City of Madison Heights

City Hall Municipal Offices
300 W. Thirteen Mile Road
Madison Heights, MI 48071

Department of Public Services
801 Ajax Drive
Madison Heights, MI 48071

Fire Department
31313 Brush Street
Madison Heights, MI 48071

Police Department
280 W. Thirteen Mile Road
Madison Heights, MI 48071

www.madison-heights.org

To: Honorable Mayor and City Council

From: Melissa R. Marsh, City Manager

Date: November 14, 2018

RE: **Five Year Financial Forecast – Fiscal Years 2019-2023**

Attached please find the five year forecast for the City of Madison Heights for the Fiscal Years 2019-2023. This forecast should be evaluated as a financial estimate, created from the best available information at this point in time.

Executive Summary

The goal of the Five-Year Financial Forecast is to provide Staff, Council, and the public with a detailed estimate of the revenues and expenditures for the current and future four years, to serve as the first step in the upcoming year budget process. This detailed look at the financial estimates serves as a tool to identify financial trends, shortfalls and issues so the City can proactively address them. The forecast, therefore, is essential for planning the future financial sustainability of the City as we proceed through the Strategic Planning, Capital Improvement and Budget Planning processes.

From 2007 to 2014, the City has had to deal with many financial obstacles including declining revenues, increased home foreclosures, skyrocketing health insurance increases and increasing legacy cost including pension and retiree health care benefit costs. During this period the City stayed fiscally sound by deferring infrastructure replacements and repairs, eliminating staff and postponing new innovated projects. Starting in FY 2014, the economic climate began to improve as noted by the majority of national, State, regional and local economic indicators. As a result the City has started to gradually address the problems created by the contraction of spending during the recession. This fall, the City embarked on its first strategic planning process in order to address the overwhelming infrastructure, capital asset, personnel and programing needs throughout the City. This forecast is one part of this overall strategic plan.

This forecast assumes continued gradual growth of the national economy with positive impacts to the local economy, which is reflective in staff's estimates of economically sensitive revenue estimates. Despite the steadily improving economic climate, the long-term financial outlook continues to identify structural challenges to the City's General, Major Street and Local Street Funds due primarily to the restrictions of Proposal "A" and the Headlee Amendment and burden of legacy costs such as pension and retiree health care benefits.

It is important to stress that this forecast is not a budget. It doesn't make expenditure decisions but does assess the need to continue to prioritize the allocation of City resources. The purpose of the forecast is to provide an overview of the City's fiscal health based on various assumptions over the current and next four years and to provide the City

Council, management, and the citizens of Madison Heights with a "heads up" on the financial outlook beyond the annual budget cycle. The five-year forecast is intended to serve as a planning tool to bring a long-term perspective to the budget process.

The Government Finance Officers Association (GFOA) recognizes the importance of combining the forecasting of revenues and expenditures into a single financial forecast. The GFOA recommends that a government should have a financial planning process that assesses long-term financial implications of current and proposed policies, programs, and assumptions that develop appropriate strategies to achieve its goals.

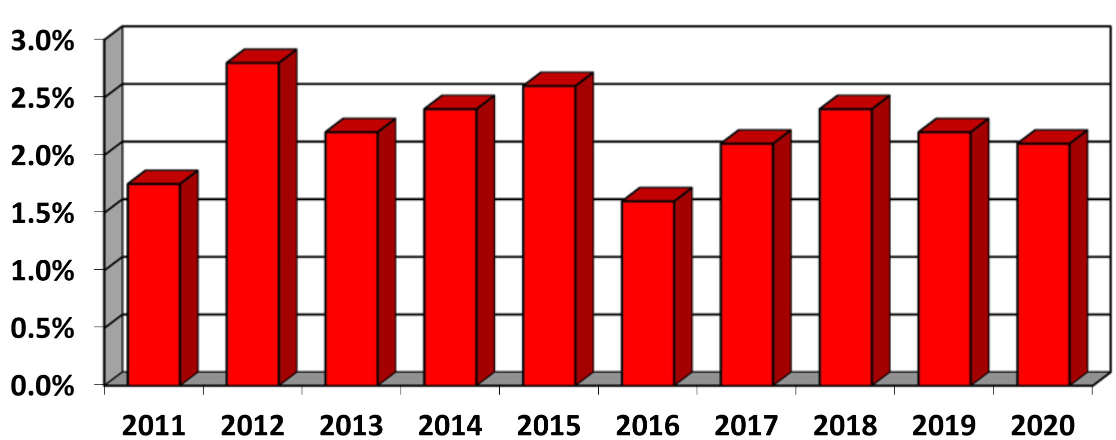
Regional Economic Outlook

The future course of the Oakland County and Madison Heights economy depends in part on the overall health of the national economy. The best single measure of the U.S. economy is inflation-adjusted, or real, Gross Domestic Product, which is comprised of all of the goods, services, and structures produced in the economy. As reported by representatives of the University of Michigan's Institute for Research on Labor, Employment, and the Economy at the June 2018 Oakland County Economic Outlook Forum, real GDP growth picked up from its disappointing pace of 1.5% in 2016 to a more respectable 2.3% rate in 2017. The year ended on a relatively strong note, with domestic final demand registering a healthy 4.4% annualized growth rate in the fourth quarter. The major factor in GDP over the next few years is federal fiscal stimulus, which will likely end up being quite substantial, adding approximately eight-tenths of a percentage point to the real GDP grown over the next three years.

This scale of fiscal stimulus in an economy near full employment is very unusual: one has to go back to the Johnson administration in the mid-1960s, with its Great Society programs and Vietnam ground war funding, to find similar historical episode. The economist also notes, this is completely unsustainable, as they project federal debt-to-GDP ratio to rise 9.2% from the end of 2017 to the end of 2020.

As forecasted, U.S. Light Vehicle Sales grew every year from the recession low point to 10.4 million units in 2009 through 2016, when they set an all-time record of 17.5 million units. Detroit's Big Three share of the light vehicle market fell from 42.7% in 2016 to 42% in 2017, as total Detroit Three sales fell be roughly 250,000 units. The Detroit Three are projected to hold steady at 42% in 2018 and inching up to 42.3% in 2020. This assumes that the United States does not withdraw from NAFTA, which remains the baseline for the Oakland County forecast.

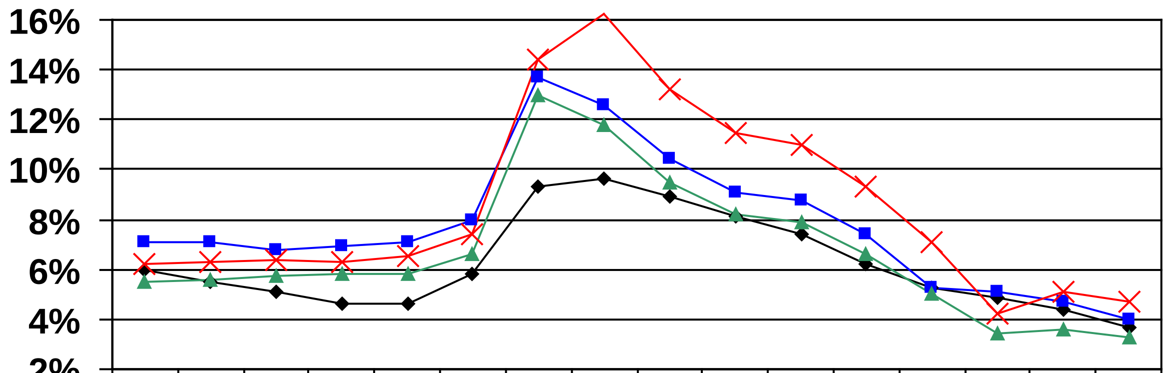
Growth in U.S. Gross Domestic Product, 2011-2020



Of the key economic factors, job growth and unemployment are two of the most important financial indicators of recovery because a loss of jobs cuts across all sectors of Michigan's economy, impacting the housing market, and funding for state and local government services which rely on income, property and sales taxes. The University of Michigan economists forecast that job growth will continue to be slower than forecasted last year. The unemployment rate for Oakland County fell to an average of just 3.5% in 2017, from 4.2% in 2016.

In summary, the financial forecast is reasonably healthy growth over the next few years, but at the potential cost of stirring up trouble down the road.

Annual Unemployment Rates, 2003 through September 2018



	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Sep-18
United States	6.0%	5.5%	5.1%	4.6%	4.6%	5.8%	9.3%	9.6%	8.9%	8.1%	7.4%	6.2%	5.3%	4.9%	4.4%	3.7%
Michigan	7.1%	7.1%	6.8%	6.9%	7.1%	8.0%	13.7%	12.6%	10.4%	9.1%	8.8%	7.4%	5.3%	5.1%	4.7%	4.0%
Oakland County	5.5%	5.6%	5.7%	5.8%	5.8%	6.6%	13.0%	11.8%	9.5%	8.2%	7.9%	6.6%	5.0%	3.4%	3.6%	3.3%
Madison Heights	6.2%	6.3%	6.4%	6.3%	6.5%	7.4%	14.4%	16.2%	13.2%	11.5%	11.0%	9.3%	7.1%	4.2%	5.1%	4.7%

(Source: Bureau of Labor Statistics)

As indicated above, unemployment rates dropped reaching the pre-recession point. Madison Heights remains slightly higher than the other unemployment indicators, but is better than any point in the last 15 years.

Financial Forecast

The forecast reflects actuals for Fiscal Year 2018, estimated expenditures for Fiscal Year 2019 and forecasted figures for Fiscal Years 2020-2023. The forecast focuses on the City's major appropriated funds which include the General, Major Street, Local Street and Water and Sewer Funds.

The General Fund is the primary focus of the forecast report because this fund is the City's operating fund which pays for services such as police, fire, library, parks, recreation, solid waste collection/disposal, and administration.

Overview of Fiscal Year 2017-18

Fiscal Year 2018 General Fund reserves ended at $7.9 million, up from $7.1 million in fiscal year 2017. Of this amount, $7.26 million is considered to be spendable and available to fund operations. This increase in fund balance was a direct result of carryforwards from FY 2018 into FY 2019 for $590,380 and increases in three main revenues sources.

In FY 2018, Local Community Stabilization Authority (LCSA) reimbursed $2.1 million across all funds with $1.8 million for the General Fund as compared to the budget of $1.3 million. This was $556,330 more than budgeted. Miscellaneous revenues source are insurance distortions allocated from rebated and investment earnings. During FY 2018, the City received insurance distributions of $627,859 of which $520,554 was allocated to the General Fund. This exceeded the budget by $170,554. Ambulance revenue came in higher than budgeted in FY 2018 by $121,733. A few revenues did underperform the budget for the year including court revenues that were received at $176,720 less than budgeted.

Overall the General Fund departments completed the year at 99.3% of the budget allocated.

Overview of the Current Fiscal Year 2018-2019

The fiscal year 2019 General Fund budget of $29.7 million, which include a budgeted use of fund balance of $520,884, was adopted by Council in May 2018. Carryforwards and budget amendments were approved in June 2018 including an additional use of fund balance of $590,380 for carry-over expenditures. Since that time, Council has approved additional budget amendments of $447,104 to cover capital asset purchases and contractual services for refuse hauling, a City Manager search firm, and phase three funding for a pumper truck. This brings the planned use of fund balance to $1.4 million in FY 2019. The majority of revenues are holding steady with a few exceptions as reported in the first quarter Council and departmental revenue and expenditure reports.

Tax foreclosure administrative fees which were budgeted at $0 have an actual of $66,500, no more revenue is expected into this account for the year. State shared revenue budgeted at $2.49 million and expected at $2.52 or $32,000 over budget. Local Community Stabilization Authority (LCSA) estimates that the personal property tax reimbursement revenue will be approximately $50,000 lower than the budget; however this is subject to change depending on the state excess funds reserve. Court revenues are currently trending lower than budget by approximately $10,000.

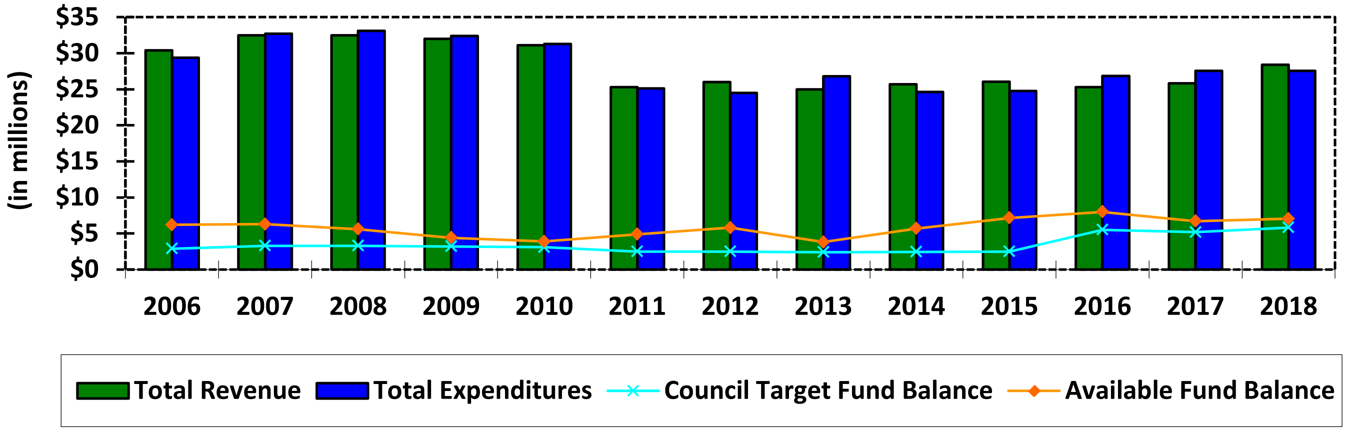
Expenditures during the first quarter are also in line with amended budgeted expenditures with the exception of Police overtime and City Manager wages. The City had a few unplanned retirements that may result in budget amendments later in the year if vacancy savings do not cover these additional charges. There may also be emergencies or unknown expenses that can cause overages as of December 31, 2018. City Council will be asked to review and approve mid-year budget amendments if overages are likely to occur in January 2019.

General Fund Reserves

In December 2015, the City Council approved the goal to modify the City's Financial Reserve Policy to comply with the Michigan Government Financial Officers Association Best Practices of adhering to an operating reserve policy setting the minimum reserve level at no less than two months or 16% of regular operating expenditures plus one year of debt payments, using fund balance reserves only for one-time expenditures. This policy was established to prudently protect the fiscal solvency of the City. Reserves are important in order to mitigate the negative impact on revenues from economic fluctuations, State budget adjustments and unfunded mandates, as well as unforeseen expenditure requirements. The following bar/line graph depicts the target and available General Fund Balances since 2006, as shown against total revenues and expenditures. In all years, the City has been able to maintain a fund balance at or slightly above the minimum target fund balance.

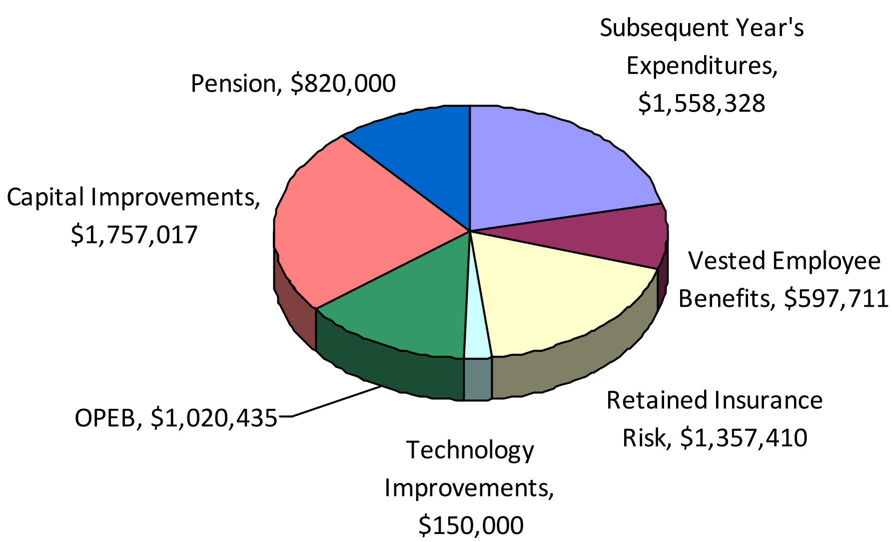
As stated previously, in Fiscal Year 2018 General Fund reserves ended at $7.9 million, up from $7.1 million in FY 2017. Of this amount, $7.26 million is considered to be spendable and available to fund operations. $1.6 million of this fund balance is already planned to be spent in FY 2019. Total FY 2019 operating expenditures (not including capital expenditures) are $27.3 million with general obligation debt payments at $1,460,885. The required fund balance reserve is $5,834,727. Strong financial policies that are reviewed on a regular basis are part of the reason the City has maintained its AA- bond rating.

General Fund - Fund Balance Compared to Total Revenues and Expenditures



In addition, staff reviews the reserve levels at the end of each fiscal year and assigns reserves to meet unfunded liabilities. Currently, reserves are assigned as follows: 21.5% to fund subsequent year's expenditures, 8.2% for vested employee benefits (not including pension or retiree health care), 18.7% for retained insurance risk, 2.1% for technology improvements, 14.1% for other post-employment benefits (OPEB), 11.3% for pension obligation bond payments and 24.1% capital improvements (see the following pie chart).

Assigned General Fund Reserves as of June 30, 2018



Overview of Five Year Forecast - FY 2019-2023

The Five Year Financial Forecast includes a baseline projection of revenues and expenditures used to evaluate the City's future financial condition and capacity to fund existing services and infrastructure needs. The growth assumptions in the baseline projections are based on the most recent economic data provided by various sources and existing City contractual obligations such as service contracts, labor agreements and debt service.

General Fund revenues are projected to continue to be stable with growth estimated to be at or slightly below the rate of inflation in the current year and next four years. This continues to be a result of the drastic loss of taxable value city-wide during the recession with recovery restricted by Proposal A and the Headlee Amendment with limited relief from real estate additions such as redevelopments. Major discretionary revenues are projected to increase an average of 1.24% overall as property taxes (our largest revenue source) are forecasted to increase over the next four years through a combination of real property and personal property by an average of 2.1% per year. This compares to an historical average decrease of total revenues of 2.9% from 2010 to 2015, which included declines in property tax revenues, court revenues and state revenue sharing. Some significant revenues such as cable television revenues and court fees are projected to decrease while state revenue sharing and personal property tax reimbursement from the state are projected to be stagnate. Expenditures are projected to expand only slightly at an annual average rate of 0.47% during the succeeding four years, taking into account the City's infrastructure needs and assumption of full implementation of the City's current Capital Improvement Plan. This forecast does not take into consideration changes in negotiated benefits or wage increases for seven the City's eight bargaining contracts which expired on June 30, 2018. The Department of Public Services contract has been settled and is included. (For reference, a 1% wage increase, with roll-up benefits, costs approximately $139,690 for the General Fund.) This forecast also does not take into consideration of any changes resulting from the City's strategic plan to change and/or enhance some service offerings.

Forecasted Challenges – FY 2019-2023

The three major financial challenges facing the City over the next decade continue to be legacy costs, infrastructure and capital outlay needs. Legacy costs are the cost of pension and retiree health care for employees after they leave the service of the City. Each benefit has a unique set of issues which are discussed separately below:

<u>*Pension*</u>

As part of the FY 2017 goal process, Council approved a goal to: *Develop and implement a plan and policy to fully address the City's unfunded liabilities for pension and other post-employment benefits.* As part of accomplishing this goal, staff researched and Council approved the issuance of Pension Obligation Bonds (POBs) in the amount of $15,250,000 for 16 years in order to fund the accrued liability for the General (non-sworn) employees in the Michigan Municipal Employee Retirement System (MERS). These bonds were issued on September 29, 2016 and funds were transferred to MERS bringing the general employees' pension system to 106% funded. The current budget and the following four year forecast include the bond payment plus the normal cost for the pension system on an annual basis. Normal cost is required to be paid even when funds are over 100% funded because the normal cost is not included in the accrued liability. It is the amount attributable to the current year of earned service.

The Police and Fire Pension Fund is only 54.5% funded down from 58.6% in FY 2017. This funding issue has not been addressed beyond making more than the annual actuarially required contribution. This pension plan remains open to new hires, although their benefits have been reduced through a tiered system. The funding of this liability is paid annually through the Public Act 345 millage which for FY 2019 is 7.5927 mills or 29.5% of the current overall millage rate. Pension is a major concern with employees and management and solutions are being discussed during the on-going union negotiations.

Retiree Health Care

Ten years ago, the Council approved the establishment of two Retiree Health Care Trust and since that time we have funded over $31.7 million; however, this pales in comparison to the amount needed which is actuarially calculated to be $108.3 million. In FY 2017 City Council prudently approved a budget amendment to make an additional contribution exceeding the recommended contribution for the fiscal year by $279,284. However for FY 2018, the City returned to the base percentage of contributions which is less than the actuarially determined contribution by $3.7 million. While this is still better than many municipalities statewide, the current funding level does not meet the new recommended State funding level of 40%. Therefore, reducing this liability while also increasing this funding will be a major focus of future budget proposals. The combined Trust funding is 29.2% of the actuarially calculated liability. The City is working on compliance plans to meet the State's threshold of 40% funding however this is only possible in a reasonable timeframe if benefits are also reduced.

The forecast includes level funding the contribution as currently included in the FY 2019 budget.

Forecast Summary/Conclusion

This long-term financial outlook continues to identify structural challenges to the City's General Fund. Specific recommendations to achieve a balanced budget for Fiscal Year 2019-20 will be presented as part of the proposed budget and will continue to attempt to address legacy costs to the City.

General Fund Forecast Summary
(in millions)

	2017-18 Actual	2018-19 Projected	2019-20 Forecast	2020-21 Forecast	2021-22 Forecast	2022-23 Forecast
Revenues	$28.396	$29.419	$29.732	$30.128	$30.564	$30.865
Expenditures	$27.573	$30.843	$30.959	$31.694	$31.597	$31.699
	$0.823	($1.424)	($1.227)	($1.566)	($1.033)	($0.834)
General Fund Non-restricted Reserves	$7.261	$5.84	$4.61	$3.04	$2.01	$1.18
% Reserves of Current Year Expenditures	**26.33%**	**18.92%**	**14.89%**	**9.6%**	**6.36%**	**3.71%**

Development of a long-term financial plan is essential to sound fiscal management. The plan is not able to predict with certainty the City's fiscal future, but rather it will serve as a tool to highlight significant issues or problems that must be addressed during the upcoming budget cycle if the City's goal of maintaining fiscal health and sustainability over the long term is to be achieved.

It should be noted that this report has focused on the City's ability to continue current services and programs using existing sources of revenues. **Based on the five-year forecast report, funding for any new programs or goals, reversal of "gap" measures used to balance the budget, during the great recession or other major initiatives will require tradeoffs during the planning and budgeting processes.**

General Fund Revenue & Expenditure Assumptions

As mentioned earlier, current economic reports indicate that the state and county are showing strong signs of recovery. Revenue estimates contained in this forecast are based on assumptions that the overall property tax will be stable with a increase of 2.6% based on the inflation rate multiplier adopted by the State Tax Commission, additions to the tax roll at year-end and roll-backs required under state law. Although the housing sector continues to expand, the Michigan tax structure limits growth to CPI or 5%, whichever is less. The State Tax Commission calculation of the Inflation Rate Multiplier has been calculated to be 2.4% for 2018 (Tax Year 2019). Real property taxable value estimates are based on assumptions received from Oakland County Equalization of a maximum of 3.0-3.5% reduced for Proposal A and Headlee, and variations are due to Michigan Tax Tribunal reductions to 2.6%. Other major revenues such as State Revenue Sharing are assumed to see a modest increase of 2.2% or $64,775 to Constitutional portion and remaining flat for the statutory portion based on the State of Michigan's budget projections.

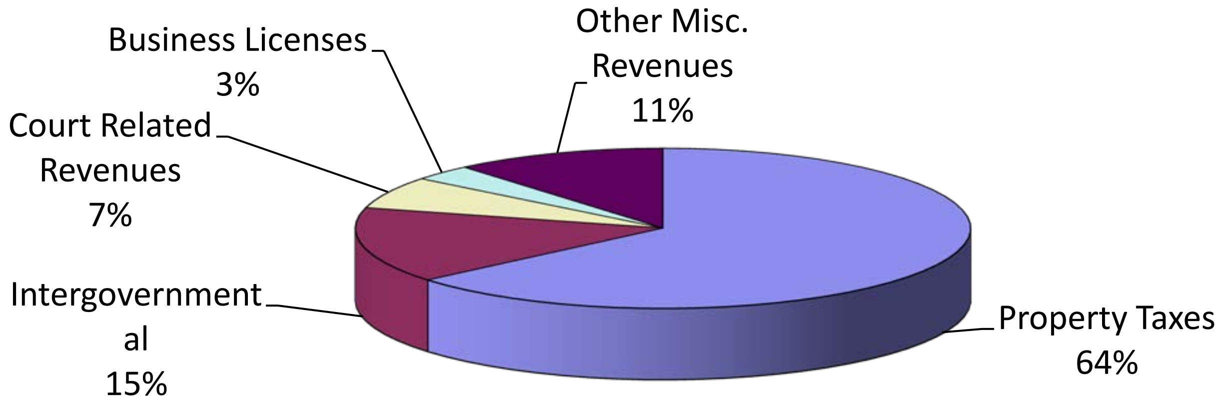
Overall total revenues are estimated to remain essentially flat without much growth over the forecast period. The projection in growth for revenues is slightly higher than the annual forecasted increase in expenditures. However, as expenditures are projected at $1.5 million more than revenues we cannot catch-up without increased revenues source or decreased revenues over the forecast period.

Forecast of Major General Fund Revenues
% Change from Prior Year

Revenue Category	2017-18 Actual	2018-19 Projected	2019-20 Forecast	2020-21 Forecast	2021-22 Forecast	2022-23 Forecast
Property Tax	5.38%	6.78%*	2.14%	1.77%	1.53%	1.63%
Business Licenses	-9.89%	0.31%	0.16%	0.23%	2.72%	0.91%
Intergovernmental	7.80%	-0.34%	-1.97%	1.71%	0.96%	0.97%
Court	-4.40%	2.27%	0.53%	0.37%	0.00%	0.00%
Other	8.32%	-3.34%	-0.22%	-1.14%	0.55%	-0.90%
Total	5.17%	3.13%	1.48%	1.23%	1.18%	1.05%

- *Increase in property taxes from FY 2018 to FY 2019 is a direct result of an increase in the millage rate for the Police and Fire Pension millage from 6.9 mills to 7.6 mills.*

General Fund Revenues
Major Revenues Forecasted in FY 2018-19 by Category



The following pages detail several key assumptions applied in the preparation of the financial forecast, as reflected in the table above.

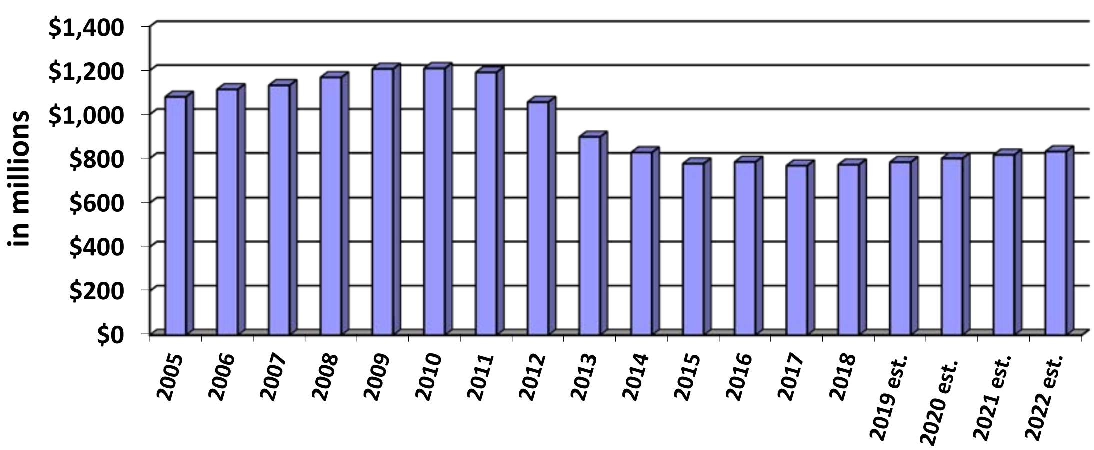
General Fund Assumptions

Major Revenues

Property Tax

Real Property Tax revenues are projected to increase 2.6%, but reduced to the amount of inflation, which has been calculated at 2.4%. Personal property is estimated to continue to decrease as more business operators take advantage of property tax exemptions available. This information is based on estimates from Oakland County Equalization.

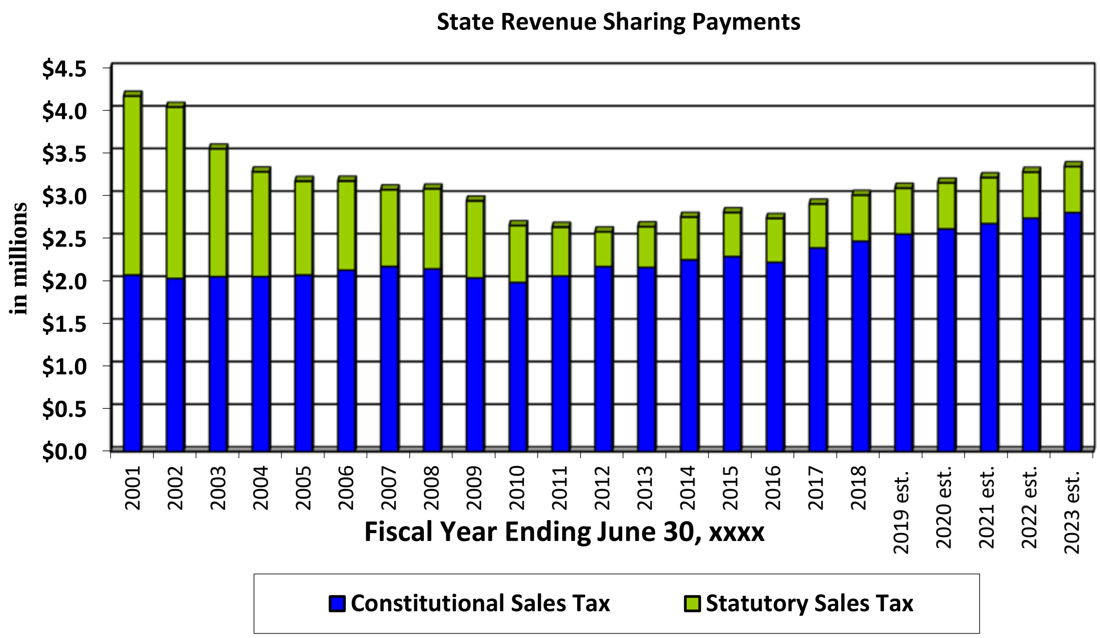
Total Taxable Value
Fiscal Year ending June 30, 20xx



It is important to note that in Michigan, taxable value is approximately 50 percent of the property's fair market value in the year following the date of transfer, as adjusted for inflation in accordance with Proposal A of 1994, which limits future increases to five percent or the rate of inflation, whichever is lower, for each individual property.

Intergovernmental – including State Shared Revenues

The State Revenue Sharing Program distributes sales tax collected by the State to local governments as unrestricted revenues. The distribution of funds is authorized by the State Revenue Sharing Act, Public Act 140 of 1971. Shared Revenues are comprised of two parts: Constitutional and Statutory which includes the city, village, and township revenue sharing (CVTRS) program. In addition, the act authorizes the appropriation and distribution of state General Fund-General Purpose revenues when local governments qualify for certain supplemental payments. The forecast includes a 2.4% increase in the Constitutional part of this payment, status quo for the statutory part. The forecast assumes that the City continues to meet all the requirements to achieve 100% of the CVTRS funds. These requirements now include a citizen's guide, performance dashboard, debt service and projected budget report. These reports have been submitted and received ahead of the December 1st deadline for the upcoming fiscal year.



Federal revenues are forecasted to decrease during the forecast years. The current federal revenue is Law Enforcement Grant revenue and Medicare Part D subsidy, the Medicare Part D subsidy was eliminated in FY 2019 as the city switched to a Medicare Employer Group Waiver Plan (EGWP) for retiree prescription payments.

Court Revenues

Court Revenues are forecasted to be up in the current year as actual revenues in FY 2018 were significantly low. The following four years are anticipated to remain steady at the Fiscal Year 2019 levels. Court fee structure and amounts retained by the State change frequently. This revenue source is also determined by collection rates.

Other Revenues

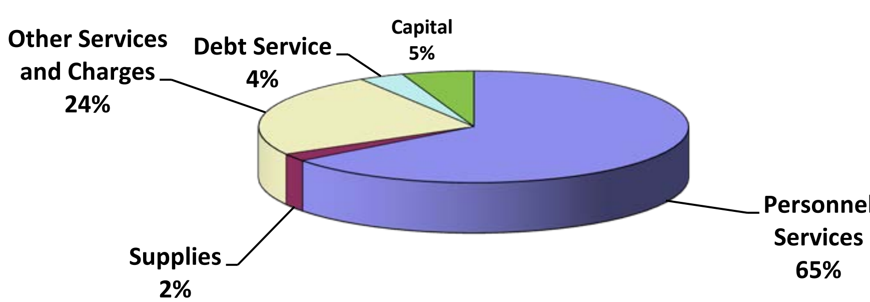
Miscellaneous Revenues are conservatively assumed to be slightly lower than FY 2019 budget level during the forecasted years. Miscellaneous revenues include revenues such as cable television franchise fees and interest income as well as one-time items. We forecast cable television franchise fees to be reduced slightly as more people opt to stream entertainment instead of rely on traditional cable. Interest rates are forecasted to increase slightly over the four year period.

Business license revenues are anticipated to increase based on historical collections for occupational licenses and continued high collection and enforcement of business licenses.

Major Expenditures

From 2009 until 2016, the City enacted a number of measures to keep operational expenditures in line with its declining revenues. FY 2017 and 2018 saw a gradual increase in expenditures. We are still very cautious as we want to insure we have a budget that is sustainable. Expenditures in the forecast are estimated to be $31.1 million for Fiscal Year 2019, $30.9 million in Fiscal Year 2020, $31.7 million in Fiscal Year 2021, $31.6 million in Fiscal Year 2022, and $31.7 in Fiscal Year 2023. Until 2021, expenditures are still forecasted to be lower than 2008 when the city ended the year with actual expenditures of $31.4 million. These expenditures are made up of personnel services, supplies, other services, and capital outlay.

General Fund Expenditures
Major Expenditures Forecasted in FY 2018-19 by Category

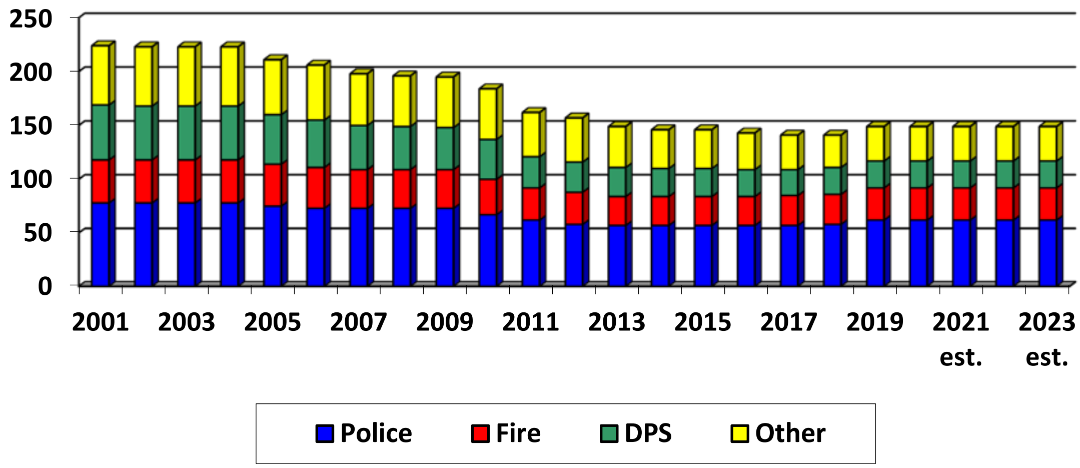


Personnel Categories

The personnel category, including health care premiums and retirement benefits, represents 64.6% of the General Fund budget.

Full-time staffing, which consists of 149 full-time employees, is assumed to remain at or near the same level for the period covered by the financial forecast. As the City is experiencing a number of retirements in the key service areas (e.g. police, fire, public services), staff are working hard to provide for timely replacement hires in order to maintain authorized strength.

Budgeted Full-Time Positions
Fiscal Year Ending June 30, XXXX

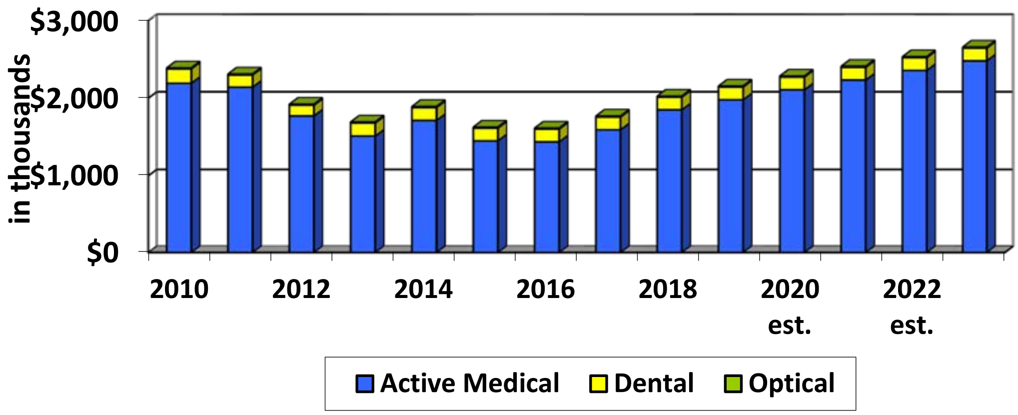


Expenditures related to negotiated salaries are not included in the forecast because all of the City's Union contracts expired on June 30, 2018, except for the Department of Public Services (DPS). The DPS has settled their agreement for three years and the provisions in their agreement are included in this forecast. For estimating purposes, the forecast assumes status quo with both wages and benefit levels for all other groups. Changes in pension contributions are based on estimates by the Municipal Employees Retirement System normal cost projections. These projections are dependent on the market returns and actuarial assumptions, but are forecast to decrease each for the next four years as follows: -4.8%, -11.8%, -8.9%, and -9.8%.

Because of the volatility of health care costs, this forecast assumes rate increases in excess of inflation. Based on estimates from the City's health care consultant and national and state trends, health insurance is forecasted to increase as follows: 7.50% in FY 2020, 6.75% in FY 2021, 6.0% in FY 2022 and 5.25% in FY 2023. The City is hopeful that the continued positive results from the implementation of the MiLife Employee Health and Wellness Center continue into future years with a positive influence on our rates. This center opened in January 2015 and first and second year results show a savings of almost $30,000 per year with $46,873 savings is year three. We have also seen a direct impact on our weekly health insurance cost. The MiLife Wellness Center delivers primary health care to employees in a center dedicated to them, offering zero co-pays and deductibles as a supplemental and voluntary alternative to using their traditional insurance benefits. The City has partnered with two other self-insured municipalities, Ferndale and Royal Oak, in this groundbreaking and innovative endeavor and in FY 2018 we welcomed two more municipal partners: Hazel Park and Oak Park.

The following chart shows the historical and forecasted medical premiums for active employees.

Active Employee Insurance Premiums
Fiscal Year Ending June 30, XXXX



As mentioned previously in this report, the most significant expenditure issue included in the forecast relates to unfunded accrued liabilities. Unfunded accrued liabilities refer to employee pensions and other post-employment benefits.

In June 2015, the Governmental Accounting Standards Board (GASB) issued two new standards addressing accounting and financial reporting by state and local governments for postemployment benefits other than pensions (OPEB, which refers to retiree healthcare). GASB Statement No. 74, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans, was effective last year and addresses reporting by OPEB plans, whereas GASB Statement No. 75, Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions, addresses accounting and reporting by employer governments that provide OPEB benefits to their employees and is effective this year.

Along with the currently required statement of fiduciary net position and statement of changes in fiduciary net position, OPEB plans will now be required to include in the financial statement more extensive footnote disclosures and required supplemental information related to the measurement of the OPEB liabilities for which assets have been accumulated. In addition, the City must now recognize on the face of the financial statements its net OPEB liability.

This two liabilities impact on the City’s government-wide net position is shown below:

	Reported at 6/30/17	With Unfunded Health Care at 6/30/18
Net position:		
Net investment in capital assets	$86,465,940	$90,214,663
Restricted	3,429,708	4,216,825
Unrestricted	(30,578,451)	(108,513,527)
Total net position	$59,317,197	$(14,082,039)

This negative total net position generally means that the City has not fully funded the total cost of government services provided to date. The fact that the unrestricted portion is negative indicates that legacy costs earned to date have not been funded; but this is largely offset by the capital assets that have been funded in advance of their use and cannot be used to fund retiree health care.

Supplies

The majority of supply account line items have been held at status quo for the current year and four forecasted years.

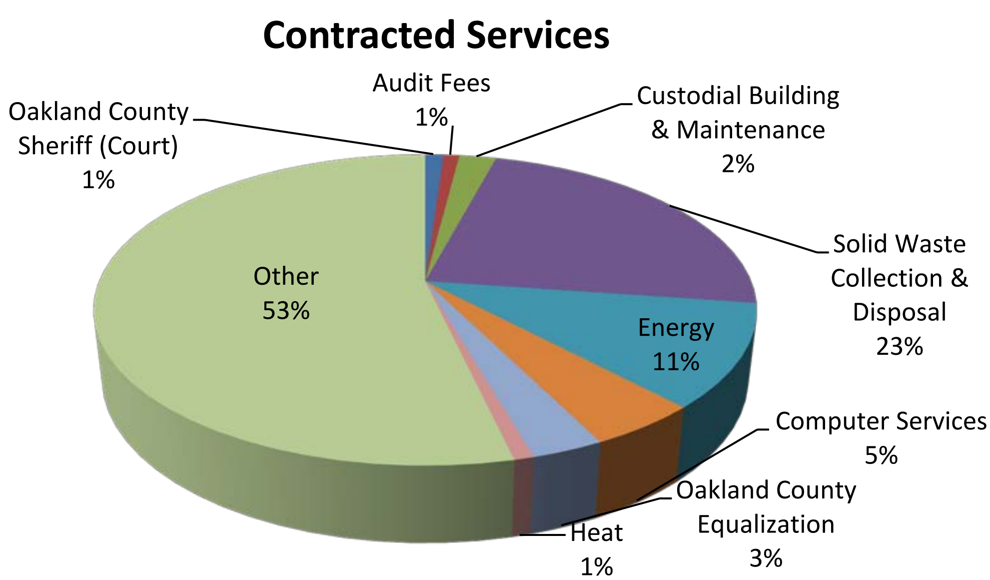
Other major expenditures included in the budget include contracted services. This category includes services for things such as legal, auditing, information technology, engineering, solid waste collection and disposal, and assessing services.

Contracted Services

In April 2016, Council approved a third three-year contract with Oakland County for Equalization Services, which include a 3% increase in cost per parcel. This amount remain fixed through FY 2019. We anticipate continuing this agreement with Oakland County and have forecasted this to continue with a 2% for the following three years increase annually.

Following, the completion of an Information Technology Assessment and Strategic Plan, City Council approved, in November of 2014 a three-year contract to BPI Information Systems which assumed reasonability for information technology support services City-wide at a base cost of $196,000 per year. As provided for under the Agreement, the contract has been extended for two one-year terms until December 2019 under the same terms and conditions.

In June 2018, the City extended an agreement with our Solid Waste Contractor, GFL Services, who was operating under a ten-year contract scheduled to expire in 2020. This extension was approved in order to lock in our rate and provide the options for larger totters for trash and recycling. Rate increases follow this extension at 2.5% annual increase until FY 2025.



Capital Outlay Summary

As a result of dedicated millages, the City continues to make some progress with the preservation of four major asset classes including Vehicles in the General Fund, Improvements to the Active Adult Center and Library, watermain and sanitary sewers in the Water and Sewer Fund, and street-related rehabilitation projects in the Local Street Fund. However, the revenue generated from these millages only cover a small fraction of the infrastructure and capital needs. Other assets included in the forecasted Capital Outlay that are not covered by special millages include computer technology, building improvements, other vehicles, and machinery and Equipment in the General Fund.

This fiscal year the City has revamped the Capital Outlay planning process eliminating the documents that is initially completed in the fall. This document will instead be included as part of the comprehensive budget plan submitted to City Council in April. This fall DPS staff has been working with all department heads to develop a detailed list of infrastructure and capital needs. This list is used in the development of the five-year forecast which includes all of the capital outlay items projected over the next five years. Capital Outlay items recommended in the budget will depend on Council priorities and available funding.

A source of funding for police, fire and maintenance vehicle replacements, Proposal "V", was renewed by Madison Heights voters at the current level for a 10-year period beginning in FY 2018. Unfortunately this millage only generates approximately $200,000 per year which requires us to save this millage for three years to have enough funds to replace one pumper.

Following is a brief summary of the General Fund capital items included in the forecast separated by year, category and funding source:

General Fund CIP Items in Financial Forecast - FY 2019-2023					
Item	**Budget**	**Forecast**			
	2018-19	**2019-20**	**2020-21**	**2021-22**	**2022-23**
Computers and Upgrades:					
IT	8,500	99,375	99,375	99,375	99,375
General Admin	20,875	-	-	-	-
Police	20,000	-	-	-	-
Fire	16,500	-	-	-	-
Total - Computers	65,875	99,375	99,375	99,375	99,375
Machinery and Equipment:					
General Admin	30,000	-	-	-	-
Police	58,800	-	-	-	-
Fire	137,100	234,000	205,000	363,000	1,135,000
Solid Waste	-	-	-	-	-
Parks	301,100	25,000	25,000	25,000	25,000
Streets	-	-	-	-	-
Total - Machinery and Equipment	497,000	259,000	230,000	388,000	1,160,000
Vehicles Proposal "V"					
Police	-	-	-	-	-
Streets	-	-	-	200,000	-
Fire	400,000	-	200,000	-	200,000
Subtotal - Proposal "V"	400,000	-	200,000	200,000	200,000
Vehicles - Non-Proposal "V"					
Police	94,376	160,000	160,000	135,000	135,000
Fire	407,321	34,000	-	363,000	935,000
Communit Development	30,000	64,000		190,000	
Streets	-	-	445,000	360,000	-
Solid Waste	-	-	-	-	-
Seniors	-	70,000	32,000	200,000	-
Subtotal - Non-Proposal "V"	531,697	328,000	637,000	1,248,000	1,070,000
Total - All Vehicles	931,697	328,000	837,000	1,448,000	1,270,000
Improvements					
General Admin	97,000	-	530,000	-	-
Police	342,000	500,000	347,000	133,000	-
Fire	118,000	15,000	155,000	96,000	36,000
Parks	160,000	83,000	79,000	376,000	292,000
Nature Center	55,000	50,000	55,000	55,000	55,000
Senior Citizens	25,000	20,000	32,000	235,000	135,000
Library	64,000	50,000	50,000	50,000	50,000
Total - Improvements	861,000	718,000	1,248,000	945,000	568,000
Total - All Items	2,355,572	1,404,375	2,414,375	2,880,375	3,097,375

Major Street Fund Assumptions

Major Revenues

The primary revenue source of the Major Street Fund is Act 51 road funding from the State. For the five years of this forecast, it is anticipated that funding will increase based on projection from the state to include the new State restricted revenue package. The Michigan Department of Transportation has released projections for FY 2020 and 2021 detailing increases of 8.1% and 10%. Once we receive this increase we are forecasting an additional 2% each year thereafter.

Major Expenditures

Other than a percentage of Department of Public Services personnel and maintenance costs, the majority of expenditures allocated in the Major Street Fund involve road construction projects. Road construction projects included in the forecast are as follows:

Major Road Project	Projection 2018-19	Forecast 2019-20	Forecast 2020-21	Forecast 2021-22	Forecast 2022-23
Joint & Crack Sealing – City Wide	$75,000	$75,000	$75,000	$75,000	$75,000
Traffic Signals	30,000	30,000	30,000	30,000	30,000
13 Mile Sectional Non-NHPP	0	250,000	0	0	250,000
Stephenson Hwy Turnarounds	175,000	0	0	0	0
Sectional Concrete Replacement - Major	475,000	1.225,000	630,000	925,000	600,000
Total	**$755,000**	**$1,580,000**	**$735,000**	**$1,030,000**	**$955,000**

The forecast does not include a transfer between Major Street and Local Street Fund in any of the years forecasted. During the budget process, staff will make recommendations if and when transfers are needed.

Due to the enactment of Public Act 459 of 2017, the City will no longer be responsible for the $4.2 million local match to support the Michigan Department of Transportation's I-75 widening and Modernization Project. This project will be starting Phase II in spring of 2019.

Local Street Fund Assumptions

Major Revenues

The primary funding source for Local Streets is the dedicated Proposal Neighborhood Roads Millage. Funds collected under this road millage have the same assumption as General Fund property tax revenues of a combined (real and personal) 2.6% and an average of 2.1% each year thereafter.

Local Streets also receives funds through the Act 51 road program from the State. The Michigan Department of Transportation has projected for FY 2020 and 2021 detailing increases of 8.1% and 10%. Once we receive this increase we are forecasting an additional 2% each year thereafter.

Major Expenditures

Other than a percentage of Department of Public Services personnel and maintenance costs, the majority of expenditures allocated in the Local Street Fund are for road construction projects. Road construction projects included in the forecast are as follows:

Local Road Project	Projected 2018-19	Forecast 2019-20	Forecast 2020-21	Forecast 2021-22	Forecast 2022-23
Brettonwoods St (11 Mile to W Farnum Ave.)	554,000	0	0	0	0
Harwood Ave (Battelle Ave to Tawas)	339,000	0	0	0	0
Brush St (W University Ave to 11 Mile)	172,000	0	0	0	0
Brush St (W University Ave to W Farnum)	207,000	0	0	0	0
Meadows Ave (Englewood Ave to Meadows)	0	263,000	0	0	0
W. Dallas Ave (Alger St to John R Road)	0	260,000	0	0	0
Kenwood Ave (Windemere to Englewood)	0	232,000	0	0	0
Madison Ave (Englewood Ave to Madison)	0	181,000	0	0	0
Kenwood Ave (Englewood Ave to Kenwood)	0	174,000	0	0	0
Windemere (Campbell Rd to Dorchester)	0	133,000	0	0	0
Westmore (30452 Westmore to Tanglewood)	0	0	975,000	0	0
Milton Ave (Moulin to Sheffield Dr)	0	0	167,000	0	0
Tanglewood Dr (Winthrop Dr to Yorkshire Dr)	0	0	72,000	0	0
Beverly Ave (Connie Ave to Dequindre Road)	0	0	98,000	0	0
Alger St (W Cowan Ave to Andover Ave)	0	0	0	212,000	0
Barrington (Mid Block -Lincoln to Cowan)	0	0	0	109,000	0
Alger St (Mid Block Alger St - Lincoln to Cowan)	0	0	0	109,000	0
Barrington St (W Lincoln Ave to W. Cowan Ave)	0	0	0	148,000	0
Alger St (W Lincoln Ave to W Cowan Ave)	0	0	0	148,000	0
Brush St (W Cowan Ave to Andover Ave)	0	0	0	120,000	0
W Cowan Ave (Stephenson Highway to Brettonwoods St)	0	0	0	140,000	0
W Cowan Ave (Alger St to John R Road)	0	0	0	75,000	0
Palmer St (W Lincoln Ave to W Cowan Ave)	0	0	0	210,000	0
W. Greig Ave (three sections)	0	0	0	0	482,000
Palmer Street (Andover Ave to W. Greig Ave)	0	0	0	0	293,000
Brush Street (Andover Ave to W. Greig Ave)	0	0	0	0	165,000
W. Greig Ave (five sections)	0	0	0	0	403,000
Sectional Replacements (R)	525,000	100,000	75,000	100,000	75,000
Sectional Replacements (Non-R)	984,000	815,000	805,000	375,000	525,000
Total	**$2,781,000**	**$2,158,000**	**$2,192,000**	**$1,746,000**	**$1,943,000**

At June 30, 2018, the fund balance for the Local Street Fund was $2.48 million, all of which is restricted for Neighborhood Road projects and will be expended on R-3 projects in the upcoming year.

Water and Sewer Fund

Major Revenues

Water/Sewer Rates

The major revenue sources in the Water and Sewer Fund are from charges for water and sewage. Although future proposed budgets will most likely reflect the need to increase water/sewage rates to the end users, the rates are not included in the forecast because the forecast is only the first step in the budget process, and we do not know the exact amount of future increases from the Oakland Water Resources Commissioner for sewage disposal and treatment and stormwater rates. As part of the FY 2018 budget process we started a detailed Water and Sewer rate analysis. This analysis demonstrated a need to increase rates 3.0% in FY 2020, 3.25% in 2021, 3.25 in FY 2022 and 3.25% in FY 2023. These increases are used in the financial forecast. However, this rate analysis will be updated once these major water and sewer expenditures and required use of fund balance are identified.

Effective with billings as or after July 1, 2016, the City began operating under a new sewer rate structure that splits out the stormwater charge based on the individual parcel's stormwater runoff as calculated by the amount of pervious and impervious surface and shown through Equivalent Residential Units (ERUs). This charge did not affect the total amount charged for stormwater, but will more accurately reflect the differential between sanitary and stormwater usage. Effective with billings as or after July 1, 2017, the City separated the George W. Kuhn Drain debt payments from the water and sewer rate and included this amount on the summer tax bill. This change completed the implementation of the rate structure model. We do not anticipate any additional billing method changes in the next four years.

Major Expenditures

Other than personnel expenditures which were calculated using the same assumptions as the general fund employees, the major expenditures in the Water and Sewer Fund are the purchase of commodities, water and sewer capital improvement projects and debt service.

Purchase of Commodities

As briefly mentioned under revenues, the City has not yet received the actual rate increase from the Great Lakes Water Authority (GLWA) or the Oakland Water Resources Commissioner. To develop assumptions for the forecast, staff looked at the past three years of history. This will reflect the change to the GLWA as well as all the billing method changes implemented by the Oakland County Drain Commissioner. Based on this review, the forecast assumes an increase of 1% per year for each of the forecast years for stormwater charges, 4.0% for sewage treatment and 3.9% for water.

Infrastructure

The Water and Sewer Fund structure has ensured that adequate funding is available to proactively address watermain replacements in the upcoming four years in coordination with the road improvement projects, and in accordance with the continuation of the residential road millage. (Watermain replacement is completed in the fiscal year prior to road construction. In addition, the forecast includes watermain replacement in areas outside the R-3 construction project areas where the older main is in critical need of replacement.

Debt Service

In FY 2018, the Chapter 20 Drain Debt Service Fund was established for the debt repayment for the George W. Kuhn Drain. Previously the bonds were repaid from the Water and Sewer Fund. The Water and Sewer Fund still includes debt payments for Automatic Meter Reading System and 12.85 percent of the General Employee Pension Obligation bonds.

The forecast includes a redemption of the Automatic Meter Reading bonds in May of 2020. This should save the system approximately $60,000 in interest over the remaining life of the bonds. The remaining amounts used in the forecast are the actual amounts to be paid over the next four year period from the bond repayment schedules. The amounts included are as follows:

	Projected 2018-19	Forecast 2019-20	Forecast 2020-21	Forecast 2021-22	Forecast 2022-23
Bond Principal Payments – Fixed Network System	105,000	110,000	640,000	0	0
Bond Principal Payments – Pension Obligation Bonds	105,370	107,298	108,583	110,510	113,080
Bond Interest Payments – Fixed Network System	29,726	25,600	46,600	0	0
Bond Interest Payments – Pension Obligation Bonds	47,425	45,866	44,042	42,033	38,407
Total	**$287,521**	**$288,764**	**$839,225**	**$152,543**	**$151,487**

At June 30, 2018, the Water and Sewer Department has built up an unrestricted net position of $5.3 million dollars. $2.3 million of this is budgeted in the current fiscal year to cover planned capital expenditures such as the meter replacement program for which the City has saved funds for over ten years. This forecast coupled with the Water and Sewer Rate Analysis forecasts a planned smoothed use of fund balance over the forecast period to spend down and then maintain fund balance at the minimum required reserve by FY 2023.