CITY OF PORTAGE **COMMUNICATION**

TO: Honorable Mayor and City Council **DATE:** May 8, 2012

FROM: Maurice S. Evans, City Manager

SUBJECT: Proposed Fund Balance of the General Fund – Information Only

At the May 1, 2012 Council Budget Review Session questions were presented in regard to past General Fund expenditures and fund balance amounts. Questions were also presented regarding the need/justification for changing City Council policy so as to increase the fund balance of the General Fund from 13 percent of expenditures to 25 percent of expenditures, as has been recommended by the City Administration. The following information is provided in response.

Results of the most recent staff produced financial analysis were shared with the City Council at the 2011 City Council Goal Session held on December 9, 2011. In the analysis, two major financial risks were identified as facing the city: The proposed reduction or elimination of the personal property tax and the reduction of Act 51 revenue by the State of Michigan. Accordingly, it was communicated that “These risks may threaten the ability of the city to meet current bond obligations and existing service delivery levels.” As a closing point to the analysis, it was communicated that “Until a clear picture of a stabilizing revenue base can be obtained, reserves above 13 percent of General Fund expenditures will be planned.”

The fiscal year 2012-2013 proposed budget has been prepared consistent with the financial analysis information provided to City Council at the 2011 Goal Session. As was communicated in the April 10, 2012 fiscal year 2012-2013 proposed budget transmittal letter, the City Administration has recommended a change to city budget policy to increase fund balance of the General Fund. As was noted, “The commitment of additional reserves will assist the city in positioning for an uncertain economic future.” Specifically, it has been recommended that “changing the Council-prescribed fund balance policy from 13 percent of General Fund expenditures to 25 percent of General Fund expenditures is advised for the foreseeable future”.

As the level of fund balance in the General Fund is prescribed by City Council policy, the amount of reserve can be changed by the Council at any time. Therefore, if the Council determines that an increase in fund balance is warranted, that amount can be increased or reduced next year (or next month) if determined appropriate by a majority of the Council.

The attached charts have been prepared to provide information relative to past budget expenditures and fund balances of the General Fund. Chart 1 shows total General Fund expenditures from 2003 through 2011. Chart 2 displays fund balance of the General Fund over the same time period. Chart 3 is provided to identify approximate fund balance amounts associated with various percentage levels of fund balance.

Conservative budgeting practices employed over the years have afforded the city the benefit of reoccurring fund balance amounts that exceed 13 percent. Most recently, savings generated through tightened expenditure controls and position eliminations have facilitated greater fund balance amounts. Importantly, as the City Administration has relied upon a managed attrition program to capture eliminated position-related savings, employee departures that materialize in any given budget year can not be anticipated when presenting fiscal year proposed budgets for Council adoption. As a result, the bulk of savings contributing to more recent fund balance amounts relate to these unplanned position eliminations and department heads being financially responsible in expenditures.

Although the major financial risks associated with the elimination or reduction of personal property tax revenue to the city and a reduction of Act 51 revenue have driven the recommended budget strategy, other factors have been considered as well, including:

- As is noted on Chart 4, total potential personal property tax revenue loss to the City of Portage is estimated at approximately $4.2 million dollars annually. If personal property tax revenue from industrial properties only is lost, over $3.4 million dollars annually is at risk (see Chart 5).
- As is currently proposed, the planned industrial property personal property tax elimination would span a period of 7 years, beginning in 2016/17. A first year loss of over $2,000,000 would result, followed by increased annual losses, up to the total loss of over $3.4 million annually in 2022/23.
- As previously noted, our state legislators have no constitutional commitment for revenue replacement and therefore I am highly skeptical on the amount of revenues that will be replaced for personal property and the duration. My skepticism is based on the facts that the state has reduced Statutory Revenue Sharing over the last decade to the point where Portage is receiving $1.2 million less per year than received in 2002/2003. In addition, the city is receiving $400,000 less in annual Act 51 revenues from the state since FY 2003/2004.
- The city is carrying a very significant level of debt as a result of its investment in infrastructure from 2000 to 2006. Even with a ten-year plan in place to assist the city with this challenge, significant reductions to the city revenue base will add to the burden of debt payment obligations.
- The city's water fund is continuing to be challenged with a working capital (cash) deficit, of $3.1 million. Currently, city-wide cash reserves (or working capital) of $3.1 million is required to support this fund, to be gradually reduced over the remaining recovery period (1-2 years). The city has filed a plan with the State of Michigan to address this issue.
- The city remains heavily reliant upon one property tax payer, Pfizer. Changes that may impact upon the continued presence of the company in the City of Portage (and to what degree), while unknown at this time, could have significant consequence to the financial health of the city.
- The 13% fund balance policy was established in 1985 during an era of municipal growth and prosperity---it was not established during the greatest recession since the Great

Depression. The 13 percent fund balance policy is no longer believed adequate in consideration of the current challenging financial conditions: A high rate of foreclosures, high unemployment, significant revenue uncertainty, etc. The proposed fund balance policy incorporates consideration of the city's significant debt levels, cash reserves needed to support the water fund and current economic conditions.

- The reserve level recommendation provided to Council of 25 percent equates to about $5.4 million, which translates to approximately 3 months of General Fund expenditures. Typically, desired reserve levels within industry (although they can vary with many factors), are 3-5 months of operating expenditures.

As a point of reference, a survey was conducted utilizing the most recently available certified financial statements of 20 Michigan cities. As will be noted from Chart 6, approximately half of the cities surveyed had a greater fund balance than the City of Portage at a fund balance level of 34 percent. At a fund balance level of 13 percent, the City of Portage would rank near the bottom of the cities surveyed. Also, as will be noted from Chart 7, approximately 70% of the cities surveyed had a greater fund balance to long-term debt ratio than the City of Portage. Furthermore, it is suggested that the vast majority of the cities surveyed are not under state mandated recovery plans with their utility fund. A few county General Fund balances and ratios have also been included for additional reference.

While it appears the more significant change to personal property tax revenue is being considered for implementation in 3 years, it is important to understand that the current accumulated fund balance of the General Fund has been built through years of expenditure savings. Reducing this “savings” balance either through project expenditure(s) or tax rate reduction will represent a likely non-recoverable action – certainly not recoverable over the next 3 budget years. That is, the ability of the city to further reduce expenditures going forward to restore fund balance will be problematic.

The City of Portage will not be alone in confronting further revenue reductions that may materialize over the next several years, whether these challenges are presented by a continuing sluggish economy, changes to the current business base of the community or changes in state law. However, the communities that take steps today to plan for this eventuality will be the communities best positioned to consider options for continuing the delivery of public services in a more difficult revenue environment. Therefore, increasing the level of fund balance of the General Fund from 13 percent to 25 percent is being advised as a prudent step for the City Council to take at this time. In light of the likely change to personal property taxation in the near future and with a potential for loss of additional Act 51 revenue, an additional level of reserve over 25 percent may be advised once legislation is in place.

CHART 1

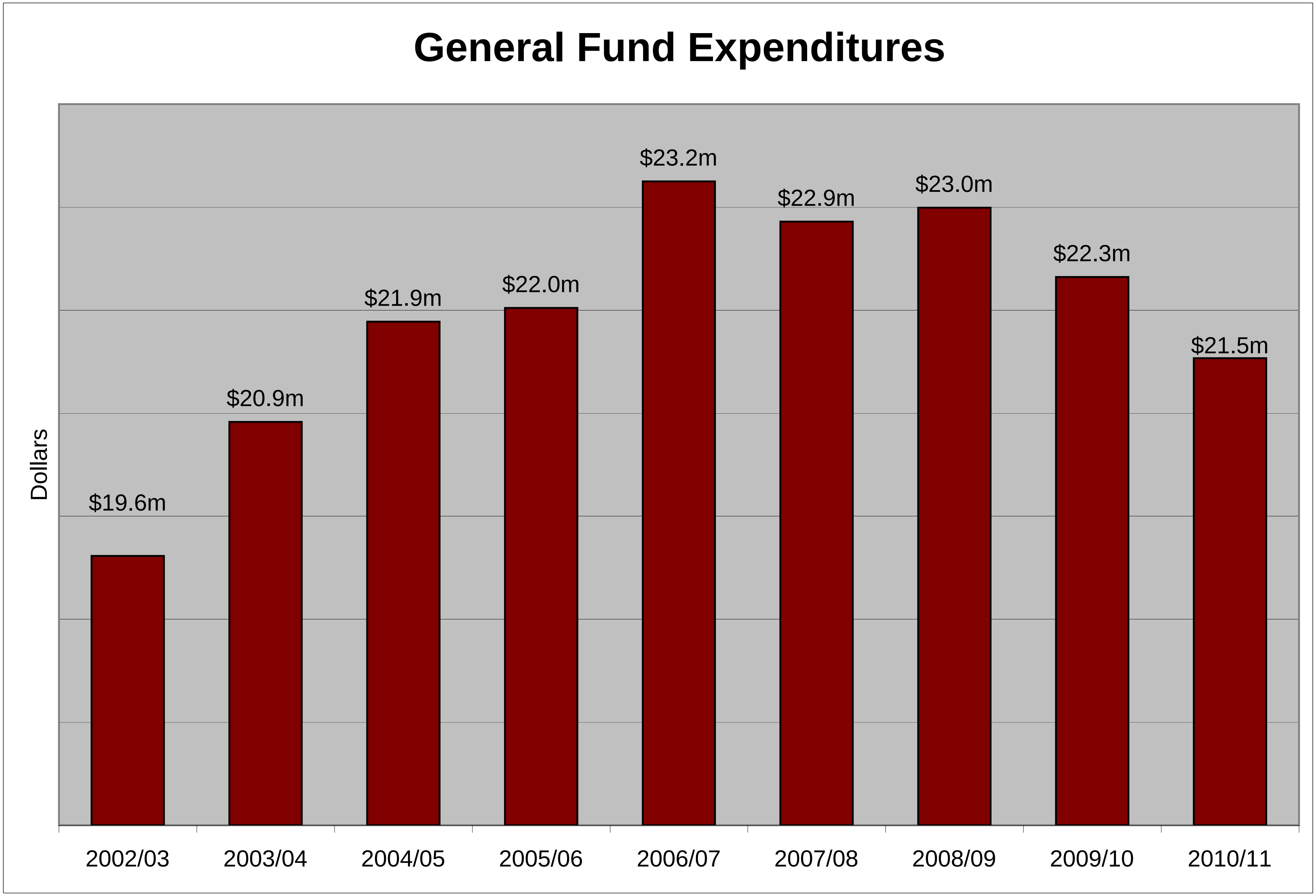
General Fund Expenditures
Dollars
$19.6m
$20.9m
$21.9m
$22.0m
$23.2m
$22.9m
$23.0m
$22.3m
$21.5m
2002/03
2003/04
2004/05
2005/06
2006/07
2007/08
2008/09
2009/10
2010/11

CHART 2

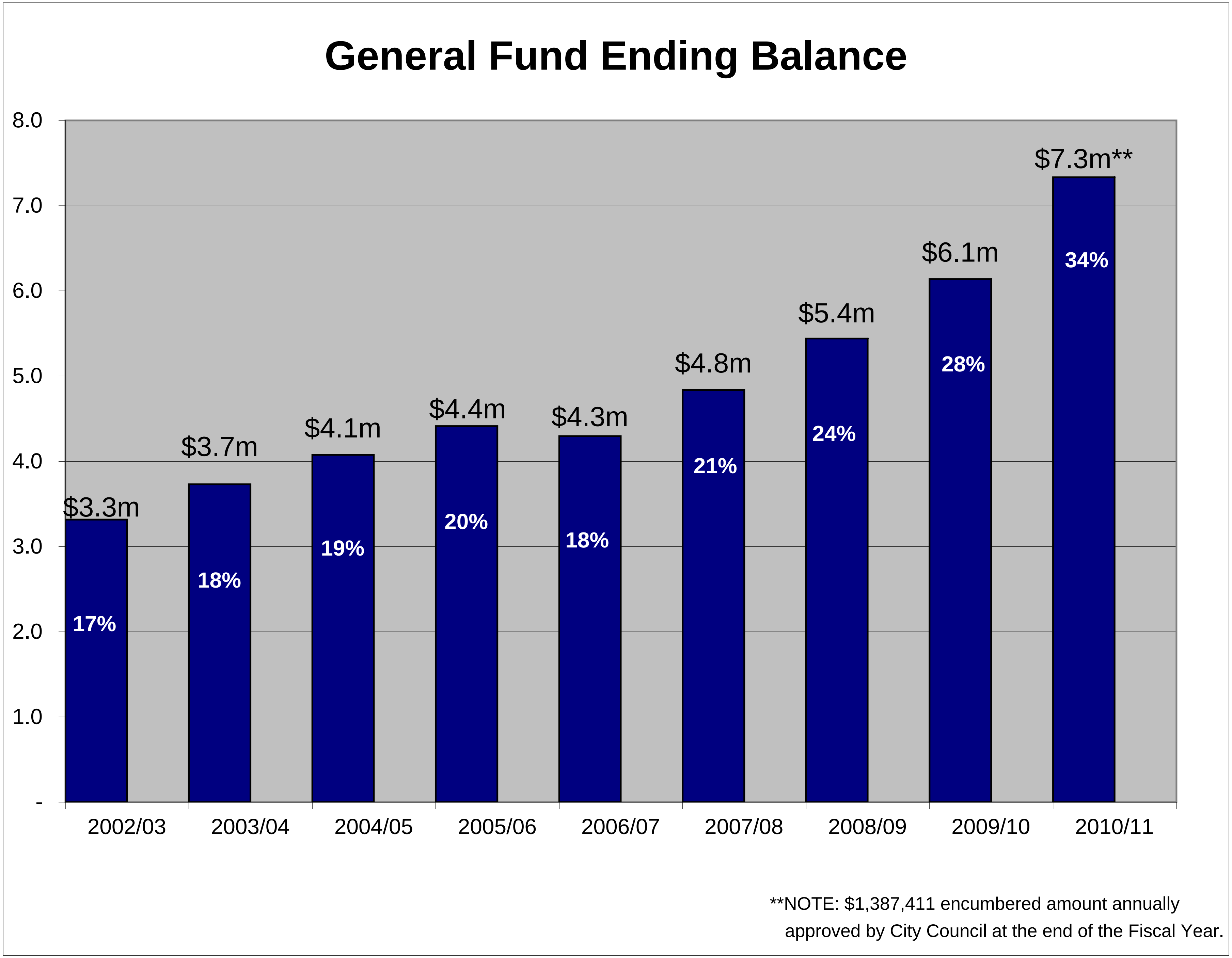
General Fund Ending Balance
8.0
7.0
6.0
5.0
4.0
3.0
2.0
1.0
-
$3.3m
$3.7m
$4.1m
$4.4m
$4.3m
$4.8m
$5.4m
$6.1m
$7.3m**
17%
18%
19%
20%
18%
21%
24%
28%
34%
2002/03
2003/04
2004/05
2005/06
2006/07
2007/08
2008/09
2009/10
2010/11
**NOTE: $1,387,411 encumbered amount annually approved by City Council at the end of the Fiscal Year.

CHART 3

Ending Fund Balance at Selected Percentages*

13%	$	2.8	m
14%	$	3.0	m
15%	$	3.2	m
16%	$	3.4	m
17%	$	3.7	m
18%	$	3.9	m
19%	$	4.1	m
20%	$	4.3	m
21%	$	4.5	m
22%	$	4.7	m
23%	$	5.0	m
24%	$	5.2	m
25%	$	5.4	m
26%	$	5.6	m
27%	$	5.8	m
28%	$	6.0	m
29%	$	6.2	m
30%	$	6.5	m
31%	$	6.7	m
32%	$	6.9	m
33%	$	7.1	m
34%	$	7.3	m

$$\frac{\text{Fund Balance}}{\text{General Fund Expenditures (including Transfers)}} = \frac{\$\,7.3\text{m}}{\$\,21.5\text{m}} = \mathbf{34\%}$$

*Percentages determined by dividing the Ending Fund Balance by the actual 2010/11 General Fund expenditures (including Transfers).

CHART 4

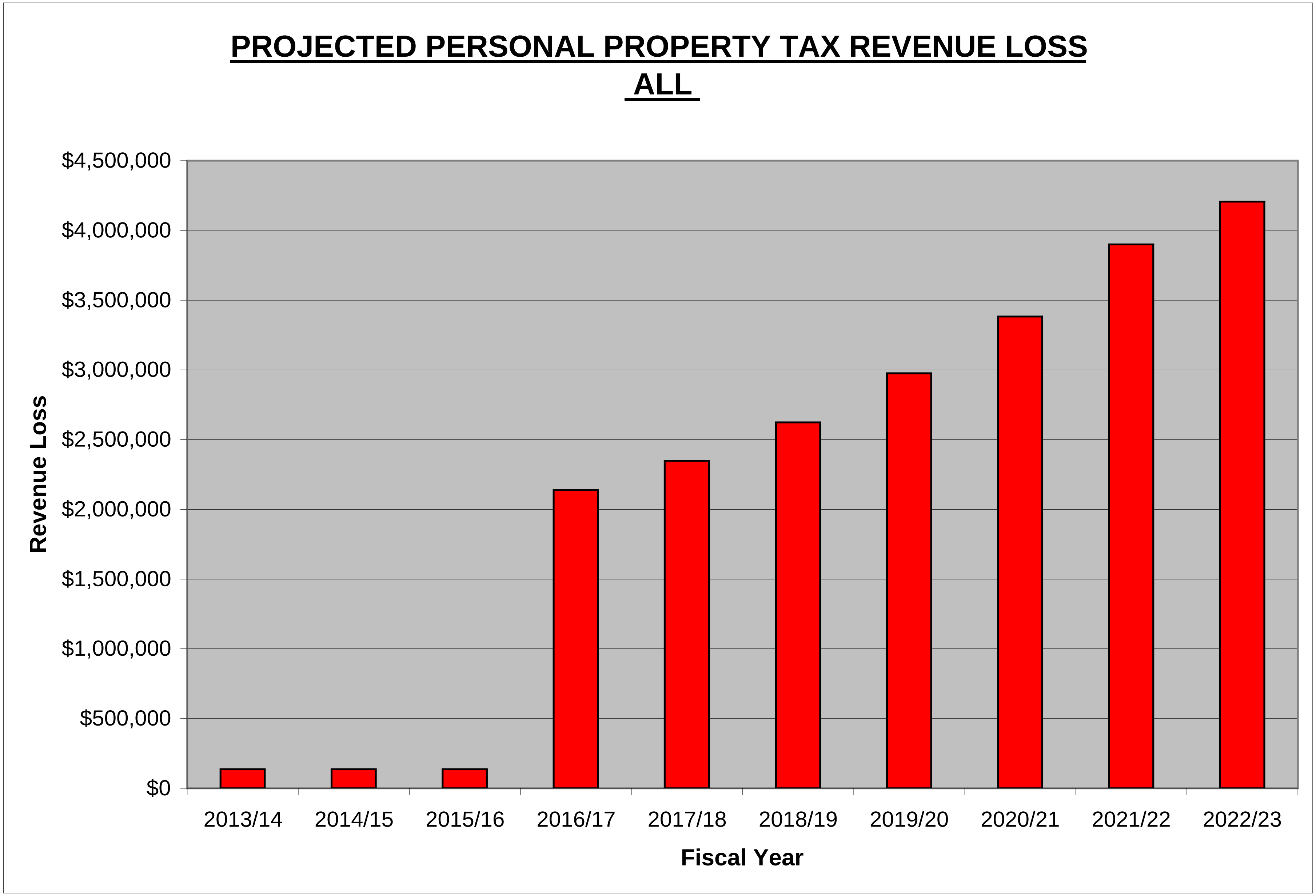
PROJECTED PERSONAL PROPERTY TAX REVENUE LOSS
ALL
$4,500,000
$4,000,000
$3,500,000
$3,000,000
$2,500,000
$2,000,000
$1,500,000
$1,000,000
$500,000
$0
Revenue Loss
2013/14
2014/15
2015/16
2016/17
2017/18
2018/19
2019/20
2020/21
2021/22
2022/23
Fiscal Year

CHART 5

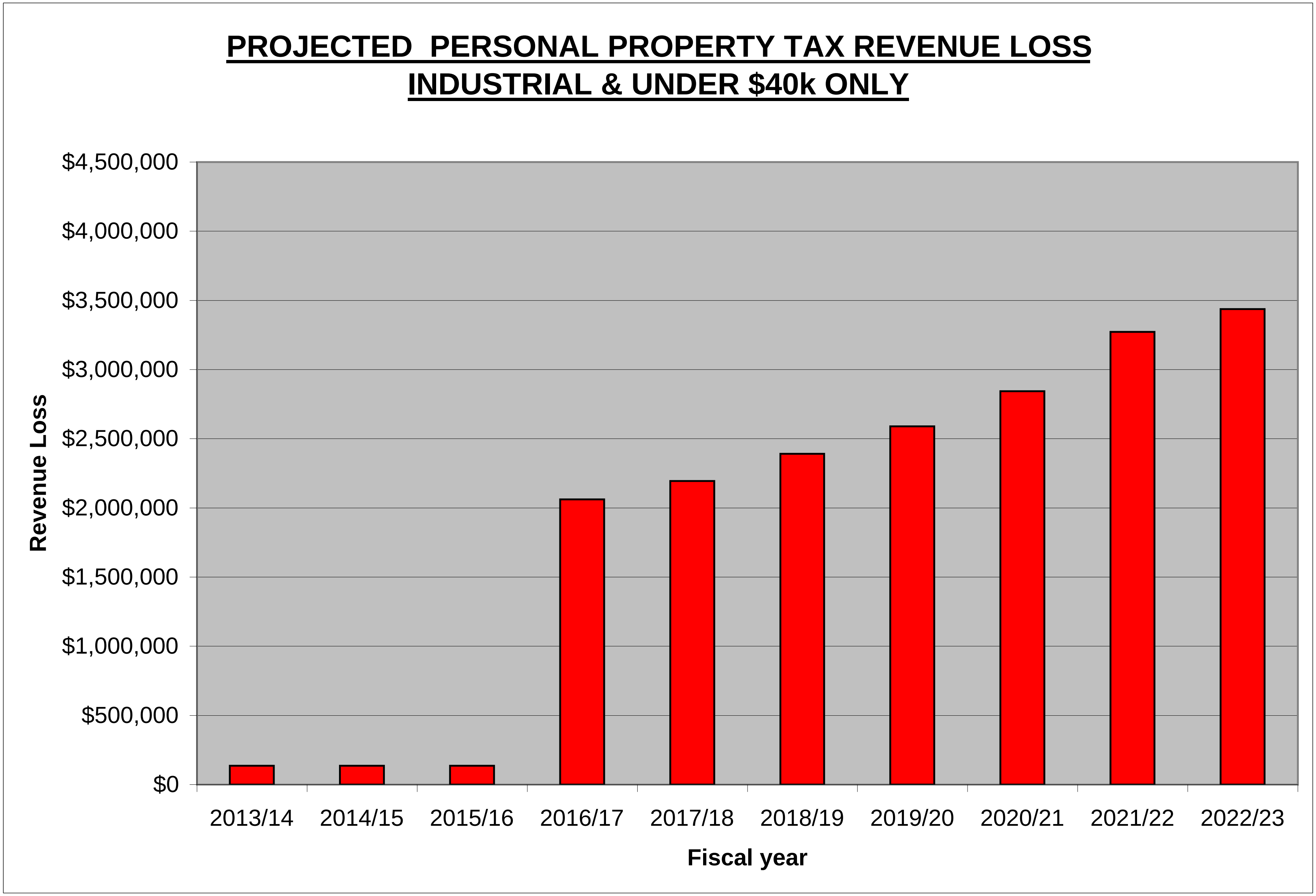
PROJECTED PERSONAL PROPERTY TAX REVENUE LOSS
INDUSTRIAL & UNDER $40k ONLY
$4,500,000
$4,000,000
$3,500,000
$3,000,000
$2,500,000
$2,000,000
$1,500,000
$1,000,000
$500,000
$0
Revenue Loss
2013/14
2014/15
2015/16
2016/17
2017/18
2018/19
2019/20
2020/21
2021/22
2022/23
Fiscal year

CHART 6

Community Survey - Fund Balance

City	CAFR date	Expenditures & Transfers Out	Fund Balance	Percentage
South Haven	06/30/11	5,585,278	3,252,900	58%
Wyoming	06/30/11	22,546,196	10,215,441	45%
Marshall	06/30/11	5,075,028	2,252,495	44%
Grand Haven	06/30/11	10,756,680	4,716,703	44%
Paw Paw	02/28/11	1,572,681	671,181	43%
Novi	06/30/11	28,041,078	11,417,075	41%
Sturgis	09/30/11	7,000,441	2,759,643	39%
Coldwater	06/30/11	8,245,211	3,166,345	38%
Hastings	06/30/11	4,645,295	1,696,786	37%
Portage	**06/30/11**	**21,533,930**	**7,332,935**	**34%**
Springfield	06/30/11	2,561,834	782,036	31%
St Joseph	06/30/11	7,635,604	2,253,143	30%
Three Rivers	06/30/11	4,089,447	1,202,190	29%
Dowagiac	09/30/11	3,436,527	1,005,588	29%
Holland	06/30/11	19,986,752	4,131,862	21%
Kentwood	06/30/11	27,284,629	5,071,193	19%
Ann Arbor	06/30/11	77,678,409	13,582,444	17%
Battle Creek	06/30/11	45,973,871	7,791,452	17%
Jackson	06/30/11	21,014,692	2,630,245	13%
Kalamazoo	12/31/10	52,090,693	4,385,183	8%
Lansing	06/30/11	110,291,950	5,330,487	5%
			average	31%

County	CAFR date	Expenditures & Transfers Out	Fund Balance	Percentage
Oakland County	09/30/11	354,974,009	201,161,884	57%
Kalamazoo County	12/31/10	60,493,785	27,846,538	46%
Kent County	12/31/10	157,432,785	68,677,003	44%
Ottawa County	12/31/10	59,090,434	17,979,501	30%
Calhoun County	12/31/10	41,835,644	4,021,729	10%
			average	37%

CHART 7

Community Survey - Fund Balance/Long-Term Debt

City	CAFR date	Fund Balance	LT Debt	Fund Balance as % of Long Term Debt
Hastings	06/30/11	1,696,786	1,635,000	104%
Paw Paw	02/28/11	671,181	1,132,340	59%
Springfield	06/30/11	782,036	2,220,909	35%
Battle Creek	06/30/11	7,791,452	25,700,000	30%
Dowagiac	09/30/11	1,005,588	3,413,813	29%
Kentwood	06/30/11	5,071,193	21,910,000	23%
Marshall	06/30/11	2,252,495	9,820,000	23%
Novi	06/30/11	11,417,075	55,925,472	20%
Coldwater	06/30/11	3,166,345	20,416,583	16%
Sturgis	09/30/11	2,759,643	18,050,793	15%
St Joseph	06/30/11	2,253,143	15,398,830	15%
Three Rivers	06/30/11	1,202,190	8,456,201	14%
South Haven	06/30/11	3,252,900	29,493,933	11%
Holland	06/30/11	4,131,862	49,552,186	8%
Wyoming	06/30/11	10,215,441	123,560,000	8%
Portage	**06/30/11**	**7,332,935**	**94,100,000**	**8%**
Grand Haven	06/30/11	4,716,703	78,407,119	6%
Jackson	06/30/11	2,630,245	44,097,577	6%
Ann Arbor	06/30/11	13,582,444	237,076,107	6%
Kalamazoo	12/31/10	4,385,183	87,040,000	5%
Lansing	06/30/11	5,330,487	272,710,116	2%
		average		21%

County	CAFR date	Fund Balance	LT Debt	Fund Balance as % of Long Term Debt
Kalamazoo County	12/31/10	27,846,538	42,774,960	65%
Oakland County	09/30/11	201,161,884	751,134,635	27%
Calhoun County	12/31/10	4,021,729	20,490,000	20%
Kent County	12/31/10	68,677,003	390,745,686	18%
Ottawa County	12/31/10	17,979,501	145,253,700	12%
		average		28%