

City of Midland, Michigan

Management's Discussion and Analysis

CITY OF MIDLAND, MICHIGAN MANAGEMENT'S DISCUSSION AND ANALYSIS Year Ended June 30, 2006

As management of the City of Midland (the "City"), we offer readers of the City's financial statements this narrative overview and analysis of the financial activities of the City for the fiscal year ended June 30, 2006. We encourage readers to consider the information presented here in conjunction with additional information that we have furnished in our letter of transmittal, the financial statements, and the notes to the financial statements.

Financial Highlights

The assets of the City exceeded its liabilities at the close of the most recent fiscal year by \$182,496,116. Of this amount, \$36,517,334 (unrestricted net assets) may be used to meet the government's ongoing obligations to citizens and creditors.

The government's total net assets increased by \$5,947,920 during the fiscal year. Governmental activities accounted for \$706,509 of this increase, while business-type activities accounted for \$5,241,411. The increase was mostly due to positive operating results in each of the City's three largest enterprise funds.

At the end of the current fiscal year, the City's governmental funds reported combined ending fund balances of \$53,699,044, a decrease of \$2,887,370 in comparison with prior year. Approximately 72 percent of this total or \$38,260,965 is reserved for various purposes. Of the remaining unreserved balance, \$3,758,299 is designated for specific purposes, leaving an unreserved, undesignated balance of \$11,162,354.

At the end of the current fiscal year, unreserved fund balance for the General Fund was \$5,392,288, or approximately 15 percent of total General Fund expenditures (including transfers).

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the City's basic financial statements. The City's basic financial statements are comprised of three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains required supplemental information and other supplemental information in addition to the basic financial statements themselves.

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Management's Discussion and Analysis (Continued)

Government-wide Financial Statements

The government-wide statements are designed to provide readers with a broad overview of the City's finances, in a manner similar to a private sector business.

The statement of net assets presents information on all of the City's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the City is improving or deteriorating.

The statement of activities presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (for example, earned but unused vacation leave).

Both of the government-wide financial statements distinguish functions of the City that are principally supported by taxes and intergovernmental revenues (governmental activities) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (business-type activities). The governmental activities of the City include general government, public safety, public works (highways and streets and other services), community development, sanitation, parks and recreation, library, airport, transportation, tax appeal defense, interest and agent fees, and other functions. The business-type activities of the City include a regional water distribution system, a wastewater collection system, a sanitary landfill, a golf course, a civic arena, parking, and real estate rental (primarily two senior citizen housing facilities).

The government-wide financial statements can be found on pages 12 through 14 of this report.

Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City, like other state or local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the City can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

Governmental Funds - Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on the near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

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Management's Discussion and Analysis (Continued)

Because the focus on governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The City maintains 14 individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the General Fund and the Major Street Fund, both of which are considered to be major funds. Data from the other 12 governmental funds are combined into a single, aggregated presentation. Individual fund data for each of these nonmajor governmental funds is provided in the form of combining statements elsewhere in this report.

The City adopts an annual budget for each of its governmental funds, except for the Cemetery and Capital Projects Funds. Budgetary comparison statements have been provided herein to demonstrate compliance with those budgets.

The basic governmental fund financial statements can be found on pages 15 through 18 of this report.

Proprietary Funds - The City maintains two different types of proprietary funds. Enterprise Funds are used to report the same functions presented as business-type activities in the government-wide statements. The City uses Enterprise Funds to account for water distribution, wastewater collection, sanitary landfill operations, civic arena operations, downtown parking, senior citizen housing, and golf course operations. Internal Service Funds are an accounting device used to accumulate and allocate costs internally among the City's various functions. The City uses Internal Service Funds to account for equipment and fleet operations, data processing services, geographic information system services, general and liability insurance, special assessment project funding, and bus garage operations.

Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The proprietary fund financial statements provide separate information for the Water, Wastewater, Real Estate Rental, Sanitary Landfill, and Civic Arena Funds, which are considered to be major funds of the City. The remaining Enterprise Funds and the Internal Service Funds are each combined into a single aggregated presentation in the proprietary fund financial statements. Individual fund data for the remaining Enterprise Funds and the Internal Service Funds is provided in the form of combining statements elsewhere in this report.

The basic proprietary fund financial statements can be found on pages 19 through 28 of this report.

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Management's Discussion and Analysis (Continued)

Fiduciary Funds - Fiduciary funds are used to account for the resources held for the benefit of parties outside the government. Fiduciary funds are not reflected in the government-wide financial statements because the resources of those funds are not available to support the City's own programs

Notes to the Financial Statements - The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

Other Information - In addition to the basic financial statements and accompanying notes, this report also presents certain required supplemental information concerning the City.

The combining statements referred to earlier in connection with nonmajor governmental funds, nonmajor Enterprise Funds, and Internal Services Funds are presented immediately following the required supplemental information.

Governmental-wide Financial Analysis

Statement of Net Assets

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the City, assets exceeded liabilities by \$182,496,116 at the close of the most recent fiscal year.

The largest portion of the City's net assets (73 percent) reflects its investment in capital assets (e.g., land, buildings, vehicles, equipment, and infrastructure), less any related debt used to acquire those assets that are still outstanding. The City uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the City's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the City's net assets (7 percent) represents resources that are subject to external restrictions on how they are to be used. The remaining balance of unrestricted net assets (\$36,517,334) may be used to meet the government's ongoing obligations to citizens and creditors.

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Management's Discussion and Analysis (Continued)

City of Midland's Net Assets (in 1,000's of dollars)

	Governmental Activities		Business-type Activities		Total	
	2006	2005	2006	2005	2006	2005
Assets						
Current and other assets	\$ 62,766	\$ 67,955	\$ 32,099	\$ 32,053	\$ 94,865	\$ 100,008
Capital assets	48,552	50,820	113,263	103,751	161,815	154,571
Total assets	111,318	118,775	145,362	135,804	256,680	254,579
Liabilities						
Current liabilities	26,311	9,228	4,352	4,378	30,663	13,606
Long-term liabilities	15,412	40,659	28,109	23,766	43,521	64,425
Total liabilities	41,723	49,887	32,461	28,144	74,184	78,031
Net Assets						
Invested in capital assets -						
Net of related debt	47,046	42,571	86,214	80,266	133,260	122,837
Restricted	11,499	11,840	1,219	1,219	12,718	13,059
Unrestricted	11,050	14,477	25,468	26,175	36,518	40,652
Total net assets	<u>\$ 69,595</u>	<u>\$ 68,888</u>	<u>\$ 112,901</u>	<u>\$ 107,660</u>	<u>\$ 182,496</u>	<u>\$ 176,548</u>

Statement of Activities

The government's total net assets increased by \$5,947,920 during the current fiscal year. Governmental activities accounted for \$706,509 of this increase, while business-type activities accounted for \$5,241,411. The increase was mostly due to positive operating results in each of the City's three largest Enterprise Funds.

Governmental Activities

As mentioned above, governmental activities increased the City's net assets by \$706,509 compared to an increase of \$9,589,153 for 2004-05. Last year's increase was mostly as a result of a reclassification of tax appeal reserve dollars. There is more discussion on tax appeal reserves in Note 17 of the notes to financial statements.

Tax appeal defense expenditures decreased by \$4,474,712 compared to 2004-05. The City experienced significantly less trial time in 2005-06 as a result of having recently settled one of the three major appeals, and having the other two cases in between court dates. Again, there is more discussion on the tax appeals in Note 17 of the notes to financial statements.

General government and public works expenditures increased by \$1,036,634 and \$1,400,397, respectively, due to the completion of several projects during the year that were expensed because they did not meet the threshold for capitalization, and an increase in depreciation expense resulting from the capitalization of projects over the past three years.

City of Midland, Michigan

Management's Discussion and Analysis (Continued)

City of Midland Changes in Net Assets (in 1,000's of dollars)

	Governmental Activities		Business-type Activities		Total	
	2006	2005	2006	2005	2006	2005
Revenue						
Program revenue:						
Charges for services	\$ 3,246	\$ 3,757	\$ 21,619	\$ 20,040	\$ 24,865	\$ 23,797
Operating grants and contributions	5,455	5,225	-	-	5,455	5,225
Capital grants and contributions	2,035	2,594	1,458	1,138	3,492	3,732
General revenue:						
Property taxes	27,672	37,178	-	-	27,672	37,178
Intergovernmental	3,667	3,654	-	-	3,667	3,654
Investment earnings	2,947	1,567	1,082	634	4,029	2,200
Other revenue (expense)	46	309	18	(47)	64	262
Total revenue	<u>45,068</u>	<u>54,284</u>	<u>24,177</u>	<u>21,765</u>	<u>69,245</u>	<u>76,048</u>
Program Expenses						
General government	4,099	3,063	-	-	4,099	3,063
Public safety	11,684	10,988	-	-	11,684	10,988
Public works	6,476	5,075	-	-	6,476	5,075
Community development	643	403	-	-	643	403
Sanitation	2,368	2,088	-	-	2,368	2,088
Parks and recreation	3,546	3,893	-	-	3,546	3,893
Library	3,819	4,407	-	-	3,819	4,407
Transportation	1,698	1,517	-	-	1,698	1,517
Tax appeal defense	1,977	6,452	-	-	1,977	6,452
Other functions	4,640	4,786	-	-	4,640	4,786
Interest on long-term debt	13	192	-	-	13	192
Water	-	-	8,992	8,246	8,992	8,246
Wastewater	-	-	5,157	5,260	5,157	5,260
Landfill	-	-	2,411	3,483	2,411	3,483
Golf course	-	-	1,019	919	1,019	919
Parking system	-	-	147	154	147	154
Real estate rental	-	-	3,119	2,991	3,119	2,991
Civic arena	-	-	1,489	-	1,489	-
Total program expenses	<u>40,963</u>	<u>42,864</u>	<u>22,334</u>	<u>21,053</u>	<u>63,297</u>	<u>63,917</u>
Increase in net assets before transfers	4,105	11,420	1,843	712	5,948	12,131
Transfers	(3,398)	(1,831)	3,398	1,831	-	-
Change in Net Assets	707	9,589	5,241	2,543	5,948	12,131
Net assets - beginning	68,888	59,299	107,660	105,117	176,548	164,416
Net assets - ending	<u>\$ 69,595</u>	<u>\$ 68,888</u>	<u>\$ 112,901</u>	<u>\$ 107,660</u>	<u>\$ 182,496</u>	<u>\$ 176,547</u>

City of Midland, Michigan

Management's Discussion and Analysis (Continued)

Business-type Activities

Business-type activities increased the City's net assets by \$5,241,411. Key elements follow:

As of July 1, 2005, the Civic Arena was transferred from an operation of the General Fund to a separate Enterprise Fund. As a result, business-type activities included \$2,177,312 in net assets that would be previously reported as governmental.

Consistent with each fund's business plan for the year, the Water, Wastewater, and Sanitary Landfill Funds each posted positive operating results of over \$1 million.

Financial Analysis of the Governments Funds

As noted earlier, the City uses fund accounting to ensure and demonstrate compliance with finance-related requirements.

Governmental Funds - The focus of the City's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the City's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the City's governmental funds reported combined ending fund balances of \$53,699,044, a decrease of \$2,887,370 from the prior year. Approximately 28 percent of this total amount (\$14,920,653) constitutes unreserved fund balance, which is available for spending at the government's discretion. The remainder of the fund balance is reserved to indicate that it is not available for new spending because it has already been committed to a variety of restricted purposes, with the largest reserve being for tax appeals (\$31,880,453). See Note 17 in the notes to the financial statements section of this report for more information on the tax appeals.

The General Fund is the chief operating fund of the City. At the end of the current fiscal year, unreserved fund balance of the General Fund was \$5,392,288, or 14 percent of total General Fund expenditures. The fund balance of the City's General Fund decreased by \$2,674,762 during the current fiscal year. This is mainly due to a reduction in the fund balance tax appeal reserve, as discussed in Note 17 of the notes to financial statements.

The Major Street Fund was also a major fund of the City. At the end of the current fiscal year, its unreserved fund balance was \$6,410,164. Its fund balance decreased by \$392,160 resulting from the expending of funds on many projects completed during the year.

Proprietary Funds - The City's proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail.

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Management's Discussion and Analysis (Continued)

The Enterprise Funds operations for the current year resulted in an increase to net assets of \$5,133,040. The Water and Wastewater Funds had increases of \$1,105,231 and \$1,311,450, respectively. Both of these funds set their user fees to allow accumulation of reserves for capital investment and debt service. The increase in net assets reflects the result of this process. The Sanitary Landfill Fund also had an increase in net assets of \$1,033,804. This was a planned increase to accumulate funding for future cell development. The Real Estate Rental Fund had a planned decrease of \$270,001. The Real Estate Rental Fund is comprised mainly of two senior housing facilities. The annual operating plans for these facilities set revenue rates to cover all annual operating costs. They do not provide excess revenue to contribute to a sinking fund for facility replacement. As such, this fund typically shows an annual reduction to net asset in an amount similar to the depreciation expense for that year.

General Fund Budgetary Highlights

Differences between the original budget and the final budget were minimal. In general, total revenues and transfers in were greater than budgeted, and expenditures and transfers out were less than budgeted. Sanitation expenditures were over budget by \$110,902 in the area of heavy refuse collection. Severe ice storms in February and March caused lengthy power outages and severe damage to trees and structures within the city.

This caused an increased amount of heavy refuse as well as a prolonged period of time for removal-generated unanticipated labor and equipment rental costs.

Capital Asset and Debt Administration

The City's investment in capital assets for its governmental and business-type activities as of June 30, 2006 amounts to \$161,815,017 (net of accumulated depreciation). This investment in capital assets includes land, land improvements, buildings, systems, machinery and equipment, streets, bridges, sidewalks, and library circulation materials. Notes 1 and 5 provide additional information regarding the City's capital assets.

City of Midland Capital Assets
(in 1,000s of dollars)

	<u>Governmental Activities</u>		<u>Business-type Activities</u>		<u>Total</u>	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Land	\$ 3,417	\$ 3,369	\$ 2,317	\$ 2,317	\$ 5,734	\$ 5,686
Construction in progress	4,565	14,040	1,290	976	5,855	15,016
Assets being depreciated, net of accumulated depreciation	40,570	33,411	109,656	100,457	150,226	133,868
Total	<u>\$ 48,552</u>	<u>\$ 50,820</u>	<u>\$ 113,263</u>	<u>\$ 103,750</u>	<u>\$ 161,815</u>	<u>\$ 154,570</u>

City of Midland, Michigan

Management's Discussion and Analysis (Continued)

Long-term Debt

At the end of the current fiscal year, the City had total bonded debt outstanding of \$27,224,063. Of this amount, \$22,604,063 comprises debt backed by the full faith and credit of the government. The remainder of the City's debt is backed solely by specified revenue sources.

	Governmental Activities		Business-type Activities		Total	
	2006	2005	2006	2005	2005	2005
General obligation bonds	\$ 175	\$ 6,750	\$ 22,429	\$ 17,709	\$ 22,604	\$ 24,459
Revenue bonds	-	-	4,620	5,775	4,620	5,775
Total	<u>\$ 175</u>	<u>\$ 6,750</u>	<u>\$ 27,049</u>	<u>\$ 23,484</u>	<u>\$ 27,224</u>	<u>\$ 30,234</u>

The City maintains an AA rating with Standard and Poor's and an A1 rating with Moody's for the issuance of general obligation debt.

State statutes limit the amount of general obligation debt a government entity may issue to 10 percent of its total equalized valuation. Currently, 10 percent of equalized valuation is approximately \$280 million.

Economic Factors and Next Year's Budgets and Rates

The State of Michigan continues to struggle economically. The City's budget for 2006-07 includes conservative forecasts for state-shared revenue, expecting to receive approximately \$900,000 less than in 2000-01.

An additional 1.7 mills will be levied for the property tax appeal reserve, causing the total millage to increase to 12.10 mills. See Note 17 for more discussion on the tax appeal reserve.

Water and sewer rates each will increase by approximately 4 percent to keep pace with inflation and provide adequate funding for long-range capital planning.

Requests for Information

This financial report is designed to provide a general overview of the City's finances for all those with an interest in the government's finances. Questions concerning the information provided in this report or requests for additional financial information should be addressed to the Finance Department at the Midland City Hall, 333 W. Ellsworth Street, Midland, MI 48640. Finance Department staff can be reached at 989-837-3322 or at cityhall@midland-mi.org. Additional information can be obtained at the City's website, www.midland-mi.org.