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Continuation of Challenging Times

Presented by Kari Shea, CPA

April 18, 2013

Current Situation

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- Difficult State economy leads to lower property taxes, less sharing of money by the state = less money for communities
- Communities have done some cost-cutting and looked for quick revenue hits
- Many have used fund balance to get by
- There have been staff reductions and pay cuts
- Delayed capital outlay
- Decrease in certain types of services
- These moves only go so far and do not always address the magnitude of the issue
- Construction and development is sluggish—negatively affects permit and inspection revenue

The Challenge

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- Demand for services continues to rise
- Difficult environment for tax increases
- Revenues are projected to remain flat or decrease in the foreseeable future (i.e., impact of property value reductions)
- Need to get by on less - new revenue reality
- Tied directly to the state of the economy and housing market rebound
- Delayed recovery and revenues with economic upswing
- Response - start with a detailed projection of where you will be based on current level of operations - multi year budgeting
- Increases in health care and pension costs
- Increased property tax chargebacks

Typical City
General Fund Revenue
Fiscal Year Ended June 30, 20xx

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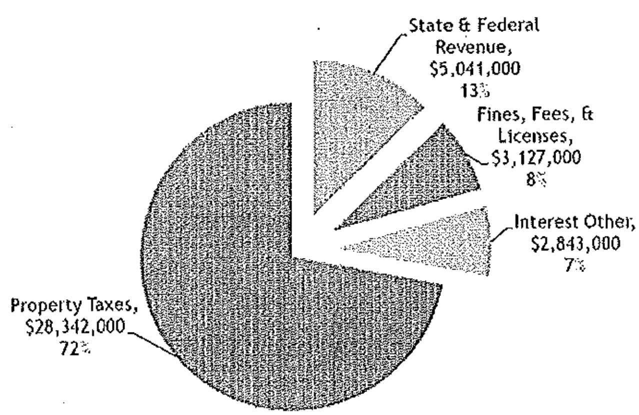

Recent Trends in Property Tax Value

(source: Bridge Magazine April 2013)

- Michigan property values have dropped over $260 billion in 5 years
- Values declined almost $36 billion from 2011 to 2012
- In 2012 home sales hit highest volume since 2005
- Oakland County values have shown a slight 1% increase in recent months; Wayne County values had a 1% decline

Property Taxes

- The Impact of Proposal A and the Headlee Amendment:
  - Taxable value on existing parcels can only increase by inflation
    - i.e. even if there is a substantial rebound it will not be seen in taxable values because limited by proposal A
  - Real estate market issues are resulting in significant drops in taxable value, which will impact the community's property tax revenue
  - Communities must have new construction/buildings in order to have growth above inflation
  - In many communities, millage rate has been rolled back from 20 authorized charter mills to 15 or so mills due to the Headlee amendment. This decrease equates to annual lost tax revenue of millions of dollars for most communities. Only a handful successful at Headlee override votes to restore lost millage capacity.

Real-life City
Timing of Property Tax Decreases

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Budget Year	6/30/09	6/30/10	6/30/11	6/30/12	6/30/13
Assessment date	12/31/07	12/31/08	12/31/09	12/31/10	12/31/11
Levy date	7/01/08	7/01/09	7/01/10	7/01/11	7/01/12
Taxable value	792,137,000	793,185,000	718,199,000	646,143,000	575,067,000
Percent increase (decrease)	---	.1%	<9.5%>	<10.0%>	<11.0%>
General fund revenue (in millions)	$15,500,000	$15,500,000	$14,300,000	$12,800,000	$11,400,000

Real-life City
Total Taxable Value (in millions)
Years Ended June 30

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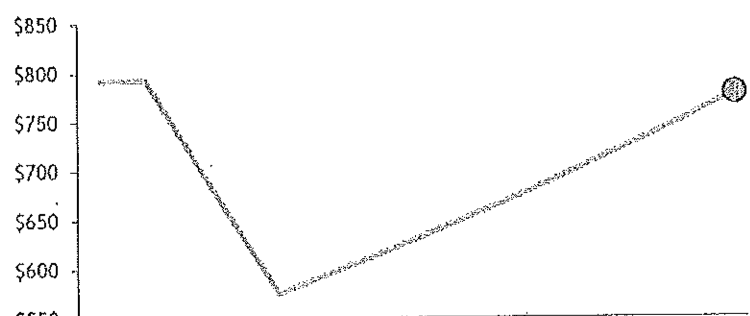

ASSESSMENT DATE	07	08	09	10	11	12	13	14	15	16	17	18	19	20	21
Total Taxable Value	$792	$793	$718	$646	$575	$592	$610	$628	$647	$667	$687	$707	$728	$750	$773
Percentage Change	0%	0%	-9%	-10%	-11%	3%	3%	3%	3%	3%	3%	3%	3%	3%	3%

Personal Property Tax - PA 397 of 2012

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- PA 397 repealed existing personal property tax law during the Legislature's lame duck session in December
- Repeal is contingent on a Statewide vote in August of 2014; however, tax bills for many communities are issued July 1 so July 1, 2014 levy is lost regardless of outcome of vote in August
- The Act phases out the industrial portion of the tax over a 9 year period beginning in 2016
- Businesses with less than $40,000 taxable value in industrial and commercial personal property in any jurisdiction would no longer pay the tax

Personal Property Tax - PA 397 of 2012
What is the impact on communities?

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- Local governments that lose at least 2.3 percent of their property tax base—eligible for reimbursement
  - Reimbursed at 80 percent of the revenue the personal property tax currently provides
  - Reimbursement is through newly created Metropolitan Area Authority - independent 5 person body (all Governor's appointments)
  - Funding for the reimbursement is projected to come from use tax and expiring credits
- Option to assess a special assessment on industrial property—Essential Services Assessment
  - Local voter approval is not required
  - Would reimburse police, fire, ambulance services, and jail operations to ensure they receive 100 percent of current funding level from personal property tax
  - This is optional and some communities may choose not to levy which could result in this being used for competition

State Revenue Sharing and Incentive Program Payments
Cities, Villages, Townships and Counties

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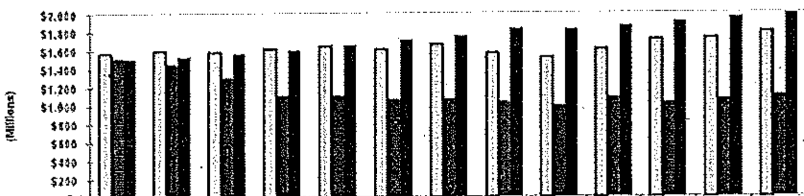

	FY 01/02	FY 02/03	FY 03/04	FY 04/05	FY 05/06	FY 06/07	FY 07/08	FY 08/09	FY 09/10	FY 10/11	FY 11/12	FY 12/13*	FY 13/14*
'98 formula	$1,571	$1,593	$1,581	$1,613	$1,644	$1,612	$1,686	$1,571	$1,523	$1,609	$1,712	$1,726	$1,797
Actual	$1,517	$1,451	$1,305	$1,112	$1,103	$1,071	$1,076	$1,040	$994	$1,092	$1,032	$1,069	$1,109
Inflation **	$1,507	$1,530	$1,565	$1,601	$1,654	$1,715	$1,754	$1,831	$1,926	$1,957	$1,907	$1,953	$1,222

Lost Rev. Sharing	$54 M	$147 M	$276 M	$506 M	$549 M	$541 M	$550 M	$531 M	$629 M	$517 M	$660 M	$657 M	$689 M

Note: "'98 Formula" FY 01/02 through FY 13/14 calculated based on constitutional revenue sharing using 21.3% of 4% of sales tax collections.

- Estimated FY 12/13 based on 1/13 Consensus; Projected FY 13/14 based on 1/13 Consensus and Proposed Budget

** Inflation applied to FY 97/98 total state shared revenue based on Proposal A inflation factor 1.6%(98/99), 1.9%(99/00), 3.2%(00/01), 3.2%(01/02), 1.5%(02/03), 2.3% (03/04), 2.3% (04/05), 3.3% (05/06), 3.7% (06/07), 2.3% (07/08), 4.4% (08/09), -.3% (09/10), 1.7% (10/11), 2.7% (11/12), 2.4% (12/13), estimated 2% (13/14)

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Economic Vitality Incentive Program (EVIP)

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- The statutory portion of state shared revenue was replaced with EVIP in 2011
- Counties and local governments no longer automatically receive these funds—they now have to "earn" them
- There is no way to earn extra funds, you get what you get
- There are 3 compliance categories
  - Accountability and Transparency
  - Consolidation of Services
  - Employee Compensation
- 1/3 of the payment is earned for completion of each category upon approval by the State

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Regional Cooperation

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Not a new concept
- Communities have been working together for years
- In rural regions, communities have combined finances to purchase large equipment, e.g. Fire equipment
- In urban areas, some services are provided to multiple communities, e.g. Libraries, School districts, Water/Sewer

Financial Value in Cooperation
- Economies of scale exist in many Governmental service offerings
- Reduced costs and maintained or improved services levels through:
  - Removal of municipal boundaries
  - Reduction of administrative overhead
  - Reduced duplication of services

The Case for Collaboration

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- Better services
- Increases manpower to improve service levels
- Improves employee performance and morale
- Enhances career opportunities for staff
- More efficient use of personnel
- Improves quantity and quality of service
- Reduces duplication of services
- Broadens resource accessibility / utilization
- Finances
- Spreads financing responsibility and risk
- Achieves volume purchasing discounts
- Achieves economies of size, scale, and scope
- Community Relations
- Meets citizen expectations for service
- Improves equity of access to service
- Expands sense of community

Source information taken from the MGFOA's white paper entitled "The Business Case for Interlocal Cooperation"

Typical City
Example of Structure Deficit

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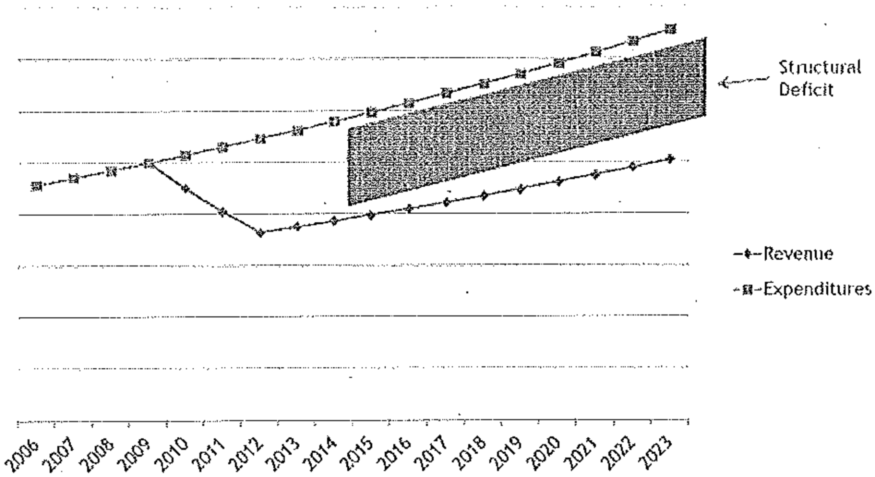

Typical City
General Fund Expenditures
Years Ended June 30

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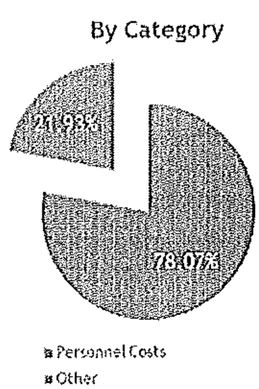

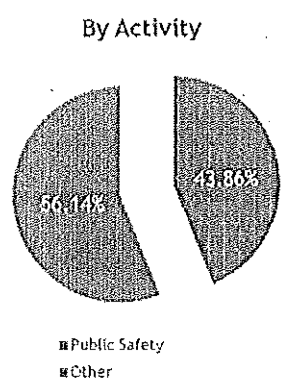

Real-life City
Pension Cost Trends

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The Retirement contributions have increased in recent years due to mixed investment results and an increase in the number of retirees

	Police & Fire Employees	Municipal Employees
2006	$1,315,000	$1,068,000
2007	$1,818,000	$1,486,000
2008	$2,172,000	$1,633,000
2009	$2,354,000	$1,726,000
2010	$2,569,000	$1,812,000
2011	$2,947,000	$2,112,000

- Some pension systems have been closing to save money
  - Creates relief in the long term
  - In short term contributions increase

Real-life City
Health Care Cost Trends

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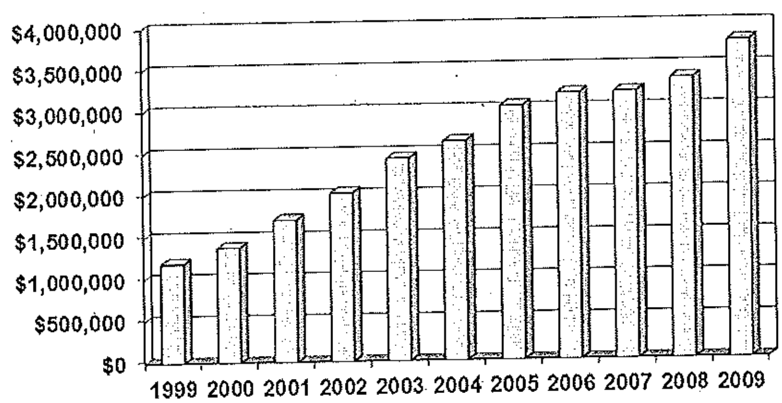

Active and Retired Employee Health Care Costs

GASB 67 *Financial Reporting for Pension Plans* and GASB 68 *Accounting and Financial Reporting for Pensions*

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- First time pension liability will be recorded on balance sheet
- Effective dates:
  - Employer reporting: years beginning after June 15, 2014
  - Pension Plans: years beginning after June 15, 2013
- Difference between pension plan net assets and the pension obligation liability will be recognized by the employer as a liability in the basic financial statements
  - Recorded at the government wide level and in proprietary funds
  - NOT recorded in the governmental funds
  - Called net pension liability or net pension asset
  - Pension plan assets will be measured at Fair Market Value (not smoothed)

GASB 67 *Financial Reporting for Pension Plans* and GASB 68 *Accounting and Financial Reporting for Pensions*

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- Everyone will now use the "entry" age actuarial cost method and the "level % of payroll" to measure the liability
- Year to year changes in the liability will be recorded as Pension expense (with the exception of a few items that will be deferred or amortized)
- Significant new footnote disclosures
- Expanded RSI
- Cost Sharing Employees:
  - Required to report their allocable portion of the net pension liability in the financial statements
- It is anticipated that similar treatment for OPEB will be coming

Emergency Financial Manager Legislation Updates

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- Public Act 4 of 2011 ("emergency manager bill") was repealed by voters in November 2012
- In response, the Legislature passed a replacement to this bill PA 436: "the Local Financial Stability and Choice Act"
- PA 436 took effect in March 2013
- PA 436 gives the distressed community 4 options:
  - Enter into a consent agreement
  - Mediation with the State
  - Emergency manager
  - Chapter 9 bankruptcy
- State is now responsible to pay the salary and other costs of the Emergency Manager—not the distressed community

Questions

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- THANK YOU

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EVIP LEGISLATION MOVES FORWARD – CHANGES TO PROGRAM LIKELY

Both the House and Senate Appropriation Committees have reported separate versions of the 2013 – 2014 General Government Budget and approval from each chamber is expected in the near future. The budget bills that include the EVIP and revenue sharing programs are in very different forms and the budget appears headed to a conference committee where all the points of difference will be worked out prior to final passage of the budget that is expected in early to mid-June.

Financial Section: The budget for 2013 – 2014 will include slight increases in the constitutional revenue sharing amounts of $29.4 million as well as a small increase to counties in their revenue sharing of $8 million and EVIP of $2 million. Funding levels for the consolidation grant program remains unchanged at $15 million. The House concurred with these increases, but the Senate increased the EVIP program an additional 4.8% for all participants.

Governor's Recommendation:

Category One: Largely unchanged from prior year requirements, except for the addition that entities include a listing of all debt service requirements in their annual financial report.

Category Two: Largely unchanged from prior year requirements except an additional consolidation, collaboration or cooperation agreement is required.

Category Three: Largely unchanged from prior year requirements except the option to choose between establishment of an employee compensation plan (pension reforms) and the Publicly Funded Health Insurance Contribution Act (Public Act 2011 – 152) has been removed and compliance with both is required. The actual requirements of each are unchanged.

House Passed Version / HB 4220:

Category One: Concurs with the majority of the Governor's recommendations but adds a requirement that entities disclose employee salaries by job classification as well as any severance agreements and any contracts in excess of $25,000.

Category Two: Concurs with the majority of the Governor's recommendations but adds language that would include innovations and privatizations.

Category Three: House language completely changes the requirements, eliminating language dealing with employee compensation and compliance with PA 2011 -152 requirements and adding language to require entities extending union contracts prior to March 28, 2013 to meet certain requirements and requirements that local units report on the status of unfunded pension and health insurance unfunded liabilities including proposals on how they intend to reduce their unfunded liability.

In addition, the House also added community colleges and universities to the list of entities that would be eligible under the terms of the grant program. The Governor's recommendation was to continue the current practice of offering the program to local government units, K-12 school districts and ISD's.

K Rhead

Senate Passed Version/SB 194:

Category One: Senate concurs with Governor's recommendation.

Category Two: Senate eliminated the requirement in the Governor's recommendation that an entity that has identified consolidation efforts in past EVIP reports identify a new proposal for FY 2013 -2014.

Category Three: Senate changed the category from "Employee Compensation" to "Unfunded Accrued Liabilities" and eliminated both the employee compensation and compliance with PA 2011 -152 requirements and added the requirement that an entity must submit a plan to reduce unfunded accrued liabilities.

ROAD COMMISSION BEST PRACTICE BILLS / HB 5301 PA 2012-466 HB 5302 PA 506 HB 5313 PA 507

- Develops Revenue Sharing / EVIP type BEST PRACTICES for Act 51 Transportation Funding
- Effects all entities that receive Act 51 funds not just Road Commissions
- Pension & Health Insurance Requirements mirror "Old EVIP" requirements

1. Beginning FY 2015 **CHOICE BETWEEN** Pension Reforms or Health Insurance Reforms
2. Health Insurance Reforms require compliance with Publically Funded Health Insurance Contribution Act – SB 7 / PA 2011 – 152 requiring an employer that provides health insurance pay an annual amount of no more than $5500 for a single employee, $11,000 for an employee and spouse and $15,000 for a family **or** require an employee contribution of at least 20% of the annual amount of the insurance premium. A limited number of local units of government do have the option to opt out of the requirements.
3. Employee Compensation Reforms require all new hires have pension benefits capped at 10% or 16.2% of base salary, restrict defined benefit pension multipliers to 1.5%, 2.25% or 3% and limit final average compensation calculations to at least 3 years, 240 hours of paid leave and no overtime. 80 / 20 health insurance cost sharing is also required. Pension multipliers and FAC calculations prior to 9-30-13 are exempt.

EVIP / GENERAL GOVERNMENT BUDGETS FOR FY 2013 – 2014

HB 4220: Constitutional revenue sharing increased by $17.1 million / $725,496,300 EVIP for all but counties remains at $225 million (counties revenue sharing increases $8 million and EVIP increases $2 million) and competitive grant program remains at $15 million.

Category One: Added requirement that entities list salaries by job classification and any contract over $25,000. **Category Two:** Remains mostly unchanged. **Category Three:** Adds "Right to Work" restrictions on employee agreements, eliminates caps on pension benefits and also eliminates health insurance limits, now requiring an entity identify ways they intend to reduce unfunded pension and health care liability

SB 194: Follows Governor's recommended revenue amounts, similar to House version. **Category One:** Eliminates House language and mirrors language in Governor's recommendation. **Category Two:** Mirrors House language except Senate language eliminates the requirement that an entity identify an additional consolidation project if they have made consolidations in the past. **Category Three:** Eliminates House language dealing with Right to Work but concurs with House by eliminating all pension and health insurance caps and requirements in favor of requiring a proposal of intent to reduce unfunded pension and health care unfunded liability.

K. Rhead

Senate Passed Version/SB 194:

Category One: Senate concurs with Governor's recommendation.

Category Two: Senate eliminated the requirement in the Governor's recommendation that an entity that has identified consolidation efforts in past EVIP reports identify a new proposal for FY 2013 -2014.

Category Three: Senate changed the category from "Employee Compensation" to "Unfunded Accrued Liabilities" and eliminated both the employee compensation and compliance with PA 2011 -152 requirements and added the requirement that an entity must submit a plan to reduce unfunded accrued liabilities.

EMERGENCY MANAGER LEGISLATION / SB 865 PA 2012-436

The first part of the EM process remains pretty much unchanged until the report from the Financial Review Team shows that an entity does indeed have a financial emergency. The new bill adds two additional options that a local unit of government may select in an attempt to resolve the financial emergency (consent agreement and an emergency manager options remain).

- Consent Agreement
- Emergency Manager
- Neutral Evaluation Process
- Chapter 9 Bankruptcy

Consent Agreement: Written agreement between Treasury and the local unit of government that must include remedial measures, a recovery plan and a continuing operation plan. Local officials could also assume the majority of the powers available to an emergency manager – except the power to modify or terminate a collective bargaining agreement. The governor may choose to place the entity into receivership should the entity breach the consent agreement.

Neutral Evaluation Process: There are many requirements that are intended to assure that the neutral evaluator is indeed neutral. This process will last 60 days with the possibility of one 30 day extension. If an agreement is reached, the content must be approved by Treasury. If Treasury does not approve, the entity must accept one of the other options. If no agreement can be reached within the allowable time limit, the governor shall recommend Chapter 9 bankruptcy.

Chapter 9 Federal Bankruptcy: A request by a local entity to seek federal bankruptcy protection must be approved by the governor. If not approved, the entity has seven days to select one of the other three options.

Emergency Manager: Powers of the EM remain pretty much unchanged, but local elected officials now have some increased powers in the new legislation including the ability to remove the EM. Should the EM be removed, the entity must submit to either a consent agreement or attempt to implement an agreement through the neutral evaluation process. The local unit can also reject the recovery plan that must be proposed by the EM, but if they do, they have ten days to receive approval of their own proposal (by the Financial Assistance Loan Board) or agree to the proposal prepared by the EM.

STOCKTON CALIFORNIA / DETROIT AND BEYOND

A federal judge's decision to accept arguments that will pit the state pension fund against bond holders and the huge banks that conduct those transactions could have a very chilling effect on public pension retirees that have always claimed constitutional protection of their pension benefits.