning Refund		(1,914,996)	
TOTAL		\$ 29,982,838	

Tax Appeal Defense Costs. The services of outside legal and appraisal consultants retained to defend the major industrial tax appeals are costly. This process involves the detailed appraisal of hundreds of buildings and a huge inventory of specialized production equipment, laboratories, etc.

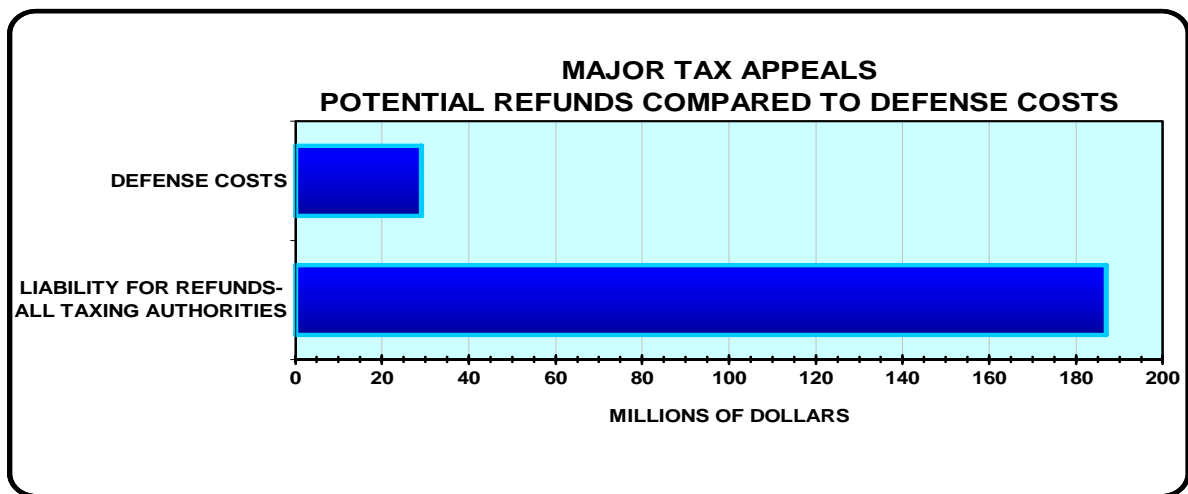
The City is responsible for defending tax appeals on behalf of itself and the following five other governmental/educational entities who derive property tax revenue from the City's tax base:

- State of Michigan Education Tax
- Midland Public Schools
- County of Midland
- Midland County Educational Service Agency
- Delta College

The cost of tax appeal defense is necessary because:

- The amount of taxes at issue for the eight-year period since these appeals were originally filed is approximately \$187 million, exclusive of interest, and is estimated to be an additional \$31 million each year thereafter.
- The City has only one opportunity to review and, if necessary, challenge such claims. Once a reduction is granted by the City or ordered by the MTT the values are capped at that level as required by the state constitution and related law.
- If these taxable values are capped at too low a value it would unfairly shift costs or reduce services to all other taxpayers.

The following graph illustrates the relationship between tax appeal defense costs and the total amount of property tax in dispute for all taxing authorities for the eight years since the appeals were filed.



As described earlier, the Dow Corning case has been settled and the MCV case is currently under appeal.

In last year's budget we anticipated that the Dow Chemical case trial would be concluded in the current fiscal year. However, the MTT has now ordered that this appeal be tried as two separate cases; one for the Corporate Center and the other for the real property of the Manufacturing Plant site. The MTT has also ordered that the Plant case be divided into three separate sub trials that are scheduled to take place as follow:

- Real versus Personal Property issues June 2005
- Highest and Best Use September 2005
- Valuation December 2005

These orders have extended this litigation into the 2005-06 fiscal year. In addition, by increasing the number of trials from one to four our estimated costs of litigation has increased by \$2.9 million over our previous budget. Approximately \$1.0 million in legal defense cost savings from settling the Dow Corning case have been used to reduce a portion of this increase.

Appraisals on both the Corporate Center and Manufacturing Plant have been exchanged between Dow Chemical and the City. The trial on the Corporate Center was completed in January 2005 and a decision is anticipated prior to the final adoption of the budget.

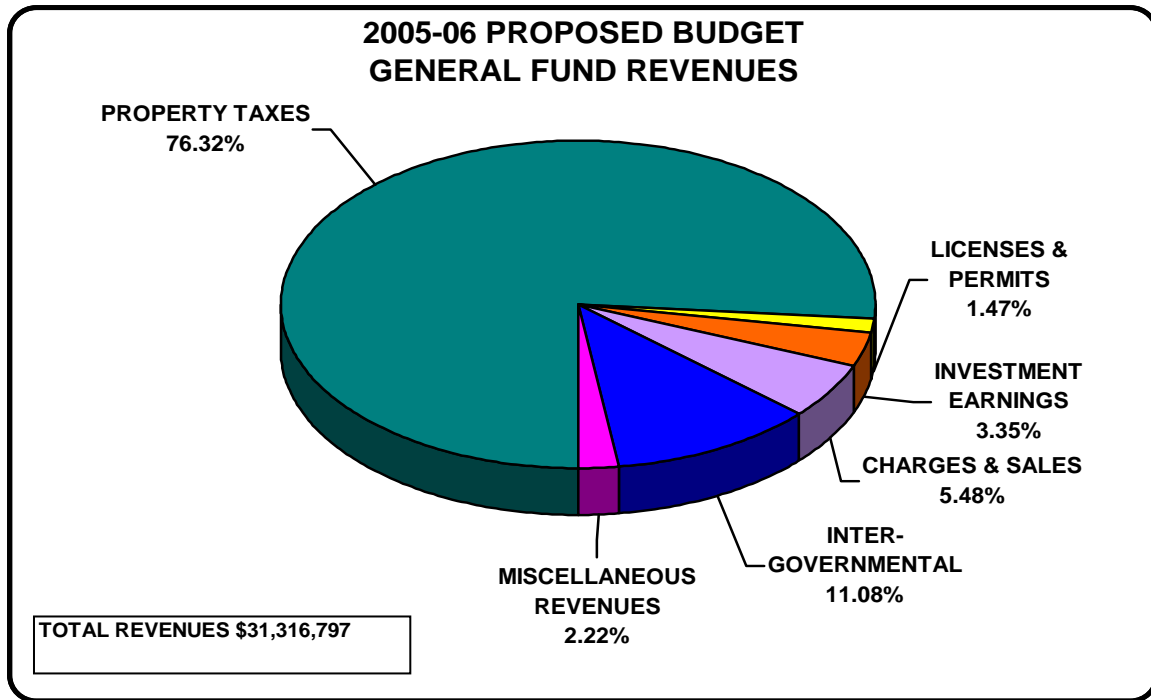
The proposed budget includes a total of \$2,241,000 in funding for defense costs for the 2005-06 fiscal year, as indicated in the following table.

<u>Case</u>	<u>Purpose</u>	<u>Amount</u>
MCV	Appeal of MTT decision	\$ 265,000
Dow Chemical Company	Trials before the MTT	<u>1,976,000</u>
TOTAL		\$ 2,241,000

With the conclusion of all three Dow Chemical trials in the next fiscal year, tax appeal defense costs are anticipated to decline substantially in future budgets.

GENERAL FUND REVENUES

The following chart indicates the various General Fund revenue sources for 2005-06 and the proposed relative percentage supplied by each.



Property Taxes. The City Council has authority for the 2005-06 fiscal year to levy a tax rate of up to 21.87 mills without a vote of the citizens, as indicated below:

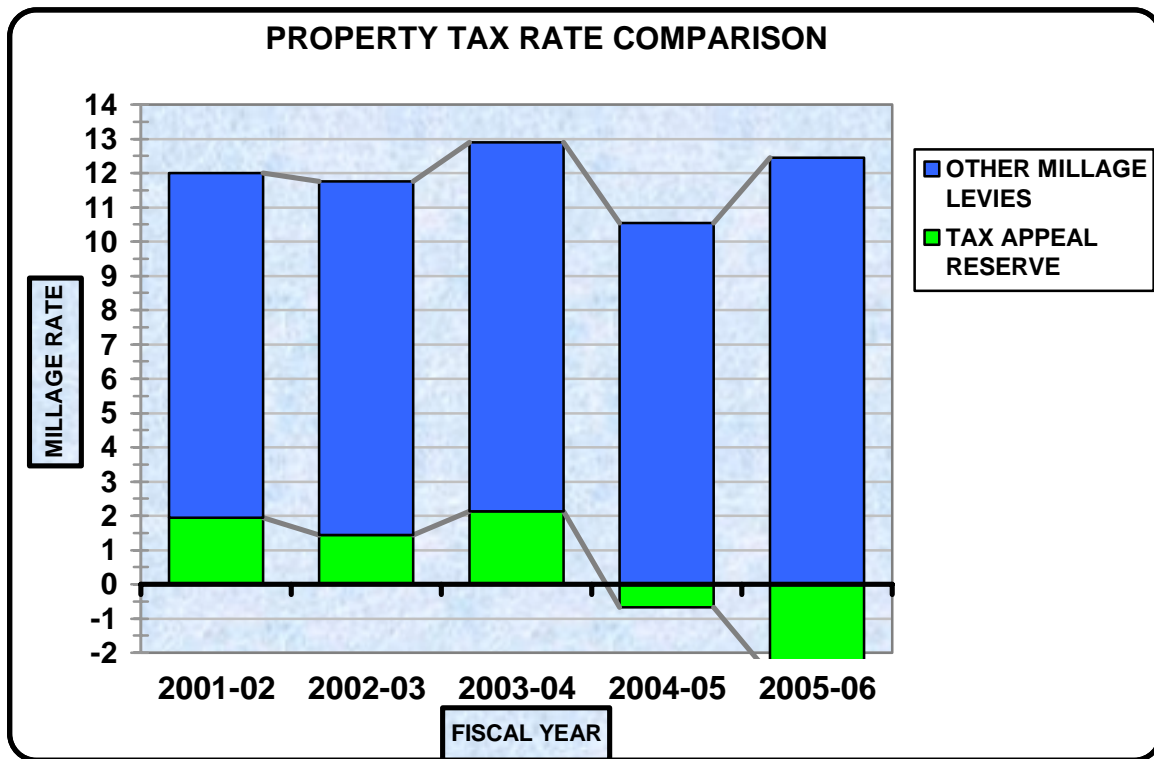
<u>Authority</u>	<u>Millage Rate</u>
City Charter	17.87 mills *
Library Statutory	1.00 mills
Solid Waste Authority	<u>3.00 mills</u>
TOTAL	21.87 mills

*18 mills authorized by Charter have been reduced by the state constitution (Headlee Amendment) to 17.87 mills.

The total millage rate proposed for 2005-06 is 9.81 mills, including 0.62 of a mill for voter-approved debt service. This represents a decrease of .06 of a mill from last year's total rate of 9.87 mills, which included 0.64 of a mill for debt.

The following table and graph present comparisons of the proposed property tax rate with those of preceding years:

	<u>2002-03</u>	<u>2003-04</u>	<u>2004-05</u>	<u>2005-06</u>
<u>CHARTER OPERATING MILLAGE</u>				
General Operations	9.56	9.29	9.35	11.70
Tax Appeal Reserve	1.44	2.13	(0.68)	(2.63)
Storm Water Management	<u>0.09</u>	<u>0.84</u>	<u>0.56</u>	<u>0.12</u>
Subtotal	11.09	12.26	9.23	9.19
<u>VOTER APPROVED DEBT MILLAGE</u>				
Sanitary Sewer Improvement Debt	<u>0.67</u>	<u>0.64</u>	<u>0.64</u>	<u>0.62</u>
TOTAL CITY MILLAGE	11.76	12.90	9.87	9.81



Rate of Growth of Property Tax Base. Data from the City Assessor indicate that industrial and commercial property values declined 3.2% and 0.6% respectively while residential property values increased 2.9%. Proposal A (a 1994 amendment to the state constitution) requires that the increase in taxable value be capped at the Consumer Price Index or 5%, whichever is less. For the 2005 tax year the Proposal A cap is 2.3%. As a result of all these factors, the total taxable value decreased by 0.13% from \$2,478,844,300 to \$2,475,543,800.

The taxable value of personal property owned by commercial and industrial taxpayers in the City declined from \$388,843,500 in 2004 to \$365,804,900 in 2005, a difference of \$23.0 million, or 5.9%. Personal property now makes up 15.0% of the City's regular tax roll, compared to 16% last year. Personal property values in the industrial sector alone declined by 5.5%. There are two principal reasons for this change: (1) a downturn in the national and international economies has caused the City's major industrial taxpayers to scale back purchases of new equipment and to retire existing equipment at a faster rate, and (2) new State Tax Commission valuation tables implemented in 2002 for personal property allow significantly accelerated depreciation of personal property on the assessment rolls. The following table illustrates this trend.

Tax Year	Taxable Value of Personal Property Added	Losses from Depreciation & Disposals	Year End Taxable Value of Personal Property	Percent of Total Reg. Tax Roll
2000	\$ 21,411,500	\$ 44,200,500	\$ 403,489,000	18.7%
2001	53,929,300	22,774,200	434,644,100	19.4%
2002	13,818,600	15,945,700	432,517,000	18.2%
2003	18,197,500	36,343,200	414,371,300	17.3%
2004	29,712,000	55,239,800	388,843,500	16.0%
2005	39,566,700	62,605,300	365,804,900	15.0%

User Fees. The proposed 2005-06 General Fund budget anticipates a total of \$1,464,660 in revenue from user fees. User fee rates are reviewed annually and adjusted as necessary to ensure that revenues realized meet standards set by the City Council with regard to recovery of the costs of providing certain services. The following is a list of the City's various categories of user fees and the projected amounts of revenue generated by each for 2005-06.

<u>User Fee Source</u>	<u>Anticipated Revenue</u>
Licenses and Permits	\$ 458,970
Cemetery Fees	118,000
Yard Waste & Refuse Collection Fees	124,593
Public Safety Charges	33,000
Swimming Pool Fees	45,000
Recreation Activities Fees	94,500
Barstow Airport Fees	76,400
Library Fines, Fees & Other	185,600
Library Township Contributions	208,597
Dial-A-Ride Fees	120,000
TOTAL	\$ 1,464,660

These user fees proposed for 2005-06 are the equivalent of 0.59 of one mill of property tax.

State Shared Revenue. The state revenue sharing program distributes sales tax collected by the State of Michigan to local governments as unrestricted revenues. Funding for the program consists of the following dedicated tax revenues:

- Constitutional – 15% of the 4% gross collections of the state sales tax
- Statutory – 21.3% of the 4% gross collections of the state sales tax

The following table shows the breakdown of the constitutional and statutory portions of the City’s state revenue sharing since fiscal year 2000-01.

<u>Fiscal Year</u>	<u>Constitutional</u>	<u>Statutory</u>	<u>Total</u>
2000-01	\$2,716,536	\$1,584,051	\$4,300,587
2001-02	2,738,246	1,601,579	4,339,825
2002-03	2,746,364	1,216,523	3,962,887
2003-04	2,785,000	944,500	3,729,500
2004-05	2,785,000	758,000	3,543,000
2005-06	2,800,000	600,000	3,400,000

Distributions of constitutional revenue sharing are based on population. The formula for statutory distributions includes factors such as taxable value per capita, local unit type, population and a tax rate yield equalization factor.

Another important difference between the two is that, with constitutional revenue sharing, the percentage of receipts that must be shared with local units of government is fixed by the state constitution, while the percentage for statutory revenue sharing is set by the state legislature and is also subject to change by executive order of the governor. In recent years, as the state’s budget crisis has become more acute, increasing amounts of these funds have been diverted to balance the state’s budget and away from providing local government services. This trend is illustrated by the preceding table. Amounts distributed under both methods also fluctuate as economic conditions impact the amount of sales tax collected by merchants and remitted to the state treasury.

Since fiscal year 2000-01, economic conditions in the state have resulted in the City receiving less actual and projected state shared revenue as illustrated in the following table:

<u>Year</u>	<u>Amount of State Shared Revenue</u>	<u>\$ Difference</u>	<u>% Difference</u>	<u>SSR as % of General Fund Expenditures</u>
00-01	\$4,300,587	n/a	n/a	14.9%
01-02	4,339,825	\$ 39,238	0.9%	14.1%
02-03	3,962,887	(376,938)	(8.7%)	11.9%
03-04	3,729,500	(233,387)	(5.9%)	10.3%
04-05	3,543,000	(186,500)	(5.0%)	9.0%
05-06	3,400,000	(143,000)	(4.0%)	9.2%

Due to conservative budget estimates for state revenue sharing, the City has not experienced any mid-year reductions in municipal services as a result of the Governor's executive orders, which reduced state revenue sharing payments to local units of government over the past two years. However, the table above demonstrates that in the proposed budget, the City anticipates receiving \$900,587 less from this important revenue source than it received in 2000-01. This loss of revenue is equal to .37 of a mill of property tax, based on the City's 2005 taxable value.

Investment Earnings. The Federal Reserve System, in an effort to stimulate the national economy, had for some time been reducing its discount rate, which had a significant effect on rates of interest the City can earn on its investments through the beginning of 2004-05. For the first time in five years, interest rates on the instruments in which municipalities can invest are trending upward, and for much of the 2004-05 fiscal year have hovered around 3%. The proposed budget assumes this rate (3%) will continue during the 2005-06 fiscal year. The following table compares the proposed budget with the experience of the past four years.

<u>Year</u>	<u>Investment Earnings</u>	<u>\$ Difference</u>	<u>% Difference</u>	<u>Investment Earnings as % of Gen Fund Expenditures</u>
00-01	\$2,916,596	n/a	n/a	10.1%
01-02	1,366,174	(\$1,550,422)	(53.2%)	4.4%
02-03	896,991	(469,183)	(34.3%)	2.7%
03-04	835,000	(61,991)	(6.9%)	2.3%
04-05	875,000	40,000	4.8%	2.2%
05-06	1,050,000	175,000	20%	2.8%

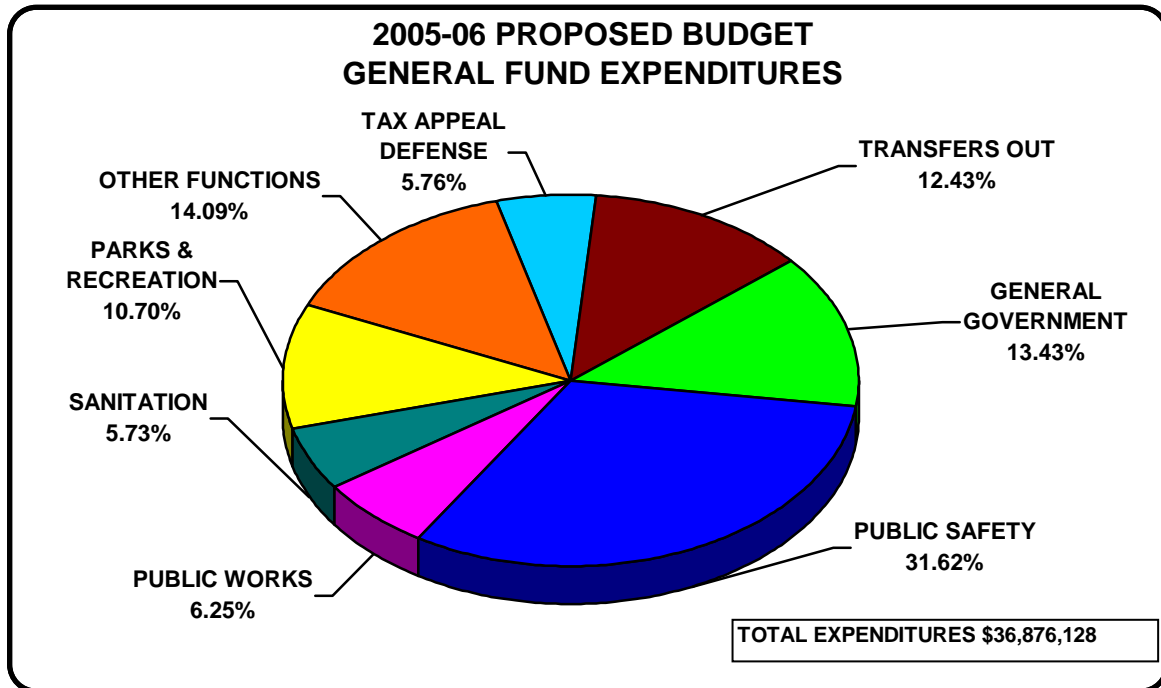
The table above demonstrates that in the proposed budget, the City is expecting \$1,866,596 less in investment earnings than the amount received in 2000-01. This loss of revenue is equal to 0.75 of a mill of property tax.

Considering losses of state shared revenues and investment earnings together, the City anticipates receiving \$2,767,183 less in 2005-06 than it received from these two sources in 2000-01. This is the equivalent of 1.12 mills of property tax.

	<u>State Shared Revenues</u>	<u>Investment Earnings</u>	<u>Total</u>
2000-01 Actual	\$ 4,300,587	\$ 2,916,596	\$ 7,217,183
2005-06 Est.	<u>3,400,000</u>	<u>1,050,000</u>	<u>4,450,000</u>
Estimated Loss	\$ 900,587	\$ 1,866,596	\$ 2,767,183
2005 Taxable Value			\$2,475,543,800
Millage			1.12 mills

GENERAL FUND EXPENDITURES

The following chart illustrates the various proposed General Fund expenditure categories and the relative percentage of each.



Plymouth Pool. In 1999 all outdoor city pool activities were consolidated at Plymouth Pool as a result of closing the Central Park Pool complex due to structural problems. In 2000 a grant request was submitted to the Clean Michigan Incentive Recreation Bond Program for money to add a leisure component to the pool and in the process resurface the entire pool with a marcite surface and deepen the end of the pool by 2" - 4" to accommodate starting blocks. The grant request was not funded and the City began budgeting money on an annual basis to fund the project.

In 2002 it was determined that a major rehabilitation of the pool should include the pool building in order to bring it into compliance with the Americans with Disabilities Act and address maintenance issues associated with the aging building. The updated cost estimates of the pool and building projects is \$850,000 broken down as follows:

<u>Improvement</u>	<u>Amount</u>
Building renovations	\$475,000
Fix structural cracks, resurface the pool and add 2 - 4 inches depth for 20 feet of the deep end to accommodate starting blocks	\$150,000
Add 12 feet to the existing shallow area to create a zero-depth entry area and add spray ground-type features	<u>\$225,000</u>
TOTAL	\$850,000

By 2003, \$357,822 had been accumulated by the City for this project. It was determined that these improvements could be accomplished using those available funds and appropriating \$250,000 in fiscal years 2004-05 and 2005-06. The 2004-05 appropriation was delayed with the intention of including \$500,000 in the 2005-06 budget. As directed by a January 10, 2005 City Council resolution, the proposed budget includes the appropriation of \$500,000 which will provide the necessary funding to begin construction in fall 2005.

Increases in Operating Costs. Two components of the City's operating costs are anticipated to increase significantly again in the 2005-06 fiscal year.

- **Health care insurance premiums:** The City has been advised by its health insurance carrier that it should expect to receive an increase of 15% in the cost of providing this benefit to active employees and retirees beginning July 1, 2005. While premium sharing provisions in the City's labor agreements will allow a portion of the increase to be passed on to active employees, no premium sharing arrangements exist regarding health insurance premiums for retirees. The combined increase for active and retired employees is expected to amount to \$998,576. The following table shows a history of increases in the cost of this fringe benefit over six fiscal years.

<u>Fiscal Year</u>	<u>Health Care Insurance Expense</u>	<u>Percent Increase</u>
2000-01	\$ 3,024,672	n/a
2001-02	4,146,605	37%
2002-03	4,747,852	14%
2003-04	5,550,103	17%
2004-05	6,499,958	17%
2005-06	7,498,534	15%

- Pension Costs:** Full-time City employees are members of either the Michigan Municipal Employees Retirement System (MERS) or the Midland Police and Fire Retirement System. Employer contributions to both of these defined benefit plans will increase beginning July 1, 2005. Increases in the MERS plan will average approximately 8% over 2004-05 levels, and the City's required contribution to the Police and Fire plan will increase from the current rate of 16% of covered payroll to 23%. Both of the increases are the result of declines in investment performance over the last three years. The combined increase for both plans is expected to amount to \$534,188. The following table shows a history of changes in the cost of this fringe benefit over six fiscal years.

<u>Fiscal Year</u>	<u>MERS Contribution</u>	<u>(Decrease) Increase</u>	<u>Police & Fire Contribution</u>	<u>(Decrease) Increase</u>
2000-01	\$1,792,201	n/a	\$ 128,828	n/a
2001-02	1,570,542	(\$221,659)	-0-	(\$128,828)
2002-03	1,825,971	255,429	-0-	-0-
2003-04	2,056,560	230,589	224,709	224,709
2004-05	2,214,281	157,721	897,917	673,208
2005-06	2,400,679	186,398	1,245,707	347,790

The combined increases for healthcare and pension expenses exceed \$1.5 million for the 2005-06 fiscal year.

General Fund Contingency Balance. In the current economic climate, there are a number of uncertainties that could result in significant unexpected expenditures and/or revenue shortfalls. For example, the level of state revenue sharing is dependent upon collection of sales tax by the state and is also subject to downward adjustment as the state deals with its budget problems. Likewise, the City continues to be faced with the uncertainty of the two major tax appeals, which could result in an unexpected expenditure. The state legislature continues to tinker with the property tax system, particularly in the area of personal property taxes. The general tax rate is annually established by the City Council when the budget is approved, and may not be changed to accommodate unforeseen events until the following May. A reserve for contingencies of \$350,000 is recommended as a separate line item in the proposed General Fund budget, and would be available for transfer without a budget amendment. As a further precaution, the City Council has also adopted a policy of maintaining an additional \$1.5 million of unreserved General Fund balance in order to provide a cushion for more significant unbudgeted events. The existence of these safeguards of the City's financial condition is also relied upon by credit rating agencies in upholding the City's excellent credit rating.

Due to unbudgeted increases in the tax appeal defense and unforeseen expenses related to the City's monitoring of the negotiations between the MDEQ and The Dow Chemical Company regarding corrective action for dioxin, the \$1.5 million of unreserved General Fund balance during 2004-05 was reduced to \$538,733. The proposed budget includes an appropriation of \$961,267 to restore the balance to \$1.5 million in compliance with the above mentioned policy.

OTHER FUNDS

Major and Local Street Funds. The proposed budgets of the Major and Local Street Funds contain construction projects totaling \$4,429,000 and \$1,137,000, respectively. These construction projects include all projects specified in the City Council's Engineering Priorities list. Budgeted fund balances in these funds at the end of the 2005-06 fiscal year meet the City Council's goals of \$400,000 for the Major Street Fund and \$250,000 for the Local Street Fund.

In accord with terms of a ballot proposal approved by Midland County voters in August 1996 and renewed in 2000 and 2005, the City receives approximately \$2.4 million annually from a 1-mill tax levy for road improvements. A portion of these funds are spent each year on road projects, while any unspent funds are reserved and carried forward to future year road projects. The proposed 2005-06 budget includes using \$3,734,250 of these accumulated funds for capital projects in the Major and Local Street Funds. Full availability of these funds is impacted, however, by the outcomes of the two large industrial property tax appeals discussed in the General Fund Revenues section of this report. For purposes of the proposed budget, a portion of the tax revenues in contention has been placed in a reserve for tax appeals using the same reserve calculation methods as described in the section regarding the General Fund.

Dial-A-Ride (DART). The City operates Dial-A-Ride which is a demand/response public transportation system with curb to curb service. The projected revenue for the operation of DART in 2005-06 is as follows:

<u>Source</u>	<u>Percentage</u>	<u>Total Dollars</u>
State	37%	\$ 558,821
Federal	10%	157,229
Fairbox	8%	120,000
Local Subsidy	<u>45%</u>	<u>667,826</u>
TOTAL	100%	\$ 1,503,876

The proposed 2005-06 budget reflects a 21% increase in the General Fund subsidy over the originally approved 2004-05 subsidy of \$550,686. This is due to both a decrease in the level of state operating assistance and an increase in expenditures.

The State has reduced the level of operating assistance it provides to public transit agencies by 9%. This change was effective October 1, 2004, after Council approved the budget for the 2004-05 fiscal year; therefore, it results in a larger General Fund subsidy in both the proposed budget for 2005-06, and the amended budget for 2004-05.

Additionally, for 2005-06, the State is requiring a 7% local match for the purchase of new buses. Formerly, these acquisitions were fully funded by State and Federal programs. This downward trend of these state subsidies is expected to continue to negatively affect the General Fund.

Expenditures have increased 9% over last year's budget. A portion of this increase is due to the same factors as discussed under the General Fund Expenditures section of this message. In addition, fuel costs have not only sustained their high level, but are continuing to increase. These high costs were not anticipated to sustain when last year's budget was approved. Finally, as our existing buses age, they require a higher level of maintenance.

Over the past several years two supervisory positions were eliminated, dispatching duties were transferred to full-time drivers, and the number of full-time drivers was decreased from nine to five and supplemented with part-time employees, which has lessened the impact on the General Fund.

Storm Water Management Fund. An engineering study in 2002 concluded that the City needed to undertake storm water collection system improvements, specifically construction of a large storm sewer along Patrick Road culminating in a new outfall to the Tittabawassee River, in order to bring the needed relief for storm water flows generated from a potential 2.1-inch per hour rain event in the George Street Basin. This storm water collection system improvement would bring the level of protection against flooding in the George Street Basin on a par with the rest of the City. This improvement primarily consists of the installation of a large diameter pipe in the greenbelt between Patrick Road and Lyon Street from Bayliss Street to State Street and then along State Street to the river. The revised costs for the improvements were \$2.6 million, \$1.25 million of which were appropriated in the 2003-04 budget of the Storm Water Management Fund. The 2004-05 budget included an additional \$1.35 million to complete the funding for this improvement. Construction was completed in November 2004 with restoration expected to be completed in spring 2005.

The majority of revenues for financing operations, maintenance and capital improvements for the City's storm water management system are provided by transfers from General Fund property tax revenues. The 2004-05 property tax rate included 0.56 of a mill for this purpose. The proposed budget for 2005-06 would reduce this rate to 0.12 of a mill as a result of completion of the George Street Basin storm sewer project.

Civic Arena Fund. Previous years' budget messages have discussed the need to renovate or replace the Midland Civic Arena. In January 2004, the City Council decided to proceed with a plan to construct a new facility, including 3 ice surfaces, one of which would be Olympic-sized. The cost of this project, was estimated to be \$10,300,000, and is to be funded as follows:

- \$3,800,000 from local foundation grants;
- \$5,250,000 from the sale of limited tax general obligation bonds;
- \$750,000 from an organization representing local users groups;
- \$500,000 from funds accumulated by the City for major maintenance of the current facility.

The new facility is expected to be completed by September 2005.

Since the financial impact of the start of operations appears for the first time in the 2005-06 fiscal year, the 2005-06 proposed budget converts this activity to an enterprise fund by removing the civic arena revenues and expenditures from the General Fund and placing them in the Civic Arena Fund. The debt service and additional operating costs are funded by increases in user fees and a \$50,000 increase (from \$150,000 to \$200,000) in the annual subsidy provided by the General Fund.

Golf Course Fund. The City owns and operates the Currie Municipal Golf Course, comprised of an 18-hole east course, an 18-hole west course and a par-three course. In 1999, the City accepted grants totaling \$2.7 million from three local foundations to renovate and expand the west course from a 9-hole course to an 18-hole course in two phases. In the first phase, nine new holes were added, and the second phase enhanced the existing nine holes.

The new nine holes opened for play in August 2001. The renovated nine holes were opened for play in September 2002. Construction of a new \$1.2 million clubhouse at the golf course, funded by a separate grant from a private citizen, was completed in April 2002.

The 2003 golf season was the first full season during which all 36 holes were available for play. It was anticipated that additional revenue would be realized as a result of the additional volume of play generated by the operation of the additional nine holes at the west course to offset the increased operating expenses. In fact, 2003 was a challenging year for golf courses throughout Michigan. The Golf Association of Michigan reported that play at its member courses declined 10% to 20% in 2003, due to a combination of unfavorable factors including the economy and weather. While Currie did experience an increase in play as a result of the additional course availability, the increase was not as large as anticipated.

At the time the 2004-05 budget was proposed it was estimated that the Golf Course Fund would incur a loss of an additional \$104,000 of working capital in the 2003-04 fiscal year, bringing the total working capital deficit to \$212,000 as of June 30, 2004.

Significant steps were taken for the 2004-05 budget to reverse this trend. Expenses were reduced by over \$100,000 through a staffing agreement with the United Steelworkers Local 14009, and revenues were adjusted through recent rate increases. In addition, marketing efforts are being increased to generate greater volumes as the west course matures and becomes a more desirable venue.

However, as a result of a number of course closures due to floods in spring 2004, estimated revenues were not realized and the total working capital deficit rose by an additional \$78,000 over the above estimate to a total working capital deficit of \$286,078 as of June 30, 2004.

The proposed 2005-06 budget projects a reduction in the working capital deficit to a total of \$278,201 as of June 30, 2005. The long-term projections show steady progress toward our working capital goal of \$150,000.

Water and Sanitary Landfill Funds. No rate changes are proposed for 2005-06, and funding for all of the City Council approved capital improvements from the Engineering Priorities Report has been provided.

Wastewater Fund. On December 13, 1999 the City Council made a commitment to Midland residents that upon completion of the sanitary sewer improvements constructed in response to the 1996 rainfall event, an analysis of neighborhood sanitary sewer systems tributary to the main sanitary sewer collection system would be performed. Since there are not enough resources and time to perform the analysis in house, it will be necessary to hire an outside engineering firm at an estimated cost of \$100,000. The proposed budget includes a sewer rate increase of 6% to conduct the local sanitary sewer system study, but includes no funding for any recommended improvements as a result of that study. The rate increase is also necessary to keep pace with increases in operating costs described in the General Fund Expenditures section of this report, as well as fund needed capital improvements approved by the City Council as part of the Engineering Priorities list, and maintain prudent levels of working capital reserves. It is expected that the impact of this rate increase, to the average resident, will be to increase quarterly water and sewer billings by approximately 3.5%.

Staffing Levels. In 1995 a second captain position was added to the Police Department when it was decided to initiate several changes in services. As part of our review of staffing requirements for the next fiscal year, it has been determined that effective January 2006, we can eliminate this position and reassign the responsibilities to the police chief, other captain and the administrative lieutenant. This change will not affect the efficiency or effectiveness of police services to our citizens.

Under the proposed budget, the General Fund would employ 261 full-time workers and the other funds would employ 115, for a total of 376. This total is five less than the number of full-time employees in the 1994-95 budget.

The following chart compares the growth of the demand for our services with the total number of full-time employees who deliver them.

	<u>1995</u>	<u>2005</u>	<u>% Change</u>
Population	40,043	42,175	+ 5.3%
Number of Water Customers*	14,435	17,565	+21.7%
Number of Full Time Employees	381	376	-1.3%

**additional employees were hired to provide township services*

RECOMMENDATION

It is recommended that copies of this proposed budget be placed on display in the City Clerk's Office at City Hall and at the Grace A. Dow Memorial Library for public examination.

We wish to remind Councilmen of the following public hearings and budget study work sessions that were set by Council on November 22, 2004. These hearings and sessions will be televised on MGTV, Cable Channel 5, to provide our citizens with as many opportunities as possible to view and participate in the City's budget process.

- Monday, April 18, 2005 - first Council budget work session (special meeting).
- Monday, April 25, 2005 - preliminary public hearing on proposed budget (regular meeting).
- Monday, May 2, 2005 – second Council budget work session (special meeting).
- Monday, May 9, 2005 – charter required public hearing on proposed budget (regular meeting). This will include a hearing required by the Truth in Taxation Act.

The City Charter requires adoption of the budget no later than the fourth Monday in May, which this year is May 23. It is planned to present Council with a resolution to adopt the 2005-06 fiscal year budget on that date, at Council's regular meeting.

It should also be pointed out that good fiscal management dictates that you wait to set the tax rate until the County Board of Commissioners meets to officially equalize property values for Midland County. This meeting is tentatively scheduled for April 19, 2005.

Respectfully submitted,

Karl S. Tomion
City Manager