



**MEMORANDUM**

*City Manager's Office*

**To:** City Council  
**From:** Jered Ottenwess, City Manager  
**Date:** October 15, 2012  
**Re:** FY2013 Budget Message

**SUMMARY**

The world and national economic outlook looks notably better than one year ago. Michigan's economic growth has outpaced the national economy. One result is that state revenue sharing has increased. We expect investment returns to start increasing again. Generally speaking, the worst results of the 2008-2009 Great Recession are starting to subside. However, the City of Ishpeming's long-term financial sustainability is still in jeopardy. Multiple systemic problems persist:

<u>Problem</u>	<u>Consequence</u>
Sewer and Water Funds revenue subsidizes General Fund activities and metered sales are declining.	~ Sewer and Water Funds continue to operate with negative cash flow. ~ City is unable to invest in vital infrastructure.
General Fund revenue is stagnant while costs continue to rise.	~ Maintaining the same workforce and providing the same levels of service cost more. ~ Despite significant reductions to workforce through attrition, costs are outpacing revenue.

If these problems are not addressed promptly and decisively, the City's Sewer and Water Funds are at risk of no longer being able to support the General Fund within several years. The City Council should take action immediately to develop a credible plan to both raise revenue and reduce costs.

The City is currently in transition in two major respects: (1) the City Council will lose its two most senior members and have two new members in December 2012 and (2) the City's collective bargaining agreements expire December 31, 2012 and as this budget flows through the approval process, it is unclear how those agreements will ultimately unfold. For these primary reasons, the proposed FY13 Budget does not adequately address the two main systemic problems noted above. Rather, the proposed FY13 Budget is another stop-gap budget, designed to try and hold the course while City Council develops a long-term sustainability plan.

In order to effectively address systemic problems and develop a long-term sustainability plan, I strongly recommend that the City Council consider the following action steps and implement them as appropriate:

- ~ Increase ad valorem (property) tax millage pursuant to Public Act 345 of 1937 as amended for the purpose of providing full employer contributions for the Ishpeming Police and Firefighter Retirement System, where currently a contribution from the General Fund is required. This would require levying a tax increase of approximately 0.8 mills in FY14.
- ~ Consider workforce reductions and develop a detailed analysis of the relevant options in order to implement in FY13 and FY14.
- ~ Increase water and sewer rates by an amount necessary to generate positive cash flow considering potential workforce reductions.

**IN MORE DETAIL**

The FY12 Budget Message cites several uncertainties that will impact personnel costs:

~ *State revenue sharing that is tied directly to union bargaining agreements;*

How has the City fared?

The City has collected all available state revenue sharing in FY11 and FY12. However, the City has not made significant changes/reductions to employee benefits targeted by the Economic Vitality Incentive Program, which could create potential non-compliance issues as the EVIP continues to evolve. The bottom line is that the City has not done enough to meet the high bar set by the State, although it appears the State legislature's appetite for imposing change on local employee benefits is waning.

~ *Union bargaining agreements that expire on December 31, 2012 may be subject to strict limitations on medical and pension benefit costs; and*

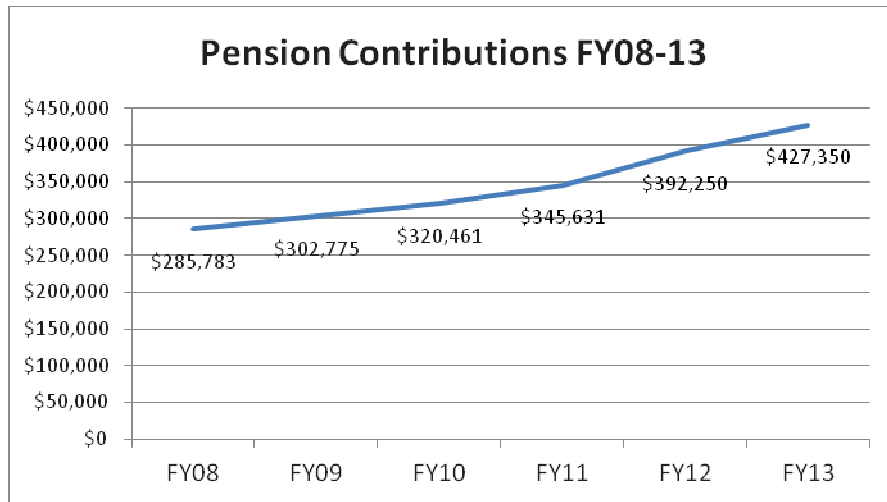
How has the City fared?

It appears that local units of government – City of Ishpeming included – may be able to continue to opt-out of the 'strict limitations' that have been created through the EVIP. Again, it is unclear if local units will essentially be able to continue to avoid imposing more requirements for employee cost sharing and reduced benefits. If the State decides to refocus its attention on local government employee benefits, the City of Ishpeming's state revenue sharing could be at risk. The City of Ishpeming has done enough to comply with the minimum requirements of EVIP, but that does not ensure future revenue sharing.

~ *Interest earnings have been very volatile recently and greatly influence revenue the City generates and required contributions for pension funds.*

How has the City fared?

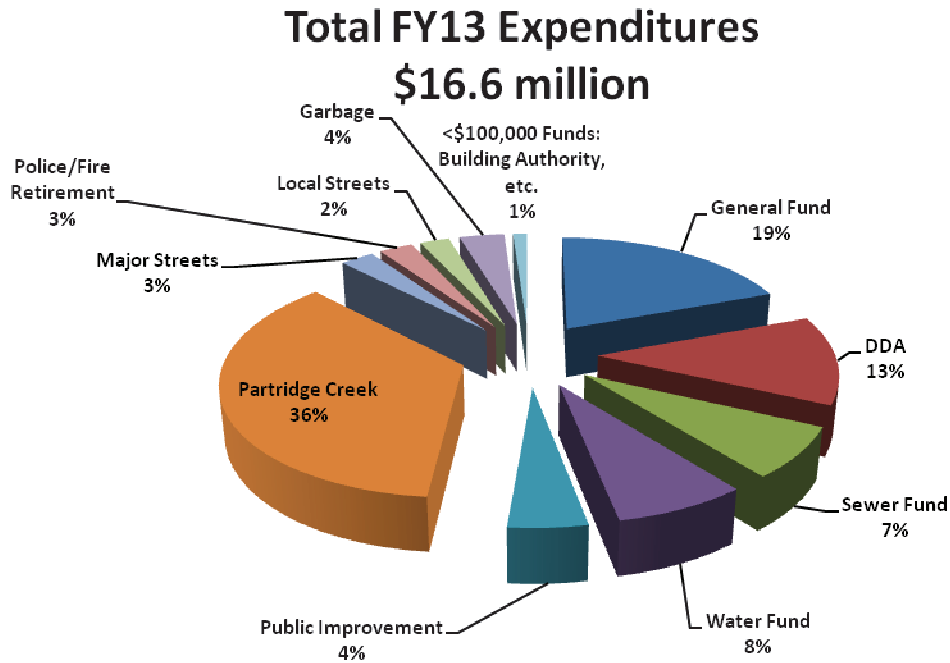
Required pension contributions are increasing dramatically. Interest and investment gains are not sufficient to cover long-term projected costs. This is a very serious problem and one that cannot easily be corrected in the near term. Pension reform is essential for long-term sustainability. Unfortunately, even if reform is accomplished immediately, cost savings will not be realized for many years. In fact, it is likely that pension reform will actually result in increased short-term costs.



**KEY FEATURES – FY13 BUDGET:**

- ~ Balanced budget increases General Fund balance by approximately \$12,600.
- ~ Includes only inflation adjustment sewer and water rate increases; no other rate increases.

- ~ Personnel remains status quo, noting that the FY12 Budget included the elimination of three (3) DPW positions through attrition.
- ~ Utilizes one-time, non-recurring \$103,000 revenue item for General Fund (Partridge Creek administration costs).
- ~ Sewer and Water Funds operate with negative cash flow.
- ~ Does not include \$200,000 allocation for MDOT Small Urban Grant program (N 2<sup>nd</sup> Street)



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

#### **GENERAL FUND**

The General Fund utilizes a \$103,000 one-time, non-recurring revenue source from the Great Lakes Restoration Initiative (GLRI) grant and does not appreciably increase its balance. General Fund staff (i.e. City Manager, Treasurer, and Manager's Secretary) provide administrative services to the DDA, which contributes \$60,000 to the General Fund. The GLRI grant revenue will not be available in FY14. DDA funding will likely start to decline in FY14. These create a significant long-term funding gap that the proposed budget does not sufficiently address.

As stated many times before, the General Fund provides more services than it can afford. As a result, the General Fund must receive subsidies from the Sewer and Water Funds. The Sewer and Water Funds do not generate sufficient revenue to continue to support the General Fund. Therefore, long-term sustainability requires that General Fund services are reduced.

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

Beginning Fund Balance: \$381,386

Ending Fund Balance: \$393,983

Primary Revenue Assumptions:

- ~ \$103,000 revenue for Partridge Creek/GLRI grant administration
- ~ 9% increase in state revenue sharing – approximately \$65,500 increase
- ~ Levy maximum millage rate = 18.8203, which projects to generate approximately \$30,000 more than FY12
- ~ Maintain similar interfund transfer structure as in recent years
- ~ Continuing low investment earnings, in particular from Cemetery Perpetual Care and Cemetery Care Funds

	FY11		FY12		Revenue +/-(-)
	Millage Rate	Tax Revenue	Millage Rate	Tax Revenue	
General Fund	13.4433	\$1,169,973	13.4433	\$1,191,423	\$21,450
Police/Fire Retirement	0.8960	\$77,979	0.8960	\$79,409	\$1,430
Public Improvement	<u>4.4810</u>	<u>\$389,982</u>	<u>4.4810</u>	<u>\$397,132</u>	<u>\$7,150</u>
	18.8203	\$1,637,934	18.8203	\$1,667,963	\$30,029

\* figures may not sum exactly due to rounding

*Primary Expenditure Changes:*

- ~ Increased pension fund contributions (resulting, in large part, from poor investment performance)
- ~ Increased personnel costs associated with health insurance costs and possibly wage increases

*Implementation:*

The following is a brief summary of some of the significant changes made to DPW operations since 2010:

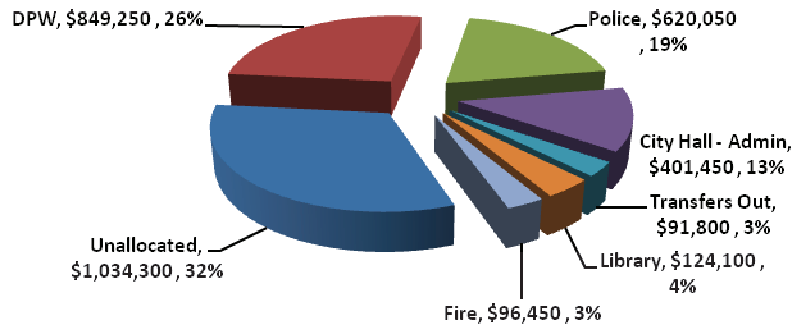
- ~ Loss of five (5) positions through attrition.
- ~ Reduced personnel costs/staff time budgeted for repair and maintenance services; Greaser position reassigned.
- ~ Prison trustees no longer provide services at the Cemetery.
- ~ Summer part time labor has been reduced by 50%.
- ~ One full-time employee is assigned to the Cemetery, augmented by other DPW staff as needed. The office is closed during winter months.

Other personnel cost savings measures implemented since 2010:

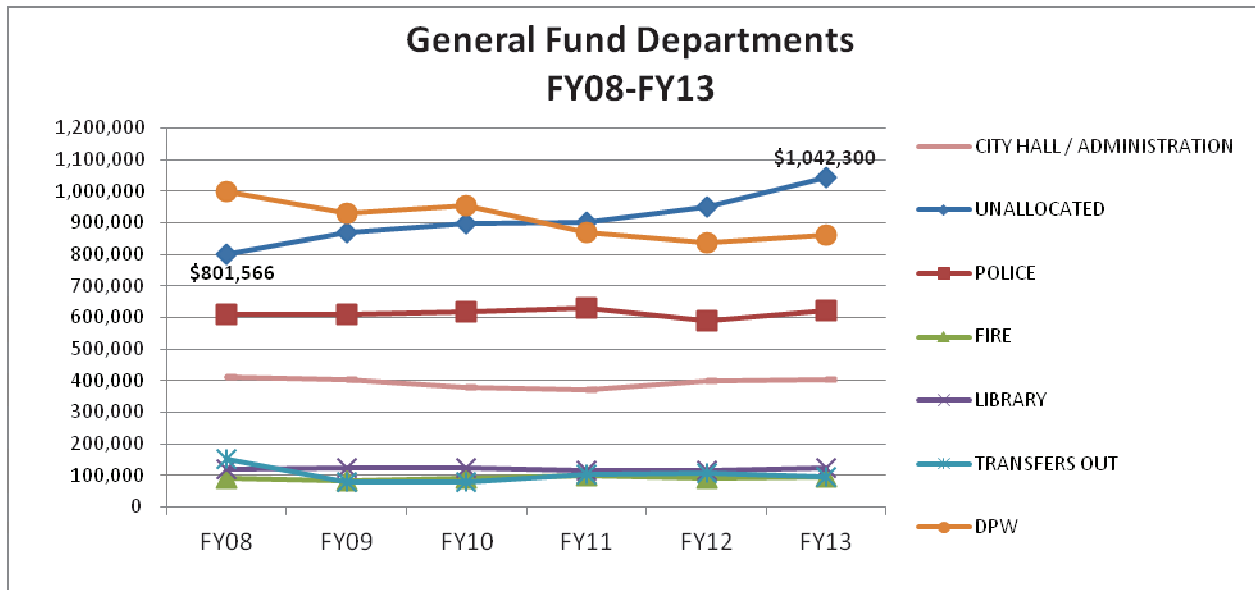
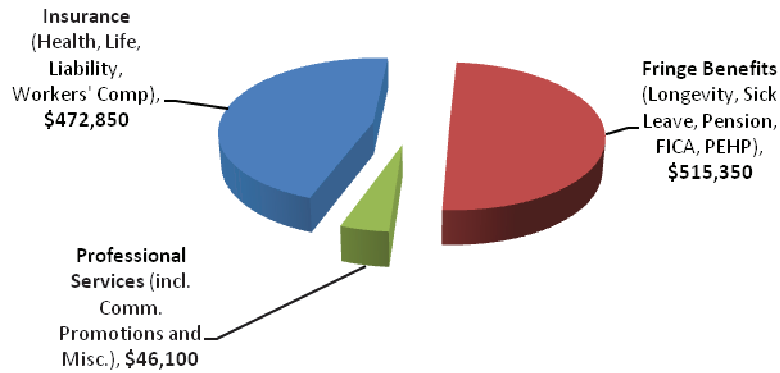
- ~ Police Chief and Detective positions combined
- ~ Reduced Library operations
- ~ Code Enforcement Officer layoff during winter months

As discussed previously, I strongly recommend that the City Council immediately develop a credible plan to increase revenue and decrease personnel costs. Such a plan is not presented here. The most important changes necessary for the long-term financial sustainability of the City of Ishpeming are not specifically addressed here. The proposed budget continues the status quo in terms of staff and service levels, which are not sustainable. Rather, these issues must be addressed in a more thorough, detailed process that coincides with the renewal of collective bargaining agreements and the priorities set by a City Council that is reconstituting.

### FY13 General Fund Expenditures \$3.2 million



### Unallocated Breakdown



**MAJOR AND LOCAL STREET FUNDS**

The proposed FY13 Major and Local Street Fund budgets are relatively status quo. 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.

The Cities of Negaunee and Ishpeming, Marquette County Road Commission, and Marqtran all collaborate to receive funding through MDOT's Small Urban Grant program, which provides up to \$375,000 for eligible construction activities (and notably does not include design and engineering costs). The local match portion is typically \$125,000, in addition to design and engineering, making the total local cost near \$200,000 in many instances. Recently, the City of Ishpeming has received a disproportionate share of this funding. The City of Ishpeming has used the funding to resurface Pine Street under two separate projects (2009 and 2011) and reconstruct the Greenwood Street bridge (2010). Unfortunately, the proposed budget does not include the City's required matching portion to resurface N 2<sup>nd</sup> Street between Empire and US 41 and my recommendation is to decline the funding opportunity in FY13.

The City Council made great strides in planning and pursuing road repair projects in FY12. Council approved a special assessment that would have assessed 43% cost sharing to adjacent property owners. However, through the design and bidding process it became apparent that the actual costs would exceed estimated costs and result in higher costs than anticipated for the City and property owners. Staff's recommendation at that time was to reject all bids for construction work, which Council did.

The City of Ishpeming's infrastructure is in dire need of a capital improvement plan, one that holistically addresses the entire right-of-way cross section and includes water, sanitary sewer, storm sewer, and the roadway itself. That is one of the critical reasons why staff recommended rejecting bids, because it is clear that it may be short-sighted and wasteful to pay for small-scale improvements in the near term when there is no comprehensive plan in place. Staff now intends to work to develop a long-range capital improvement plan that addresses all infrastructure with support from Council. Therefore, no significant repair or construction activities are included in the proposed FY13 Budget.

Major Street Fund

*Target Fund Balance:* \$0

*Beginning Fund Balance:* \$261

*Ending Fund Balance:* \$3,511

Local Street Fund

*Target Fund Balance:* \$0

*Beginning Fund Balance:* \$268

*Ending Fund Balance:* \$168

*Primary Revenue Assumption:*

- ~ General Fund and Public Improvement Fund subsidy continuation
- ~ Increased gas/weight and snow fund revenue in FY12 and similar trend expected in FY13

*Primary Expenditure Assumption:*

- ~ No large-scale repair work
- ~ N 2<sup>nd</sup> Street MDOT Small Urban project not included
- ~ Continue to reduce and minimize winter maintenance overtime-related wages

*Implementation:*

The FY13 Budget anticipates a slightly more severe winter than in 2011-12, although the trend has continually been milder in concert with warmer global temperatures. 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.

***GARBAGE FUND***

The FY13 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:* \$676,321

*Ending Fund Balance:* \$684,171

*Primary Revenue Assumption:*

~ No rate increase

*Primary Expenditure Change:*

~ Slight increase to personnel costs associated with increasing service at monthly drop-off site

*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 increases service at the monthly drop-off site so that up to three (3) DPW staff can work the site on the last Saturday of each month. The site has grown in usage and requires more manpower to ensure efficient operations.

The Garbage Fund has a significant fund balance, which represents at FY13 year-end more than one (1) year of operating expenditures (including transfers).

***<\$100,000 FUNDS: BUILDING AUTHORITY, ETC.***

***Iron Ore Heritage Trail***

In recent years, DPW line items – usually in the General Fund – have been used to pay for costs associated with trail maintenance and repairs. Generally, these costs have been minimal and there is no formal agreement between the City and Iron Ore Heritage Recreation Authority to provide continued maintenance services for the trail, which is owned by the City of Ishpeming in most sections in town. The Authority and City have both provided minimal maintenance in FY11 and FY12. There will most likely be some additional maintenance work in FY13, so this is the first budget where costs are specifically allocated for maintenance with a transfer/revenue coming from the General Fund.

*Implementation:*

Iron Ore Recreation Authority representatives have informally told me that the Authority intends to take over full maintenance responsibilities. I believe City Council and staff should prioritize an effort to formalize this arrangement.

**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 includes \$75,000 for demolition which may accommodate approximately four (4) to five (5) demolitions.

**Library State Aid**

This fund is used primarily to pay for services provided by the Superiorland Library Cooperative, which helps provide low cost internet and other services. The fund had a substantial fund balance even as recently as 2008. However, as state revenues have plummeted, the fund balance has been used to maintain service and this is the first year where a transfer/revenue from the General Fund is required to balance the fund, \$3,800. I expect this trend to continue in FY14.

**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 continually underperforming investment returns.

**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 \$181,000 for annual operating expenses.

DDA annual operating expenditures include administration, promotions, and beautification. Promotions include \$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:* \$ 1,695,695

*Ending Fund Balance:* \$505,895

*Primary Revenue Assumption:*

~ Bond projects skew revenue figures

*Primary Expenditure Change:*

~ Limited operating expenditures, focus on bond projects

~ Continued payment to General Fund for administrative services

*Implementation:*



The bond projects will continue to 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***

In FY13, this fund will include approximately \$6 million for engineering and construction activities associated with the Great Lakes Restoration Initiative grant award to complete sewer reconstruction and creek diversion by September 2013.

*Target Fund Balance: \$0*

*Beginning Fund Balance: \$0*

*Ending Fund Balance: \$0*

*Primary Revenue/Expenditure Assumption:*

~ Revenue and expenditures solely related to 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 police vehicles. Note that the bond issue for equipment purchases from 1999 will mature in 2014 and make available approximately \$98,500 in annual (FY13) expenditures, which are now used for debt service.

The proposed FY13 PIF Budget includes \$733,906 in revenue and \$771,650 in expenditures, thereby using \$37,744 of the fund balance. The PIF balance is substantial and will be bolstered by the payoff of the 1999 bond in 2014. Given the demands placed on the PIF and the needs of various departments, I recommend utilizing a modest portion of the fund balance.

*Target Fund Balance: varies*

*Beginning Fund Balance: \$662,243*

*Ending Fund Balance: \$ 624,499*

*Primary Revenue Assumptions:*

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

*Primary Expenditures:*

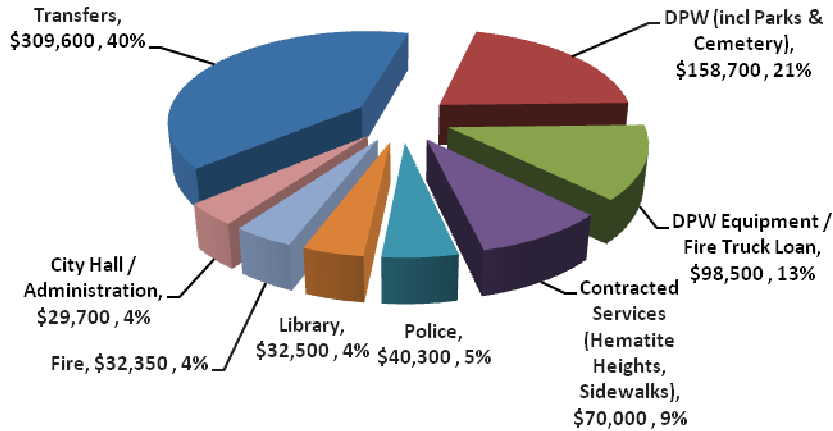
- ~ City Clerk includes \$15,5000 to codify and digitize the City's ordinances and make available online
- ~ City Hall includes \$13,000 to repair the climate control system, which has never worked properly since the 2000 renovation and its inefficiency is costly.
- ~ Police Department includes a new car (\$25,000) and miscellaneous items.
- ~ Fire Department budget includes a variety of relatively small items, some of which may be offset by grant funding.
- ~ Fire and Police Departments include \$7,500 each to pay for continuing the Fire Hall evaluation and study process and miscellaneous repairs that may arise.
- ~ DPW equipment includes a used bucket truck (\$40,000) and repairs to the sewer drains in the DPW garage (\$50,000).

- ~ Parks and Cemetery include a new columbarium (\$35,000) and riding lawn mowers (\$35,000), which are greatly needed now that City staff no longer has prison trustee labor, 50% summer labor, and reduced staffing overall. The mowers are vital to maintain efficiency.
- ~ Parks and Cemetery also include a variety of smaller scale items including topsoil, mower attachment, and landscaping restoration at Lake Bancroft.
- ~ Library includes two (2) new computer workstations (\$3,000), building improvements (\$5,000), and various routine expenditures.
- ~ Contracted Services include \$30,000 for fencing between the Iron Ore Heritage Trail and the landfill, and an increase in funding to address deteriorated sidewalks and curbing (\$25,000 and \$10,000 respectively).
- ~ \$98,500 for bond payments

**PIF Transfer Summary**

<u>Transfer To</u>	<u>Amount</u>
General Fund	\$13,600
Major Streets Fund	\$72,000
Local Streets Fund	\$80,000
Building Authority	\$66,500
Partridge Creek	\$77,500
TOTAL	\$309,600

**FY13 Public Improvement Fund  
Expenditures \$771,650**



***SEWER AND WATER FUNDS***

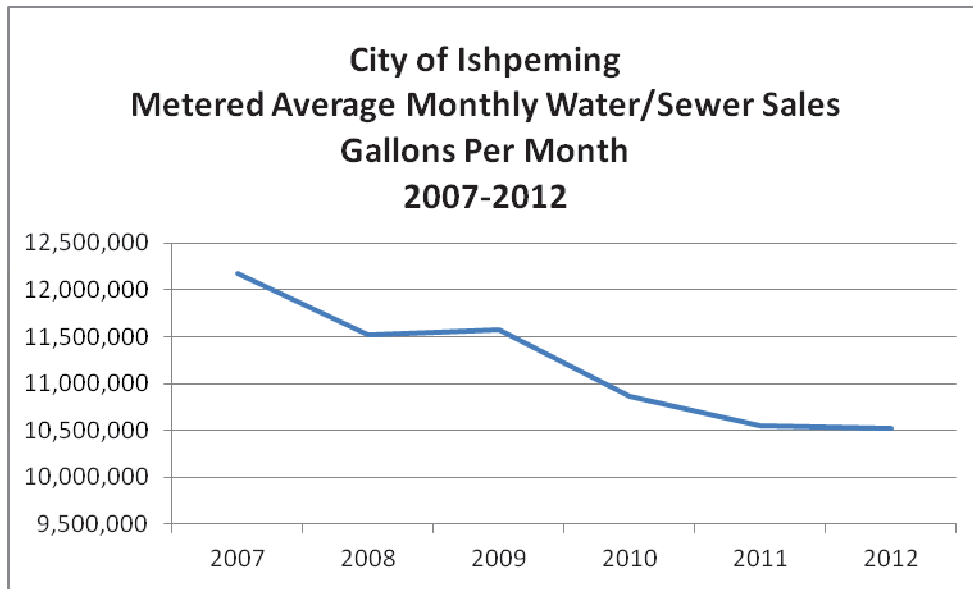
The Sewer and Water Funds are in poor financial condition. The following is a summary showing revenue versus expenditures as depicted in the FY13 Budget:

	<u>Sewer</u>					
	<u>FY08</u>	<u>FY09</u>	<u>FY10</u>	<u>FY11</u>	<u>FY12</u>	<u>FY13</u>
Revenue	948,498	1,053,742	1,375,980	1,051,271	1,050,050	1,086,290
Expenditures	843,502	920,333	976,153	1,107,083	1,130,370	1,216,700
Cash Flow (loss)	\$104,996	\$133,409	\$399,827	(\$55,812)	(\$80,320)	(\$130,410)

	<b>Water</b>					
	<u>FY08</u>	<u>FY09</u>	<u>FY10</u>	<u>FY11</u>	<u>FY12</u>	<u>FY13</u>
Revenue	1,087,342	1,049,325	1,357,364	1,222,920	1,055,335	1,089,635
Expenditures	1,089,501	1,034,871	1,120,095	1,137,353	1,199,100	1,283,000
Cash Flow (loss)	(\$2,159)	\$14,454	\$237,269	\$85,567	(\$143,765)	(\$193,365)

Revenue is a function of metered sales and rates. While rates have increased slightly over the past several years, these increases have been negated by reduced sales, a rare pattern:

<b>Year</b>	<b>Average Monthly Metered Sales (Gallons)</b>
2007	12,178,908
2008	11,516,467
2009	11,568,633
20010	10,867,542
2011	10,553,800
2012	10,517,163



As discussed often, the Sewer and Water Funds are not financially able to reinvest in critical infrastructure that is deteriorating rapidly. The best source of financing large-scale infrastructure projects is with U.S. Department of Agriculture – Rural Development (USDA-RD) funding. USDA-RD has indicated that the City of Ishpeming is not eligible for funding so long as the Payment In Lieu of Tax (PILT) remains in the City’s budget, which is the means by which the the Sewer and Water Funds subsidize General Fund operations.

The Sewer and Water Funds:

- ~ Cannot rebuild needed infrastructure.
- ~ Subsidize General Fund operations.
- ~ Appear to be on a trajectory to run out of money within two to five (2-5) fiscal years.

For these primary reasons, I strongly recommend that City Council take action immediately to develop a credible plan to increase rates over time and reduce General Fund services that rely on the Sewer and Water Funds.

**SEWER FUND**

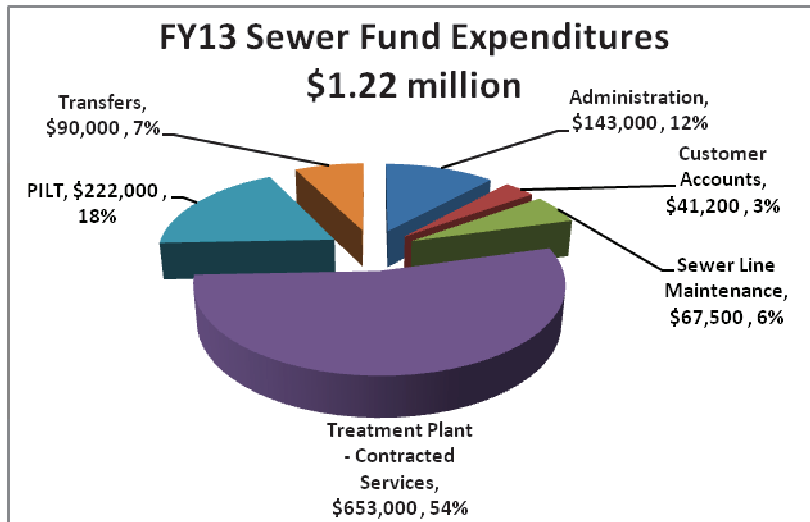
The proposed FY13 budget is status quo and continues operating with negative cashflow, a situation that is unsustainable, will lead to severe consequences within four to five (4-5) fiscal years if unabated, and must be addressed immediately.

The City of Negaunee's sewer line extension project is scheduled for completion in late 2013 and is expected to be in service at that time, which will create cost savings for contracted treatment services. Estimated at approximately 15%, these savings would result in roughly \$100,000 annual savings. This potential savings could mitigate the need for rate increases and expenditure reductions.

*Target Fund Balance: asset accounting*  
*Cash Flow w/o Depreciation (loss): (\$130,410)*

*Primary Revenue Assumption:*  
~ 2% inflation adjustment built into rate structure  
~ Decreasing sales pattern continues

*Primary Expenditure Change:*  
~ Increased treatment plant costs, approximately 7.4% increase



**WATER FUND**

The proposed FY13 budget is relatively status quo and continues operating with negative cashflow, a situation that is unsustainable, will lead to severe consequences within two to three (2-3) fiscal years if unabated, and must be addressed immediately.

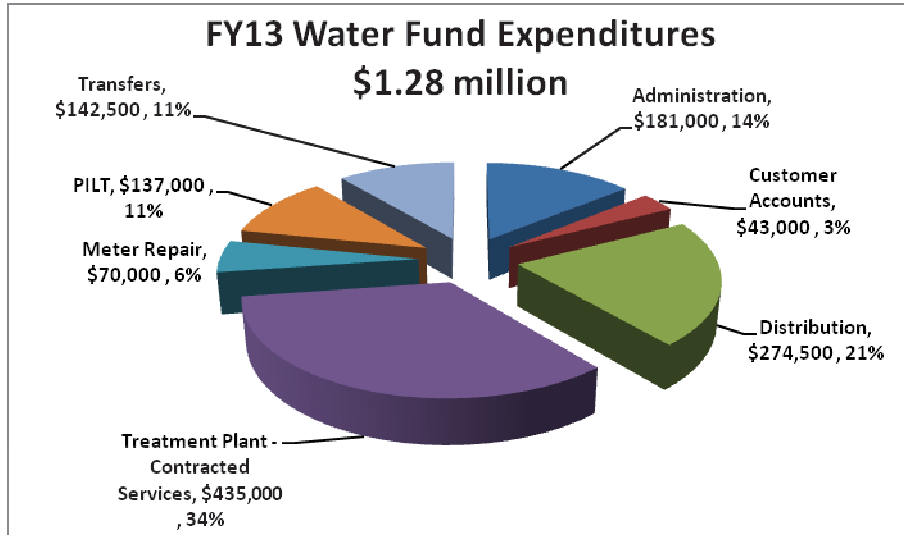
*Target Fund Balance: asset accounting*  
*Cash Flow w/o Depreciation (loss): (\$193,365)*

*Primary Revenue Assumption:*

- ~ 2% inflation adjustment built into rate structure
- ~ Decreasing sales pattern continues

*Primary Expenditure Change:*

- ~ Increased treatment plant costs, approximately 3.6% increase
- ~ \$52,000 allocation for water tank maintenance agreement



***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.

*Target Fund Balance:* asset accounting / 80%+

*Beginning Fund Balance:* \$4,135,993

*Ending Fund Balance:* \$3,937,952

*Primary Revenue Assumption:*

- ~ Status quo interest earnings and zero appreciation

*Primary Expenditure Change:*

- ~ Increased General Fund contributions from \$71,250 to \$77,350