



MEMORANDUM

City Manager's Office

To: City Council
From: Jered Ottenwess, City Manager
Date: October 17, 2011
Re: FY2012 Budget Message

Summary

The City of Ishpeming has low property values and historically generated a very significant amount of revenue from specific ore taxes, which allowed the City to provide high levels of service that have become unaffordable as costs have risen disproportionately relative to property values and tax revenue. The City of Ishpeming organization faces two major systemic financial problems that must be overcome in order to achieve long term sustainability:

<u>Problem</u>	<u>Symptom</u>
1. Water and Sewer Fund revenue subsidizes General Fund activities.	Inability to invest in vital infrastructure because utility rates subsidize the General Fund instead.
2. A reliance on statutory revenue sharing subjects the organization to the whim of the state legislature.	Staffing levels and services are tied directly to political decisions made in Lansing.

Both problems have a common set of solutions: increase revenue or decrease costs. The Water and Sewer Fund can increase revenue by increasing rates. The General Fund cannot easily raise revenue. In fact, the General Fund is forced by amendments to the State of Michigan constitution to remain relatively stagnant. Therefore, the only feasible solution for the General Fund is to decrease costs, which means reducing staff levels.

This budget does not adequately address these systemic problems. Rather this is a stop gap budget, designed to stay the course in FY12 because there is a great deal of uncertainty associated with several critical factors that influence the broad trajectory of the budget, in particular, union bargaining agreements and interest revenue. However, the systemic problems must be addressed at some point. This budget works in that direction, but it falls far short of achieving structural change necessary for long term sustainability.

The gap between revenue and personnel costs - in spite of decreasing staff levels - persists (see chart below), although personnel costs are beginning to trend downward. Despite significant staff reductions in the past six (6) years, revenue has not kept pace with increasing costs. Several uncertainties will impact this in FY12:

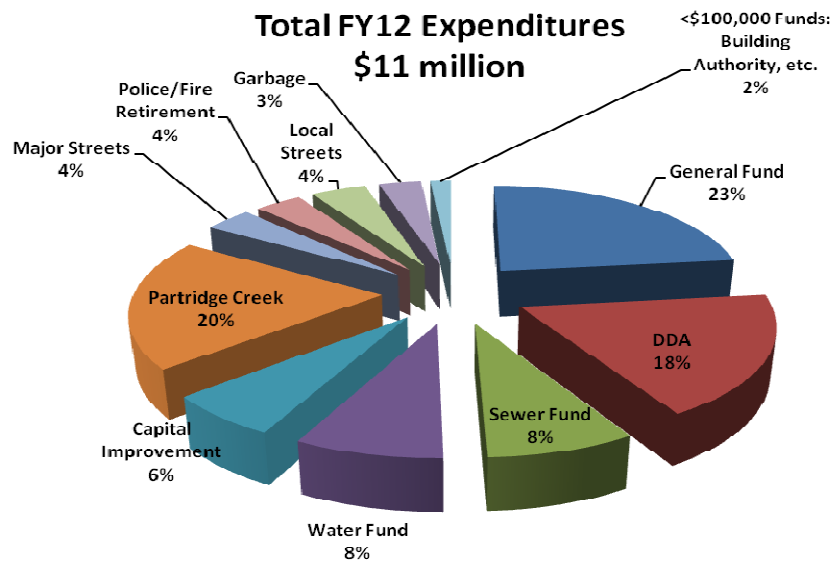
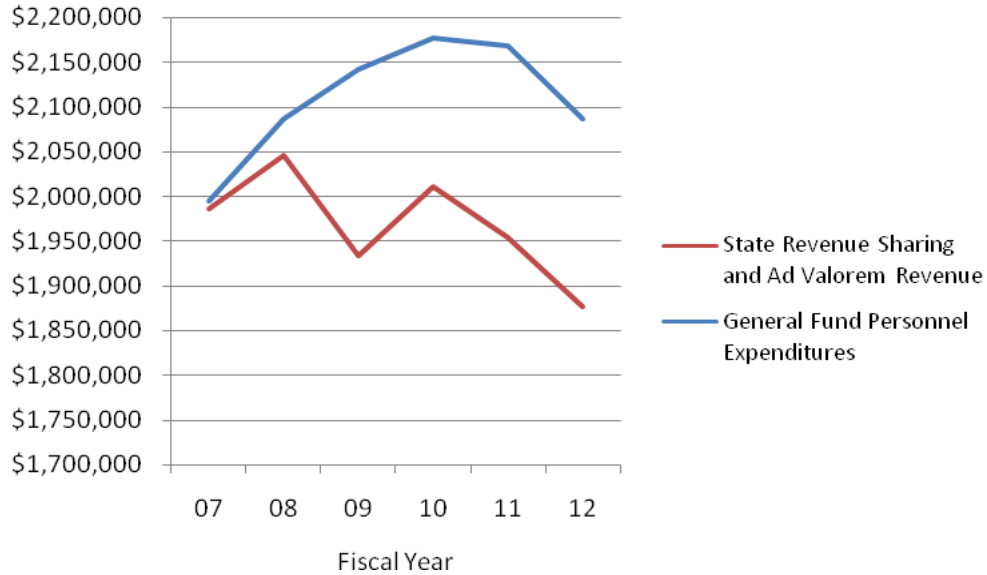
- ~ State revenue sharing that is tied directly to union bargaining agreements;
- ~ Union bargaining agreements that expire on December 31, 2012 may be subject to strict limitations on medical and pension benefit costs; and
- ~ Interest earnings have been very volatile recently and greatly influence revenue the City generates and required contributions for pension funds.

For these reasons, because of this uncertainty and pressure to restructure, I believe it is prudent and fiscally responsible to utilize fund balances in order to cover revenue shortfalls and increased costs for FY12. However, the City must develop a credible solution to its systemic problems in the coming year. Utilizing fund balances for routine operations is not a responsible long term management policy. I

strongly encourage the City Council to adopt a policy to address continued reliance on statutory revenue sharing for operating expenses.

Key features of the proposed FY12 Budget include:

- ~ Utilizes approximately \$50,000 of an expected General Fund Balance increase;
- ~ Utilizes approximately \$132,000 of the Public Improvement Fund balance;
- ~ Does not include any rate increases of any kind, utility or otherwise; and
- ~ Anticipates the loss of three (3) Department of Public Works (DPW) positions through attrition (retirements).



Note: two significant projects skew the typical breakdown of fund expenditures depicted here: Partridge Creek Diversion and DDA bond projects.

General Fund

Decreases in revenue sharing, limits on property tax collection, and increasing personnel costs continue to compel the City to become more efficient with existing staff. The FY12 Budget anticipates the loss of three (3) DPW positions through attrition (retirement). In order to achieve long-term sustainability - no reliance on Water and Sewer Fund subsidies or statutory revenue sharing - the General Fund will likely have to eliminate several more positions.

Target Fund Balance: \$500,000-\$1,000,000 (60-120 days operating expenses)

Beginning Fund Balance: \$509,594

Ending Fund Balance: \$458,409

Primary Revenue Assumptions:

- ~ 35% decrease in statutory revenue sharing – approximately \$113,000 reduction
- ~ Levy maximum millage rate = 18.8203
- ~ Maintain similar interfund transfer structure as in recent years
- ~ Decreased interest earnings, in particular from Cemetery Perpetual Care and Cemetery Care Funds

	2010		2011		Revenue +/-(-)
	Millage Rate	Tax Revenue	Millage Rate	Tax Revenue	
General Fund	13.4839	\$1,170,746	13.4433	\$1,169,972	\$(774)
Police/Fire Retirement	0.8988	\$78,037	0.8960	\$77,979	\$(58)
Public Improvement	<u>4.4946</u>	<u>\$390,246</u>	<u>4.4810</u>	<u>\$389,982</u>	<u>\$(264)</u>
	18.8773	\$1,639,029	18.8203	\$1,637,934	(\$1,096)

* figures may not sum exactly due to rounding

Primary Expenditure Changes:

- ~ Eliminate three (3) DPW positions through attrition
- ~ Reduce DPW Greaser position to part-time duties (and reassign to other duties as well)
- ~ One full-time DPW employee to serve Cemetery, with part-time supplement from other staff
- ~ Combine Police Chief/Detective position
- ~ Lower personnel costs at Library
- ~ Increased pension fund contributions (resulting, in large part, from poor investment performance)
- ~ Increased personnel costs associated with union wage increases

Implementation:

The FY12 Budget plans for the loss of three (3) positions through attrition. The DPW is approaching a critical threshold where any future loss of personnel will seriously compromise their ability to perform services that have become expected, such as snow plowing and hauling and park maintenance. Already, the likelihood that the DPW will be able to continue to perform demolitions is questionable.

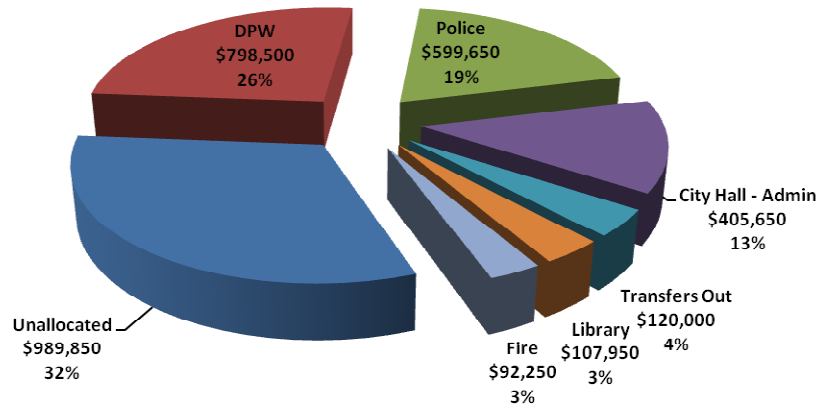
DPW continues to utilize an increasing amount of contracted services for repair and maintenance. The City does not have adequate facilities or equipment to properly service and repair heavy equipment. Therefore, the budget anticipates reducing personnel costs for repair and maintenance services. Actual implementation of this entails that the Mechanics and other positions will take on more greasing and fewer repair duties.

The DPW will also face pressure to properly maintain the Cemetery. Prison trustees are no longer available. Summer part time labor has been reduced by 50%. One full-time employee will be assigned to the Cemetery. The office will be closed during winter months.

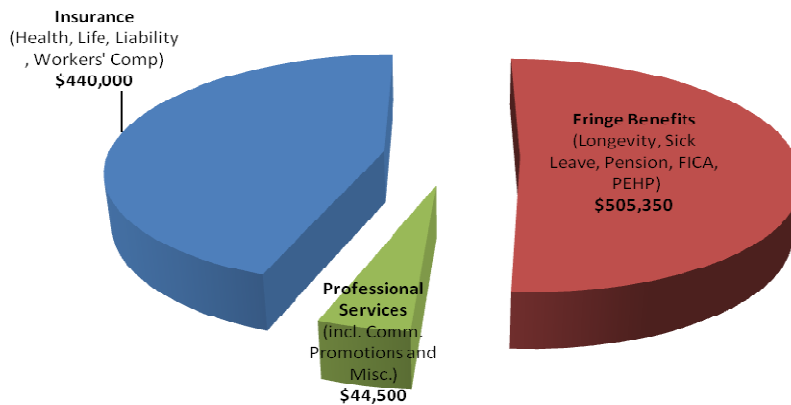
The savings that result from combining the Police Chief and Detective positions is offset, in part, by increasing personnel costs including overtime and pay increases in the union bargaining agreements.

The Library will have a new director, which will save costs because a new director will have a lower pay scale initially. The director starts at 80% of salary for the first six (6) months, 90% for the next, until reaching full salary after one (1) year pursuant to the Supervisory Unit bargaining agreement. The budget also plans for the Library to continue to be open forty (40) hours per week, which is a reduction of between five (5) to ten (10) hours from recent years.

FY12 General Fund Expenditures \$3.1 million



Unallocated Breakdown



Major and Local Street Funds

The proposed FY12 Major and Local Street Fund budgets are relatively status quo. As statutory revenue contributions decline, the General and Public Improvement Funds must subsidize (transfer) funds to maintain the Street Funds. So there is a direct link between winter and routine maintenance personnel costs and the General Fund's balance. The Street Funds cannot sustain their services with state (gas and weight tax) revenue alone.

Ray Roberts is scheduled to present a 5-year Capital Improvement Plan to City Council at the November regular meeting. The Plan recommends the most significant change to the Street Funds for the FY12 Budget: the addition of approximately \$200,000 funding for important road work, primarily milling and resurfacing failing roadways. This is a low-cost method for extending the life of roadways that have already failed or are on the verge of failing. Funding for this work comes from two proposed sources: (1) approximately one (1) mill or nearly \$100,000 from the Public Improvement Fund and (2) approximately one (1) mill or nearly \$100,000 from a special assessment fee on adjacent property owners who received a "special benefit" from the road work. It is speculative to estimate a cost per property owner for such a special assessment, but \$50-\$100 per year for ten (10) years has been a working assumption to date.

The Major Street Fund balance is presently in question as the Pine Street Phase II project is completed and the reimbursement process is currently underway. The reimbursement process from the Michigan Department of Transportation - the funding agency for the project - is cumbersome and directly affects the year end fund balance.

Major Street Fund

Target Fund Balance: \$0

Beginning Fund Balance: \$51,573

Ending Fund Balance: \$3,908

Local Street Fund

Target Fund Balance: \$0

Beginning Fund Balance: \$17,198

Ending Fund Balance: \$4,663

Primary Revenue Assumption:

- ~ General Fund and Public Improvement Fund subsidy continuation
- ~ Public Improvement Fund transfer and special assessment to fund road repairs
- ~ Stagnant/decreasing gas/weight and snow fund revenue

Primary Expenditure Assumption:

- ~ Reduce and minimize winter maintenance overtime-related wages

Implementation:

The FY12 Budget will put pressure on DPW staff to closely monitor winter maintenance and adjust accordingly. I will continue to direct the DPW to reduce overtime services associated with Sunday plowing and overtime double-shifts. I intend to work closely with DPW staff to formulate strategies to accomplish this. Please keep in mind that the winter maintenance budgets are very similar to previous years, however, depending on the severity of the winter months, some modifications to standard practices may be necessary.

I strongly recommend that City Council take action immediately and direct the City Manager to begin the special assessment process so that road work can be completed in the 2012 construction season.

Garbage Fund

The FY12 Garbage Fund budget is status quo. The costs associated with this fund are paying for contracted services from North Country Disposal and personnel costs to operate the compost site, including monthly cleanups.

Target Fund Balance: \$60,000-\$120,000 (60-120 days operating expenses)

Beginning Fund Balance: \$654,626

Ending Fund Balance: \$740,326

Primary Revenue Assumption:

~ No rate increase

Primary Expenditure Change:

~ None

Implementation:

The proposed budget plans for personnel services to maintain the compost/yard waste function at the current recycling center site and monitor the monthly cleanup containers that are included within the garbage collection agreement – roll-off containers are provided on-site. The proposed budget accomodates approximately twelve (10) hours per week of staff time at the compost site.

Despite increasing costs built into the contract with North Country, a significant fund balance may allow the City to keep rate constants for the next several years, if not the duration of the contract, which expires December 31, 2015.

<\$100,000 Funds: Building Authority, etc.

Al Quaal Trails

DPW has requested some additional funding to complete the homologation process and continue preparing Al Quaal for national race events. I have recommended the additional \$13,600 of expenses for this as a transfer from Public Improvement Fund to General Fund - Al Quaal, rather than include this within the Al Quaal Trails Fund.

Building Authority

This fund continues to be used for bond payments associated with renovations at City Hall and the Fire Hall.

Community Development

Primary Expenditure Change:

~ Community Development increases in demolition funding from \$60,000 to \$100,000 may accommodate up to five (5) or more demolitions.

Implementation:

DPW may no longer be able to provide demolition services due to the lack of available staff.

Library State Aid

Surprisingly, there is a slight uptick in revenue from the State of Michigan for library services from about \$4,000 to \$6,000 as budgeted. This fund is used to pay for services from the Superior Library Cooperative, which helps provide low cost internet and other services.

Cemetery Care and Cemetery Perpetual Care Funds

These funds are used to generate interest revenues which help offset the cost of General Fund services necessary in order to operate the Cemetery. Revenues are down substantially due to the faltering U.S. and world economies.

Downtown Development Authority (DDA) Fund

The DDA is in the process of implementing several bond projects which total more than \$2.4 million and include infrastructure expansion along US 41, extension of Malton Road, improvements to entryways along US 41, sidewalk and streetscape improvements in the downtown area, and recreation improvements in Hematite Heights. As a result of the recent bond issue and previous debt obligations, the DDA plans to utilize approximately \$150,000 for annual operating expenses.

DDA routine expenditures include administration, promotions, and beautification. Promotions includes \$27,500 for Chamber of Commerce services. The DDA no longer employs an executive director. Instead, the DDA budget includes administrative expenses directly for the City Manager, City Manager's Secretary, and Treasurer. Beautification is carried out primarily through contracted services to maintain plantings and the downtown area in general.

Target Fund Balance: varies

Beginning Fund Balance: \$2,911,658

Ending Fund Balance: \$464,978

Primary Revenue Assumption:

~ Bond projects skew revenue figures

Primary Expenditure Change:

~ Limited operating expenditures, focus on bond projects

Implementation:

The bond projects will put pressure on City Hall staff to administer their implementation. Otherwise, the DDA plans to carry out similar activities for beautification and event promotion as in previous years.

Partridge Creek Fund

This fund is new in the FY12 Budget, the purpose of which is to implement projects for creek diversion. In FY12, that will include approximately \$2.57 million for engineering and construction activities associated with the Great Lakes Restoration Initiative grant award to begin storm sewer reconstruction.

Target Fund Balance: \$0

Beginning Fund Balance: \$568,373

Ending Fund Balance: \$0

Primary Revenue/Expenditure Assumption:

~ Revenue and expenditures solely related to bond issue and GLRI grant

Public Improvement Fund

More and more pressure has been placed on the PIF as transfers are made to prop up the Street Funds and special projects arise such as the Fire Hall, Partridge Creek, road capital improvements, and so on. Yet,

there continues to be demand for heavy equipment that the City must have to operate like snow plows and a street sweeper.

The proposed FY12 Public Improvement Fund (PIF) budget utilizes a portion of its fund balance in order to purchase a street sweeper (\$175,000) for DPW. If you eliminate that purchase from the budget, the PIF would be sustainable in that revenue would exceed expenditures. I believe the need for a street sweeper and other important projects compels using a portion of the existing fund balance. This is not a situation that should occur regularly.

Target Fund Balance: varies

Beginning Fund Balance: \$617,190

Ending Fund Balance: \$484,795

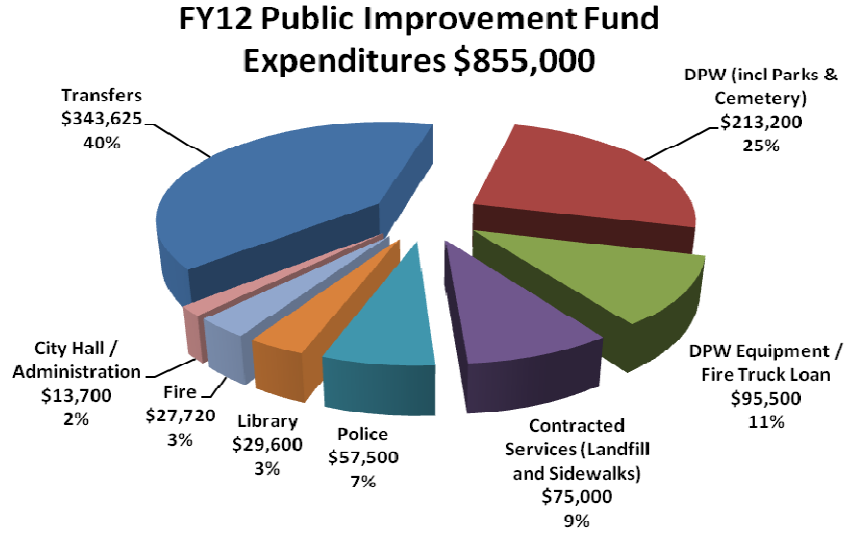
Primary Revenue Assumptions:

- ~ Continue 4.4 mills Public Improvement millage
- ~ Continue interfund transfers and PILT from Water and Sewer Funds

Primary Expenditures:

- ~ City Hall's climate control system needs repair (\$12,500) – since the \$1 million renovation in 2000 it has never functioned optimally. Its inefficiency is costly.
- ~ Police Department includes new Sport Utility Vehicle (\$50,000) - oldest SUV now has over 100,000 miles.
- ~ Fire Department budget includes only several, smaller items that may be offset by a grant that is currently being pursued.
- ~ Fire and Police Departments include \$7,500 each to pay for continuing the Fire Hall evaluation and study process.
- ~ DPW equipment includes a necessary attachment for the loader that purchased in FY11 (\$12,000); a street sweeper that is overdue for replacement (\$175,000); and miscellaneous equipment including safety gear for confined spaces (\$15,000).
- ~ \$50,000 for landfill fence
- ~ \$95,500 for bond payments
- ~ Transfers table:

<u>Transfer To</u>	<u>Amount</u>
General Fund	\$13,600
Major Streets Fund	\$35,000
Local Streets Fund	\$150,000
Building Authority	\$66,000
Partridge Creek	\$79,025
TOTAL	\$343,625



Sewer and Water Funds

The Sewer and Water Funds, especially Water, need a capital improvement plan, similar to the one prepared by Ray Roberts. These funds do not currently have the capacity to invest in capital projects. Funding for such projects can be accomplished by raising rates or creating a specific fee for infrastructure, or reducing costs such as PILT payments to the General and Public Improvement Funds. I strongly recommend that the City Council develops a viable plan to address this situation. Failure to do so will lead to a continued lack of investment. Ultimately, these systems will begin to fail, causing excessive water breaks and possibly even complete system failure. A viable plan should include revenue increases and cost decreases, gradually occurring through time.

The Michigan Rural Water Association (MRWA) conducted a rate study in 2011, recently completed and scheduled for presentation at the November regular City Council meeting. This study comes about after rates were increased in 2010 amidst complaints that there was not a substantive, objective analysis conducted in order to establish the current rates. MRWA has answered those complaints and they provide a defensible, logical, and credible method for creating a rate structure. I strongly encourage the City Council to implement their recommendations and establish a new rate structure immediately so that it can take effect for FY12. At a minimum the City Council should modify current ordinances in order to establish an automatic annual increase based on the Consumer Price Index (inflation).

Sewer Fund

The proposed FY12 budget is status quo. Please keep in mind that the FY11 Sewer Fund budget actually operates at a loss on a cash flow basis, excluding depreciation. The proposed FY12 budget continues this trend.

Target Fund Balance: asset accounting
Cash Flow w/o Depreciation (loss): (\$74,500)

Primary Revenue Assumption:
 ~ No rate changes

Primary Expenditure Change:
 ~ Increased treatment plant costs, approximately 3.5% increase

Water Fund

The proposed FY12 budget is status quo. Please keep in mind that the FY11 Water Fund budget actually operates at a loss on a cash flow basis, excluding depreciation. The proposed FY12 budget continues this trend.

Target Fund Balance: asset accounting
Cash Flow w/o Depreciation (loss): (\$45,000)

Primary Revenue Assumption:
~ No rate changes

Primary Expenditure Change:
~ Increased treatment plant costs, approximately 6.2% increase

Police/Fire Retirement Fund

Actuarial analyses determine the contribution that must be made in order to maintain this fund. Ideally, the fund would be able to pay out 100% of its liabilities if they all came due at one time. In reality, 80% funded is a more realistic goal, especially in the current economic environment, and one that the fund has maintained.

Target Fund Balance: asset accounting / 80%+
Beginning Fund Balance: \$4,179,053
Ending Fund Balance: \$3,934,153

Primary Revenue Assumption:
~ Status quo interest earnings and zero appreciation

Primary Expenditure Change:
~ Increased General Fund contributions from \$50,000 to \$71,250