

April 11, 2011

Mayor and City Council
 City of Midland
 333 W. Ellsworth
 Michigan, MI 48640

Dear Mayor and Councilmen:

In accordance with the City Charter you will find following the proposed City budget for fiscal year 2011-12. This budget document provides a snapshot of each municipal department and activity fund that highlights organizational structure, service goals, historic funding, employment levels, and basic performance indicators. This budget continues the conservative spending philosophy embodied in budgets adopted for the past several fiscal years.

Following is a chart that illustrates the broad approach taken to balancing budgets since 2008-09. In an effort to preserve services demanded by citizens, the millage rate was increased in 2008-09 and 2009-10 followed by no increase during 2010-11. In addition, significant spending reductions were implemented in each of those budget years.

<u>Fiscal Year</u>	<u>Millage Increase</u>	<u>Reductions / Savings</u>
2008-09	0.75	\$1.4 million
2009-10	0.95	\$2.2 million
2010-11	0.00	\$2.6 million
2011-12	0.85	\$1.2 million

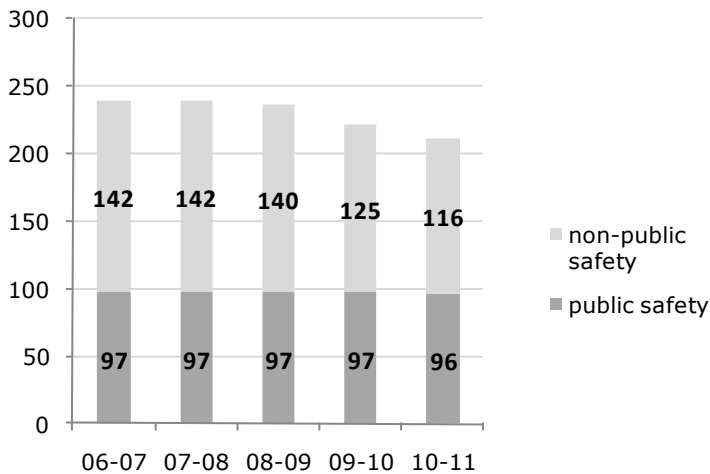
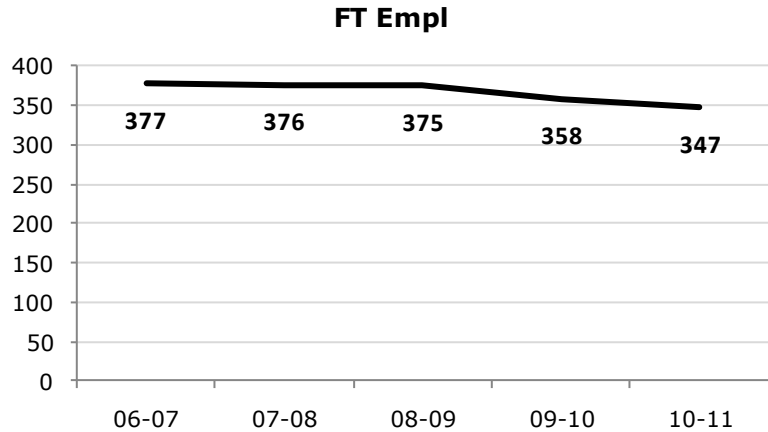
Similar to prior fiscal years the 2011-12 budget proposes a net millage increase and further reductions in spending. The General Fund 2011-12 budget is balanced by eliminating four full-time positions as they are either currently vacant or retirements are planned during the year. Affected positions include: Assistant City Manager, Assistant Library Director, Heavy Equipment Operator, and Dial-A-Ride Transportation Dispatcher. Protecting the City’s fund balance, modifying delivery of certain services, and utilizing unanticipated prior-year savings in excess of the targeted fund balance to fund the remaining deficit are also important measures implemented in this proposed budget.

EMPLOYMENT COSTS

During its annual planning retreat City Council reviewed information regarding the key cost centers associated with municipal service delivery. It is valuable to note that personnel costs are the most significant component of expenditure for most local units of government. During 2010-11 personnel costs accounted for 62% of spending within the General Fund.

Staffing Levels

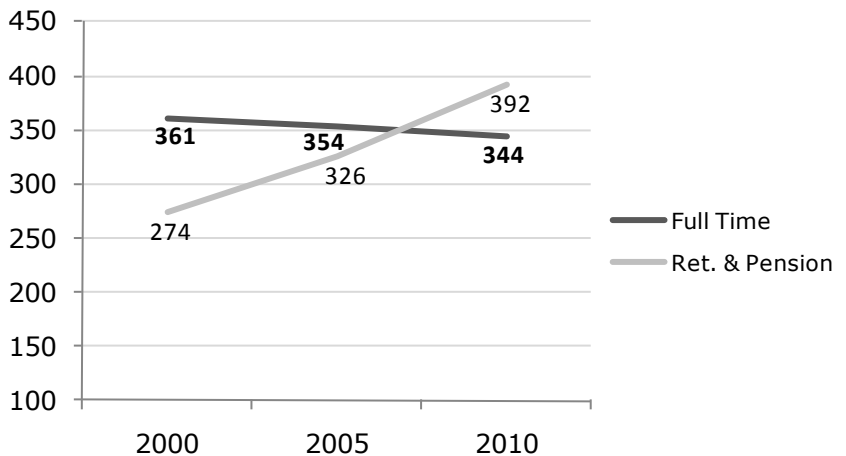
While the City has been diligent in working to contain employment related costs by freezing wages, reducing benefits, and benchmarking fiscal performance, recent economic conditions have required the organization to reduce staffing levels by eliminating positions. During the past five years total full-time employment has been reduced by 8%.



It remains important, however, to consider the fact that position reductions have not been implemented uniformly over the entire organization. In keeping with citizen priorities not a single uniformed public safety position has been eliminated. This action helps sustain Midland as a special and safe community but it also places tremendous pressure on service delivery processes employed by other departments. In fact, civilian workforce employment within the General Fund has been reduced 18% during this same five year period.

Legacy Costs

Employment costs are not driven exclusively by the number of active employees within the organization. Legacy costs associated with former employees also place pressure on the budget each year. Since 2000 the number full-time City of Midland employees has fallen below the number of retired employees as illustrated here.



The net effect of this change is that in 2000 retiree related expenses accounted for 19% of annual personnel spending. By 2009 this ratio had increased to 28% of annual personnel spending. In a

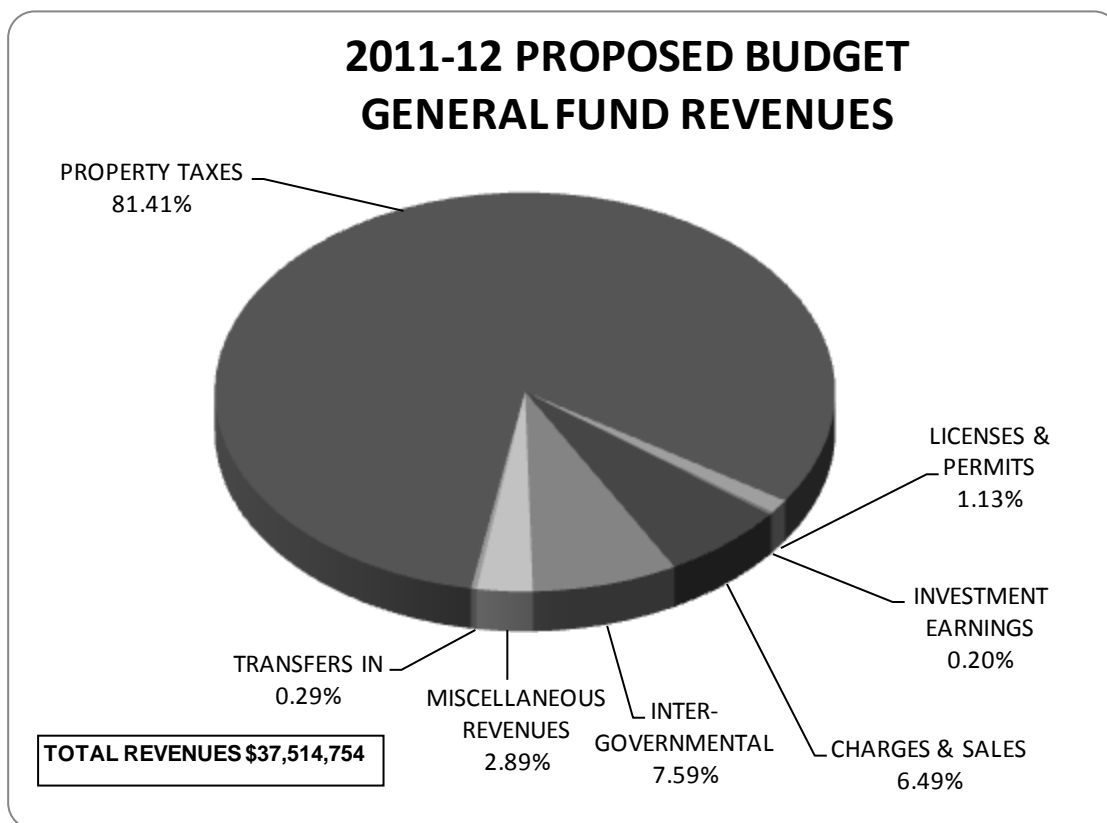
significant effort to control these costs the City’s civilian employee groups moved from defined benefit pension programs to defined contribution pension plans.

The City of Midland will continue to rigorously benchmark employment costs and work diligently to contain them.

FINANCIAL TRENDS

General Fund Revenues

The following chart indicates the various General Fund revenue sources for 2011-12 and the proposed relative percentage supplied by each.



Property Taxes: The City Council has authority for the 2011-12 fiscal year to levy a tax rate of up to 21.87 mills without a vote of the citizens, as indicated below:

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

**18 mills authorized by Charter have been reduced by the state constitution (Headlee Amendment) to 17.87 mills. The City may also levy taxes in excess of the Charter to meet annual minimum funding requirements for the police and fire pension system.*

The total millage rate proposed for 2011-12 is 14.79 mills, including 0.29 of a mill for voter-approved debt service. Also included for the first time is 1.06 mills for police and fire pension system minimum funding requirements as provided by Michigan Public Act 345. The proposed 2011-12 total millage rate of 14.79 mills is an increase of .85 mills over the 2010-11 millage rate of 13.94 mills.

The following table presents comparisons of the proposed property tax rate with those of preceding years:

Charter Operating Millage	2007-08	2008-09	2009-10	2010-11	2011-12
General Operations	9.49	11.49	12.54	12.55	12.31
Tax Appeal Reserve	1.34	-	-	-	-
Storm Water Management	<u>0.17</u>	<u>0.21</u>	<u>.13</u>	<u>.12</u>	<u>.13</u>
Subtotal	11.00	11.70	12.67	12.67	12.44
Library Operations - statutory	1.00	1.00	1.00	1.00	1.00
Public safety pension – statutory	-	-	-	-	1.06
<u>Voter Approved Debt Millage</u>					
Sanitary Sewer Improvement	<u>0.24</u>	<u>0.29</u>	<u>0.27</u>	<u>0.27</u>	<u>0.29</u>
TOTAL CITY MILLAGE	12.24	12.99	13.94	13.94	14.79

Rate of Growth of Property Tax Base: In preparing the City’s tax roll each year, the City Assessor is required to consider many factors that impact property valuation including but not limited to additions and deletions to property, reductions for depreciation and obsolescence, adjustments due to market conditions, and the effect of Proposal A on property held from the previous year. Proposal A (a 1994 amendment to the state constitution) requires that the increase in taxable value on held property be capped at the Consumer Price Index or 5%, whichever is less. For the 2011 tax year the Proposal A cap is 1.7%. As a result of all these factors, the City’s net taxable value increased by 1.85% from \$2,340,618,615 to \$2,383,993,240. Specific data from the City Assessor indicate that industrial property values increased 1.92%, utility property values increased 6.86%, commercial property values increased 10.56%, and residential property values increased .06%.

In May of 2009 Midland Cogeneration Venture (MCV), one of the City’s largest taxpayers, sold 100% of its interest in the company prompting the related property to become uncapped for valuation purposes in accordance with the General Property Tax Act (PA 206 of 1893). In order to determine the value for this property the City Assessor contracted with an independent appraiser and arrived at a value that increased the taxable value.

The taxpayer is not in agreement with this valuation increase and is appealing its values for the 2010 and 2011 tax years. The City continues to work with MCV to reach a resolution, but until such time that occurs, the City has determined it prudent not to consider the incremental revenue derived from the values under contention as available for budgeting purposes. As such, these contended values are excluded in calculating the Net Taxable Value for tax years 2010 and 2011, as reported in the table below. The table reports those values which are used to project property tax revenue. The reader will note that the table below provides for a 1.5% increase in Net Taxable Value from 2010 to 2011 while the amount reported above is 1.85%. Because some of the values included in the 1.85% increase are expected to be contended they are excluded from the table values, thereby causing the increase from 2010 to 2011 to be a smaller percentage.

The following table presents the City’s net taxable value for the recommended year, and previous five years:

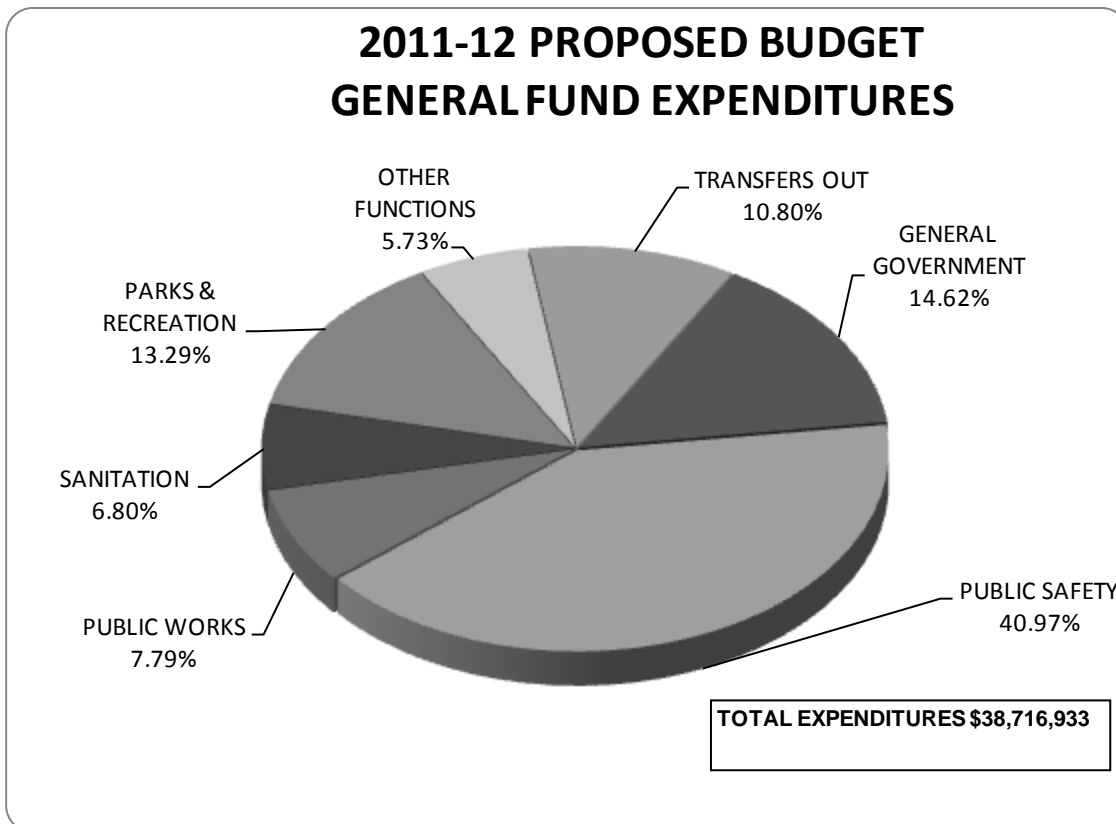
Fiscal Year	Tax Year	Net Taxable Value	% + (-)
June 30, 2007	2006	2,544,140,950	2.86
June 30, 2008	2007	2,548,121,750	0.16
June 30, 2009	2008	2,119,354,000	(16.83)
June 30, 2010	2009	2,183,920,628	3.05
June 30, 2011	2010	2,156,952,615	(1.23)
June 30, 2012	2011	2,189,389,240	1.50

State Shared Revenue: The state revenue sharing program distributes sales tax collected by the State of Michigan to local governments as unrestricted revenues. The most recently available revenue projections from the State include distributions to the City that are comparable to the \$2,773,615 previously budgeted by the City for 2010-11. The proposed budget for City’s 2011-12 General Fund includes \$2,750,000 for state shared revenue.

Investment Earnings: For the fourth consecutive year investment earnings will provide very little revenue stream to the City’s budgets. The City is expecting annualized returns of less than .5%.

General Fund Expenditures

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



The above pie chart categorizes each expense of the General Fund into the function, or service, it provides. Within each of these shaded areas of the pie chart expenses can be further classified into these sub-categories:

- Personal services: salaries, wages, and employee benefit costs
- Supplies: materials and other consumable products
- Other charges: purchased services and rental
- Capital outlay: large purchases or projects to be consumed over many years

Personal Services: Within the General Fund, the largest expense classification is personal services. Each year the City faces challenges during the budget process in searching for ways to control these costs through negotiating collective bargaining agreements, modifying benefit plans or exploring creative funding mechanisms. Like prior year budgets, the 2011-12 recommended budget must consider these same challenges. It includes a 7% increase in contributions to the defined benefit pension plan for non-police and fire employees, and a 6.5% increase in contributions to the police and fire defined benefit pension plan.

Health insurance costs for active employees are projected to increase by 4%. However, the City's annual required contribution to fund post-employment health benefits will decrease by 13.3% as actuarially determined by the most recent study.

In July of 2005 the City closed the defined benefit pension plan to all non police and fire new hires. This decision will result in higher contributions for the next several years until the plan is near fully funded status, expected to occur by year 2017. After such time, annual City savings will be significant as City contributions will be reduced to funding plan maintenance as opposed to plan benefit prefunding.

In an effort to control the overall cost of personal services the City makes it a priority to keep the number of employees to the minimal level required to provide the level of service requested by Citizens. In addition, positions are regularly evaluated to determine whether the proper staffing should be full-time or part-time. The 2011-12 City-wide proposed budget includes the elimination of four full-time positions and two part-time position, all which fully or partly funded by the General Fund budget. These staffing reductions are expected to save the City approximately \$400,000 during 2011-12.

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. Here are just a few:

- The impact of Michigan's continued economic struggles and Michigan Legislature on State Shared Revenue.
- Economic challenges posed to any of the City's larger taxpayers.
- Michigan Legislature's ongoing plans to change the State property tax structure and the methods by which taxpayers are able to appeal their taxable values.
- Property tax appeals by any of the City's largest taxpayers.

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 \$400,000 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 reserving \$1.5 million of unreserved General Fund fund balance in order to provide a cushion for more significant unbudgeted events. Credit rating

agencies as well as the City’s independent auditors have recommended that the City begin building its unreserved fund balance to further provide the City protection against future unfavorable budgetary situations. The existence of these safeguards of the City’s financial condition is considered by credit rating agencies in upholding the City’s favorable credit rating.

The proposed budget maintains a General Fund fund balance reserve for contingencies of \$1.5 million. In addition, an unreserved fund balance of \$2.7 million is projected to be available, if needed, for future unfavorable budgetary situations. Total fund balance is projected to be approximately \$4.2 million.

Other Activity

Water Fund: The 2011-12 recommended budget includes a 2% rate increase.

A summary of water rate increases over the last five years is shown in the table below:

<u>Year ending June 30</u>	<u>% increase</u>
2008	4%
2009	3.5%
2010	3%
2011	3%
2012	2%

Wastewater Fund: The 2011-12 Wastewater Fund budget includes a 0% rate increase.

A summary of wastewater rate increases over the last five years is shown in the table below:

<u>Year ending June 30</u>	<u>% increase</u>
2008	5%
2009	5%
2010	5%
2011	5%
2012	0%

The City has performed a neighborhood study to determine the capacity of neighborhood sanitary sewer systems. The results of the neighborhood study help identify the most appropriate method of increasing capacity of the system. This includes further sewer lining, selective removal of footing drains, and other options. The Wastewater Fund’s long range financial plans provides for working capital in excess of the goal that could be used to partially fund these improvements. However, complete implementation of the indentified improvements would likely involve additional rate increases for a pay-as-you-go approach, or the sale of a bond issue.

MAJOR BUDGET INITIATIVES

During its annual goal setting work session conducted in January the City Council revisited community values expressed via several citizen input methods including the 2005 community roundtables sessions, the 2008 citizen telephone survey, and the 2008 community roundtables sessions. Ultimately Council directed that the 2011-12 budget continue to preserve major services, protect public safety, and retain the City's unreserved fund balance. Key proposals contained in this proposed budget include:

Emerald Ash Borer Response

Emerald Ash Borer is an invasive exotic species of pest that is expected to kill roughly 7.5 billion ash trees across the United States. Of roughly 28,000 outlawn trees in the City, 20% are currently under attack and many have already been infested to the point of killing the host tree. The cost to remove and replace these 4,500 trees is estimated to be \$750 per tree or \$3.4 million. Treatment of trees is estimated to cost approximately \$40 per tree and lasts three years.

This budget includes \$500,000 to initiate a three year strategy addressing Emerald Ash Borer. In the first year roughly 500 street trees will be removed, 500 park trees will be planted, and 4,000 street trees will be treated. It is anticipated that ongoing removals and treatment will cost \$500,000 in each of the next two fiscal years.

Performance Measurement

Since the 2008-09 budget cycle the budget document has included basic performance data intended to give the user an accounting of not only how resources are utilized, but also how effectively they are utilized. Performance measurement provides a systematic approach to assessing service delivery quality and effectiveness while providing benchmarks useful in improving services and their delivery.

This budget includes \$16,500 for participation in the International City and County Management Association Center for Performance Measurement. Participating will allow for tracking Midland performance against itself, and Midland with other member cities over time.

In addition to being provided access to best practices reports on communities who are in the top percentile of service areas, this endeavor will also include administration of the National Citizens Survey which measures citizen satisfaction regarding community and services and helps identify community priorities. This survey instrument will produce an updated view of citizen expectations.

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. In addition, the entire document can be viewed on the City's web site, www.midland-mi.org.

We wish to remind Councilmen of the following public hearings and budget study work session that were set by Council. These meetings will be televised on MGTV, Cable Channel 96, to provide our citizens with as many opportunities as possible to view and participate in the City's budget process.

- Monday, April 18, 2011 – City Council budget work session (special meeting).
- Monday, April 25, 2011 – preliminary public hearing on proposed budget (regular meeting).
- Monday, May 9, 2011 – charter required public hearing on proposed budget (regular meeting).
- Monday, May 23, 2011 – charter mandated date for adoption of the budget by City Council (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 12, 2011.

Respectfully submitted,



Jon Lynch, AICP ICMA-CM
City Manager

