

City of Midland, Michigan

Management's Discussion and Analysis

CITY OF MIDLAND, MICHIGAN MANAGEMENT'S DISCUSSION AND ANALYSIS Year ended June 30, 2008

This section of the City of Midland's annual financial report presents our discussion and analysis of the City's financial performance during the fiscal year that ended June 30, 2008. Please read it in conjunction with the transmittal letter, which was provided earlier in this report, and the financial statements which begin on page 11 of this report.

FINANCIAL HIGHLIGHTS

- The assets of the City exceeded its liabilities at the close of the most recent fiscal year by \$208.1 million. Of this amount \$22.4 million (unrestricted net assets) may be used to meet the government's ongoing obligations to citizens and creditors. This is made up of \$24.5 million in business-type activities, and a deficit of \$2.1 million for governmental funds, due to the settlement of a multi-year tax appeal with the City's then largest tax payer. Information on this settlement is explained further below and in Note 17 in the notes to financial statements.
- The City's total net assets decreased by \$9 million during the fiscal year. Governmental activities decreased by \$10.2 million while business-type activities increased by \$1.2 million.
- At the end of the current fiscal year, the City's governmental funds reported combined ending fund balances of \$35.9 million, a decrease of \$10.6 million in comparison with prior year. Approximately 59% of this total, or \$21.2 million is reserved for various purposes. Of the remaining unreserved balance, \$4 million is designated for specific purposes, leaving an unreserved, undesignated balance of \$10.6 million.
- At the end of the current fiscal year, unreserved fund balance for the General Fund was \$8.5 million or 18 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 supplementary information and other supplementary 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. The statement of activities presents all of the City's revenues and expenses, and is reported based on when the underlying event giving rise to the revenue or expense occurs, regardless of when cash is received or paid.

The government-wide statements of the City of Midland are divided into two categories:

Governmental Activities - Most of the City's basic services are included here, such as police, fire, public works, sanitation, parks and recreation, community development, library, transportation, and general administration. Property taxes, state-shared revenue, and charges for services finance most of these activities.

Business-type Activities - The City charges fees to customers to recover all or a significant portion of certain services it provides. These business-type activities include water distribution, wastewater collection, landfill, golf course, civic arena, and senior citizen housing.

Fund Financial Statements

The fund financial statements provide more detailed information about the City's most significant funds, not the City as a whole. 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 of Midland has three types of funds:

Governmental Funds - Many of the City's basic services are included in governmental funds which focus on how cash and other financial assets that can be readily converted into cash flow in and out. The funds also show the balances left at year end that are available for spending.

The governmental funds focus on a short-term view, rather than the long-term focus of the government-wide statements, so additional information is provided after each of the governmental fund statements that explain the relationship or differences between the fund and government-wide statements.

The City maintains 14 individual governmental funds. Separate information is presented 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, considered to be "nonmajor" 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.

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Management's Discussion and Analysis (Continued)

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.

Proprietary Funds - Proprietary funds are used to report services where the City charges a fee to the customer to recover most or all of the cost of the service rendered. Proprietary funds provide both long- and short-term financial information. The two types of proprietary funds are enterprise and internal service funds.

- Enterprise Funds and business-type funds are the same, but the fund statements provide more detail and additional information such as cash flows.
- Internal Service Funds are used to report activities that provide supplies and services to the City's other programs. Examples of internal service funds include the Equipment Revolving Fund and the Data Processing Fund.

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.

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 supplementary 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 supplementary information.

City of Midland, Michigan

Management's Discussion and Analysis (Continued)

The City of Midland as a Whole

The City's total combined net assets for the fiscal year ended June 30, 2008 is \$208.1 million, made up of \$119.2 million in business-type activities, and \$88.9 million in governmental activities.

Combined unrestricted net assets, the part of net assets that can be used to finance day-to-day operations, is \$22.4 million. Business-type activities unrestricted total is \$24.5 million, while governmental activities has an unrestricted deficit of \$2.1 million. The governmental activity deficit is the result of settling a multi-year tax appeal with the City's then largest tax payer. The settlement was final in April 2008, with the refund due to the taxpayer in July 2008. The City's refund obligation was \$36.3 million, with \$18.7 million being paid from existing funds and \$17.6 million coming from judgment bonds which were issued in July 2008. Because the refund liability was much larger than anticipated, the governmental-type unrestricted net assets decreased from \$9.2 million in 2007 to a \$2.1 million deficit.

The City will implement budgetary strategies to fund future debt payments and restore the City's reserves. As this will be a multi-year plan, it may take more than one year to eliminate the unrestricted net asset deficit. In the notes to financial statements, see Note 17 for more detail on the tax appeal and Note 9 for more detail on the judgment bonds.

This also explains the shift from long-term to current liabilities, as well as the general increase in liabilities for the governmental activities, when compared to 2007.

The following table shows comparisons of total assets, total liabilities, and total net assets (in millions) in a condensed format as of June 30, 2008 and 2007.

	Governmental Activities		Business-type Activities		Total	
	2008	2007	2008	2007	2008	2007
Assets						
Current and other assets	\$ 50.7	\$ 57.0	\$ 31.0	\$ 34.0	\$ 81.7	\$ 91.0
Capital assets	83.9	81.6	115.1	113.8	199.0	195.4
Total assets	134.6	138.6	146.1	147.8	280.7	286.4
Liabilities						
Current liabilities	43.2	21.1	3.8	4.7	47.0	25.8
Long-term liabilities	2.5	18.4	23.1	25.1	25.6	43.5
Total liabilities	45.7	39.5	26.9	29.8	72.6	69.3
Net Assets						
Invested in capital assets -						
Net of related debt	82.9	80.4	93.5	89.7	176.4	170.1
Restricted	8.1	9.5	1.2	1.2	9.3	10.7
Unrestricted	(2.1)	9.2	24.5	27.1	22.4	36.3
Total net assets	\$ 88.9	\$ 99.1	\$ 119.2	\$ 118.0	\$ 208.1	\$ 217.1

City of Midland, Michigan

Management's Discussion and Analysis (Continued)

The City's combined total net assets decreased by \$9 million during the current fiscal year. Governmental activities decreased by \$10.2 million while business-type activities increased by \$1.2 million.

Governmental Activities

As mentioned previously, governmental activities net assets decreased by \$10.2 million, primarily related to the settlement of a multi-year tax appeal. This accounts for the \$12.6 million increase in the tax appeal defense costs, which also explains virtually all of the increase in total expenses from last year to this year.

Total revenues decreased by \$2.5 million. Investment earnings were less due to the declining rates in the investment market, and the City receiving fewer capital contributions during the current year, when compared to last year.

Business-type Activities

Net assets for business-type activities increased by \$1.2 million during the year ended June 30, 2008, compared to a \$5.1 million increase last year.

Revenue decreased by \$3.2 million, primarily due to receiving grants from local foundations in 2007 to fund new construction at the Golf Course and Civic Arena.

Expenses for each business-type activity increased, with the total increasing by 3 percent. This is attributable to inflation and contractual increases connected with collective bargaining agreements.

The following table shows the comparison of the change in net assets (in millions) in a condensed format as of June 30, 2008 and 2007.

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Management's Discussion and Analysis (Continued)

City of Midland Changes in Net Assets (in millions of dollars)

	Governmental		Business-type		Total	
	Activities		Activities			
	2008	2007	2008	2007	2008	2007
Revenue						
Program revenue:						
Charges for services	\$ 3.7	\$ 3.4	\$ 23.0	\$ 23.7	\$ 26.7	\$ 27.1
Operating grants and contributions	5.3	5.7	0.1	2.4	4.4	8.1
Capital grants and contributions	2.3	3.6	0.7	0.9	3.0	4.5
General revenue:						
Property taxes	33.6	33.7	-	-	33.6	33.7
Intergovernmental	3.5	3.5	-	-	3.5	3.5
Investment earnings	2.4	3.4	0.8	0.9	3.2	4.3
Other revenue	0.1	0.1	0.2	0.1	0.3	0.2
Total revenue	50.9	53.4	24.8	28.0	75.7	81.4
Program Expenses						
General government	3.8	4.2	-	-	3.8	4.2
Public safety	13.4	13.5	-	-	13.4	13.5
Public works	9.2	9.9	-	-	9.2	9.9
Community development	1.0	1.0	-	-	1.0	1.0
Sanitation	2.5	2.4	-	-	2.5	2.4
Parks and recreation	3.0	3.8	-	-	3.0	3.8
Library	4.4	4.4	-	-	4.4	4.4
Transportation	1.7	1.8	-	-	1.7	1.8
Property tax appeals	20.8	8.2	-	-	20.8	8.2
Airport/other functions	0.3	0.3	-	-	0.3	0.3
Interest on long-term debt	-	-	-	-	-	-
Water	-	-	9.0	9.0	9.0	9.0
Wastewater	-	-	5.9	5.8	5.9	5.8
Landfill	-	-	2.8	2.7	2.8	2.7
Golf course	-	-	1.5	1.1	1.5	1.1
Parking system	-	-	0.2	0.2	0.2	0.2
Real estate rental	-	-	3.5	3.3	3.5	3.3
Civic arena	-	-	1.7	1.7	1.7	1.7
Total program expenses	60.1	49.5	24.6	23.8	84.7	73.3
Increase (Decrease) in Net Assets						
Before Transfers	(9.2)	3.9	0.2	4.2	(9.0)	8.1
Transfers	(1.0)	(0.9)	1.0	0.9	-	-
Change in Net Assets	(10.2)	3.0	1.2	5.1	(9.0)	8.1
Net Assets - Beginning of year	99.1	96.1	118.0	112.9	217.1	209.0
Net Assets - End of year	\$ 88.9	\$ 99.1	\$ 119.2	\$ 118.0	\$ 208.1	\$ 217.1

City of Midland, Michigan

Management's Discussion and Analysis (Continued)

The City of Midland's Funds

Analysis of the City of Midland's major funds begins on page 14, following the government-wide financial statements. The fund financial statements provide detailed information about the most significant funds, not the City as a whole. Funds are created to help manage money for specific purposes, as well as show accountability for certain activities, such as specific property tax millages and restricted receipts from federal and state sources.

The City's General Fund fund balance decreased by \$8.7 million to a balance of \$24.9 million. This decrease was due to the tax appeal settlement as discussed throughout this report.

The fund balance of the Major Street Fund decreased by \$1.9 million to a balance of \$4.9 million. This decrease was caused by a conscious decision to spend down fund balance to fund capital improvements during the year, as well as to fund excessive snow removal costs caused by the record level of snow the City received during the year.

General Fund Budgetary Highlights

Over the course of the year, the City amended the budget to take into account events during the year. The most significant amendments to the budget follow:

- Increase: \$13.7 million to pay a tax appeal refund to the City's then largest taxpayer. Detailed information on this settlement is provided in Note 17 of the notes to financial statements.
- Increase: \$1.8 million for unspent budget appropriations from 2007, encumbered into 2008.
- Decrease: \$1.45 million, identified during the mid-year budget amendment process consisting of \$1.2 million in ordinary budget savings, and \$.25 million from additional reductions implemented by department heads.

As a result, the General Fund original budget was increased by \$14 million during the year.

At year end, actual revenue exceeded budgeted by \$.58 million, mainly due to achieving better than anticipated investment results. Property tax appeal costs were less than budget by \$3.4 million due to settling a multi-year tax appeal with the City's then largest tax payer. Due to the settlement, the budgeted professional fees and court costs associated with the tax trial were avoided. Most other favorable budget variances are due to the timing of capital spending or delays in filling vacant positions.

City of Midland, Michigan

Management's Discussion and Analysis (Continued)

Capital Assets and Debt Administration

At June 30, 2008, the City of Midland had \$176.4 million invested in a broad range of capital assets including land, buildings, police and fire equipment, water and sewer lines, roads, sidewalks, and other infrastructure, net of debt. Last year this total was \$170.1 million. The increase is due to significant capital additions during the year, primarily in major streets, water system improvements, and landfill cell development, which exceeded depreciation expense for the year. Additional information about the City's capital assets is presented in Note 1 and Note 5 of the notes to financial statements.

At June 30, 2008, the City of Midland's total bonded indebtedness was \$21.7 million. Of this amount \$19.4 million 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.

In July 2008, the City issued \$17.9 million in judgment bonds as discussed in Notes 9 and 17 of the Notes to Financial Statements.

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. These ratings place Midland's debt in the range of investment grade bonds of high quality and upper medium quality, respectively.

Current Economic Events

As discussed elsewhere in this report, the tax appeal settlement with the Midland Cogeneration Venture resulted in not only a \$36.3 million tax refund liability, but also contributed to a 17 percent reduction in the City's taxable value for the 2008-2009 fiscal year, presenting a challenge to the City's ability to increase revenues through property taxes. The City is receiving \$1 million less in state-shared revenue than five years ago and there is no indication that this situation will improve.

The City of Midland balanced next year's General Fund budget by reducing departmental budgets, utilizing a portion of unreserved fund balance, and increasing millage by .75 mills, to a rate of 12.99 mills. Property values in the Midland area are expected to change very little in the near future, and the State's woes are expected to continue. The City will continue to exercise conservative budgeting strategies, remain focused on long-term objectives, and appeal to the public for input and support for future budgetary decisions.

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.