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CITY OF ADRIAN
FY2010-11 RECOMMENDED BUDGET AND
GENERAL APPROPRIATIONS ACT

BUDGET MESSAGE

April 17, 2010

Hon. Gary McDowell, Mayor and City Commission:

In accordance with Public Act 621 of 1978, *the Uniform Budgeting and Accounting Act for Local Units of Government*, please find attached the FY2009-10 Recommended Budget for the City of Adrian. Revenue and Expenses are balanced for each fund, as follows, (compared to FY2009-10 Adopted Budget):

	FY2010-11 Recommended Budget	FY2009-10 Adopted Budget
101 General Fund	\$11,154,667	\$19,812,299
202 Major Street Fund	995,000	2,466,875
203 Local Street Fund	992,856	1,255,515
204 Municipal Street Fund	431,856	464,608
205 Harriet Kimball Fee Estate Fund	801,058	700,058
267 Omni Fund	86,900	86,900
275 Community Development Fund	112,100	107,600
276 Economic Development Fund	226,600	241,420
279 Brownfield Redevelopment Authority	209,874	10,781
280 Downtown Development Authority	37,400	42,400
281 DDA-Tax Increment Finance Fund	416,187	693,399
282 Local Development Finance Authority Fund	62,000	66,800
283 Vibrant Small Cities Grant Fund	0	2,241,945
394 DDA-Debt Fund	90,665	95,785
496 Capital Projects Fund – Water	360,000	299,000
497 Capital Projects Fund – Sewer	238,000	179,000
585 Auto Parking Fund	2,810,100	2,749,100
588 Transportation Fund	702,750	734,664
590 Sewer Fund	4,434,000	4,185,055
591 Water Fund	4,007,888	3,644,000
598 Storm Water Utility Fund	260,200	260,200
599 Capital Projects Revolving Fund	160,000	182,748
661 Information Technology Fund	386,786	384,842
662 Motor Vehicle Pool Fund	1,193,051	1,465,198
711 Perpetual Care Fund	40,000	30,000
Less: Intra-Fund Eliminations	<u>(3,233,711)</u>	<u>(3,781,954)</u>
Total – All Funds	<u>\$26,976,227</u>	<u>\$ 38,618,238</u>

The FY2009-10 Budget Recommendation is being submitted at a time when economic conditions have been stagnant and property values in a state of decline for a third consecutive year. (See Economic Outlook below for more detailed description and analysis.) The City's primary source of revenue derives from the property taxes which, in turn, are dependent upon the Taxable Value of real and personal property located within the City boundaries. Generally, property tax revenue lag current economic conditions because property values are established based on a moving 12-month historical timeframe. In addition, taxable property values are constrained to prevailing price levels, as measured by the Consumer Price Index (CPI), in accordance with the State Education Finance Act of 1994 (Proposal A). The CPI actually reached a point of deflation in 2009, resulting in a factor of -0.3%. And lastly, the Headlee Constitutional Tax Limitation Amendment (1978) requires that the millage rate be reduced to a level that reflects the rate of inflation, if property values increase beyond the CPI.

The net effect of the foregoing is an overall year-to-year reduction in General Fund property tax revenue amounting to \$213,499, equivalent to a 3.4% decrease.

The second most prominent source of funds to operate City government is **State Revenue Sharing**, which is derived from Sales Taxes collected and distributed by the State, which annually appropriates funds based on the overall condition of the State budget. Because the State budget has been under increasing financial stress, estimated revenue from this source is, likewise, in a state of decline, resulting in **a year-to-year decrease of \$209,643, equivalent to a 9.0% reduction**. This cut was implemented by a gubernatorial executive order on May 5, 2009, one day following adoption of the City's FY2009-10 Budget and due to legislative action later in the year. The \$2.1 million the City expects to receive is almost \$1.0 million less than the City received at the beginning of this decade and equals the amount received in 1996.

The City is on the verge of completing major capital improvement projects, including the following:

- Acquisition of the former Lenawee Bank Building in the central business district and renovation to house City Administrative Offices, as well as Parks & Recreation, Inspection, and Community & Economic Development;
- Renovation of Adrian Public Library, located next to the new City Hall;
- Construction of a new Police Facility, located next to the Library;
- Purchase and renovation of the former Adrian Post Office, located next to the new Police Facility, to house City Chambers;
- Acquisition and renovation of an industrial building located at 381 Miles Drive to house Parks & Forestry maintenance and operations; and
- Retirement of all outstanding general obligation debt, previously issued for such things as acquisition of the Marvin Farm for expansion of the City's industrial park.

To fund the foregoing projects, the City took advantage of provisions of the American Recovery and Reinvestment Act (ARRA) of 2009, which provided for issuance of Build America Bonds and Recovery Zone Economic Development Bonds. Both of these bonds are taxable, which makes them more competitive in the marketplace and, due to the federal stimulus program, are eligible for 35% and 45% rebates on interest expense from the U.S. Department of Treasury. The net effect is two-fold: first, over \$6.0 million will be saved over the 25-year life of the bonds due to the net interest cost of 3.71% per annum; and second, the annual debt service will only increase \$200,000, equivalent to \$20 per annum for a typical residential taxpayer.

In anticipation of the increased debt service, it is important to note that in the three years leading up to issuance of the bonds the **City was proactive in achieving significant operating savings**, through service consolidations, staff reclassifications and collaborative efforts, **in order to withstand the increased debt service without raising taxes.**

Also, it is important to understand that the capital expenses will have been fully incurred and financed by the end of the FY2009-10 Fiscal Year. Therefore, the FY2010-11 Budget is a completely new plan subject to the new financial challenges presented by the estimated revenue reductions noted above.

City Of Adrian Strategic Action Plan

Included with the Recommended Budget for the third straight year is the City's Strategic Action Plan, which, as after several meetings of City stakeholders, including the City Commission, the Planning Commission, City Administration and Department Heads, as well as both union and non-union employee representatives, has been updated since inception of the Plan two years ago (Please reference Tab #2). Also included are a Statement of Values, Vision Statement and Statement of Mission and Purpose.

All of the goals are considered of equal priority, however, the action strategies are designated either *High Priority* or *Priority When Resources are Available*, thereby providing an action agenda to be considered when formulating the FY2010-11 Annual Operating and Capital Budgets. Development of future Strategic Action Plans will be expanded to involve the active participation of other critical stakeholders such as the Downtown Development Authority, the Brownfield Development Authority, the Local Development Finance Authority, as well as citizens at-large and should take place prior to the beginning of FY2013-14.

General Fund Revenue (\$11,154,667)

Estimated Property Tax Revenue is based on a Taxable Value of \$442,273,036, which represents a \$14,656,333 decrease, equivalent to -3.2%, compared to the \$457,273,036 Taxable Value recorded last year. The Recommended Budget proposes that the tax rate for general operations, including road improvements, be set at **15.6039 mills, the same for five years running**, and 1.7591 mills less than the Maximum Allowable Tax Levy as constrained by the Headlee Tax Limitation Amendment to the Michigan State Constitution, equivalent to a tax savings of \$778,607.

The tax levy for General Operations and Refuse Collection (14.6293 mills; \$6,453,945 revenue) complies with the Headlee Constitutional Tax Limitation Amendment, which requires a permanent millage rollback when the increased level of estimated tax collection on existing property exceeds the rate of inflation. Please note that Road Improvement millage (1.0000 mill), renewed by the voters in November, 2005 continues to be subject to Headlee Rollback requirement, even in the first year of its application (per Attorney General Opinion #7193, dated March 30, 2006). This amounts to an additional tax reduction of \$8,347 in the first year and an estimated \$83,470 over the ten-year renewal period.

The one mill levy for Refuse Collection and Disposal generates \$441,167, insufficient to cover the cost of \$601,500 necessary to provide these services. The City Commission has the authority to increase this tax levy to 2.7591 mills without referendum; an increase to 1.3590 mills would generate the aforementioned \$601,500.

Total Ad Valorem Property Taxes are adversely impacted by tax incentives granted for economic development purposes, emanating from legislative authority enabling the establishment of Tax Increment Financing Districts to capture taxes for the Downtown Development Authority, Local Development Authority, and Brownfield Redevelopment Authority. In addition, the City Commission was empowered by Public Act 198 of 1974 to grant Industrial Facility Tax (IFT) Certificates reducing Property Taxes by 50% for new industrial capital facility and equipment investments for up to twelve years. The total impact amounts to \$168,011 of captured tax revenue

and \$145,265 of exempted tax revenue, for a total of \$313,276. Fortunately, expiring IFT Certificates have resulted in increased tax revenue amounting to \$179,312. Also, current estimates peg the inflation rate at 1.7% for 2010, which will slightly reduce the Proposal A restraint on property tax revenue for the FY2011-12 Budget.

Other revenue sources are being adversely impacted by the hostile economic climate. General Fund Investment Income is estimated to decrease by \$50,000 compared to the prior Adopted Budget, reflecting deteriorating money market conditions and a reduced investment base related to the City's aggressive Capital Projects initiatives. Additionally, revenue emanating from Building Permits has decreased by \$54,000. This reduction is partially offset by a \$40,000 increase in Rental Housing Registrations, since FY2010-11 will be the third year in a 3-year cycle for required registrations.

Fund Balance

Many communities in southeast Michigan are heading into a fiscal storm without sufficient emergency savings to preserve services and avoid tax hikes. A *Detroit Free Press* analysis shows that cities, counties and townships drained much of their savings during the economic downturn that started five years ago but failed to plan for the bigger crisis in the housing market that is expected to drive property taxes down to record levels in the next two years. Wayne County, Detroit, Pontiac and River Rouge all have zero savings compared to the 20% of budget recommended by the Government Finance Officers Association. Gross Pte. Park, Dearborn Heights, Berkley, Belleville, and Highland Park all have ten percent or less. Due to forward financial planning, the City of Adrian is not in such dire financial straits but, rather, in a position to deal on a rational basis with projected revenue shortfalls through prudent financial management.

As specified in the Financial Policy Manual adopted by the City Commission in October 2004, the adequacy of the fund balance shall be evaluated annually to consider minimum cash requirements prior to receipt of current year property tax collections. To maintain the **City of Adrian's credit rating**, (which has been **established by Standard & Poor's Investor Services in October, 2009 at A+/stable**) and meet seasonal cash flow shortfalls, the budget shall provide for an anticipated unreserved fund balance of at least fifteen (15%) percent to twenty (20%) percent of annual budgeted operating expenditures for general government operations. Application of these parameters would require a minimum Fund Balance of \$1.7 million to \$2.2 million. The audited Fund Balance, as reported in the FY2008-09 Comprehensive Annual Financial Report (CAFR) amounted to \$4.6 million, equivalent to 41% of general fund operations.

Please reference Tab 9 of this document, the FY2009-10 Third Quarter Financial Forecast, for a projection of Fund Balance at the conclusion of the current fiscal year.

In addition to the General Fund accumulated Fund Balance, the City Commission established the Information Technology Fund (Fund 661) with adoption of the FY2004-05 Budget. The IT Fund is an Internal Service Fund, which is a Governmental Activity and is a subsidiary fund of the General Fund. This designation is relevant to any discussion regarding Fund Balance or City solvency. As reported in the FY2008-09 Audited CAFR, the IT Fund net assets (i.e., Fund Balance) at the end of year amounted to \$641,538.

The FY2009-10 Recommended Budget and General Appropriations Act includes authorization to expand Fire Department – Motor Vehicle Pool Fund (Fund 662) to include vehicles and equipment for the Department of Public Works, Parks & Forestry Division and Police Department, among others. The Motor Vehicle Pool Fund is similar to the Information Technology Fund, that is to say it also will be classified as a Governmental Activity and be considered a subsidiary of the General

Fund; however, by expanding this Internal Service Fund, depreciation expense will be funded thereby providing automatic funding for replacement of the City's entire vehicle fleet. The General Appropriations Act further authorizes the transfer of \$700,000 from General Fund accumulated Fund Balance to the expanded Motor Vehicle Pool Fund. The amount represents a portion of the accumulated depreciation on existing vehicles and will serve as working capital to operate the new fund. As reported in the FY2008-09 Audited CAFR, the Fire Department – Motor Vehicle Pool Fund net assets (i.e., Fund Balance) at the end of year amounted to \$603,835.

General Fund Expenditures (\$11,154,667)

Recommended General Fund appropriations are balanced with Estimated Revenue at \$11,154,667. Personnel Costs (Salaries and Fringe Benefits) represent the largest single cost in the FY2010-11 Budget, \$11.0 million of the total-all funds budget of \$27.0 million, equivalent to 40.7%. The General Fund absorbs \$7.8 million of these costs, representing 70% of general revenues. To maintain a competitive level of compensation, a Classification & Compensation Study was completed and implemented for non-union personnel during the 2007-08 fiscal year. As a result, the City's wage structure was reduced from over 40 Salary Grades to 17 and completion of a satisfactory performance evaluation is required to progress through the Salary Steps within each grade. A new employee, beginning at Step 1, would take six years to progress in 3.8% increments to a journeyman's level (Step 7).

Reflecting the current state of the local economy and the adverse impact on property tax revenues, the Recommended FY2010-11 Budget contemplates, for the second straight year, a wage freeze for all non-union personnel. Four unions representing police, fire and other workers, comprising approximately one-half of the City's workforce, all have bargaining agreements that expired on June 30, 2008. The Firefighters recently settled their 3-year contract, which includes no salary increases in the first and third year, but a one (1%) percent increase in the second year. Negotiations have been ongoing with the remaining union workers with the expectation that economic issues related to salaries and fringe benefits will be challenging and will require greater employee participation in cost sharing of health care and pension benefits.

Fringe Benefits (\$3.1 million) are equivalent to 39.1% of salaries, compared to 40.9% last year. The year-to-year reduction is due primarily to implementation of a high-deductible Health Care Program that includes a Health Reimbursement Arrangement (HRA) with Blue Cross/Blue Shield of Michigan. The Recommended Budget reflects distribution of Fringe Benefits, as well as the traditional distribution of Salaries & Wages (including Overtime), to non-General Fund operations, such as Major & Local Streets and Sewer & Water Funds. A summary of fringe benefit component costs and their relative percentage of salaries follows:

	<u>Amount</u>	<u>Percent</u>
Hospitalization (BCBS)	\$1,359,669	17.1%
Retirement Contribution (Employer)	963,763	12.1%
Social Security (FICA)	437,625	5.5%
Workers' Compensation Insurance	252,959	3.2%
Unemployment Compensation Insurance	74,134	0.9%
Life Insurance and AD&D	27,815	0.3%
Total	<u>\$3,115,965</u>	<u>39.1%</u>

In an effort to provide an economical yet competitive fringe benefit program to City employees, the City Administration is working closely with Kapnick Insurance Agency, performing a continuing review of all employee fringe benefits for the purpose of providing the best benefits available within the constraints of available funds. Also, in a constant effort to continually upgrade the knowledge and skills of our workforce, the Human Resources Budget includes funding for enhanced In-Service Training and Tuition Reimbursement Programs, as well as Safety Training in conjunction with the City's ongoing Risk Management Program and Motor Vehicle Safety Policy. Consistent

with adoption of Business Expense Reimbursement Policy, the recommended budget contemplates the current IRS mileage reimbursement rate of \$.50 per mile.

In an environment of difficult economic times, when taxpayers are experiencing harsh realities of adjustments to the global marketplace, the City of Adrian is endeavoring to be a good steward of the financial resources provided by its citizens. As reflected in the FY2010-11 Personnel Budget Summary (Tab 6), full-time staff reductions during the past two years have trimmed the City's workforce from 161 to 148, or a total of thirteen (13) positions. The following economies have been achieved in the current budget recommendation:

Assessing Department:	Elimination of City Assessor position in favor of contracting with Lenawee County
Police Department:	Elimination of one (1) Patrol Officer and addition of two (2) Part-Time Office Assistants
Inspection Department:	Privatization of one (1) Electrical Inspector position
Parks & Forestry Division:	Privatization of two (2) Tree-Trimming positions: one (1) funded by the General Fund and one (1) funded by the Fee Estate
Adrian Public Library:	Elimination of one (1) Library Assistant position
Auto Parking Fund:	Elimination of one (1) Part-Time Parking Enforcement Officer position
Utility Funds:	Elimination of two (2) positions: one (1) Public Service Employee (PSE II) position at the Wastewater Treatment Plant, and one (1) P.S.E. II position in the Operations and Maintenance Division

Budget stringencies come in the form of not only revenue reductions but, also, uncontrollable cost increases, such as electric and gas utility rates and employer contributions to employee pension program (\$166,176). Several actions have already been taken to offset these stringencies and are reflected in this budget recommendation. The resultant savings are summarized as follows:

- Reduced health care premiums due to initiation of high-deductible insurance program (\$187,602);
- Utility expenses are down due to more modern and energy efficient buildings (\$89,000);
- Firefighter's Union Contract settlement (\$50,833);
- Reduced Debt Service due to debt consolidation (\$50,508);
- Successful Tax Appeal to Board of Review (\$50,000);
- Reclassification of Parks & Forestry Superintendent position (\$14,090);
- Elimination of one (1) Patrol Officer and addition of two (2) Part-Time Office Assistants (\$26,940); and
- Publication and distribution of Maple City Focus on-line rather than hard copy (\$21,000);

Additional cost-saving measures are also proposed in this budget recommendation. The anticipated savings are summarized as follows:

- Eliminate composting program (86,000);
- Postpone zoning consultant to revise zoning ordinance (\$65,000);
- Reduce Library staff and operating expenses (\$59,744)
- Contract out certain inspection services (\$53,411);
- Implement furlough days, (1) for Firefighters and (2) for all others (\$43,976);
- Seasonal staff cost saving measures (\$30,000);
- Eliminate Recycling Program (\$30,000);
- Eliminate City Band Funding (\$10,000);
- Postpone Piotter Sr. Citizens' Center floor replacement (\$6,000);
- Reduce Sister City program funding (\$2,000);
- Eliminate Mayor's Youth Council Funding (\$2,000); and
- Eliminate Mayor Exchange Day funding (\$2,000).

Capital Projects

Last year's Capital Budget amounted to over \$16.4 million, \$7.0 million funded by the previously mentioned bond proceeds and over \$2.0 million in grants from various sources. In January, the City Commission adopted the FY2010-16 Capital Improvement Program and FY2010-11 Proposed Capital Budget. The latter (\$8,359,858) has been reviewed and modified to fit within available resources before being incorporated in this Budget Recommendation. The recommended amount of Capital Outlay for FY2010-11 amounts to \$2,336,058 and is detailed under Tab 8 of this document, as well as identifies those specific items that were not funded.

As previously indicated, the City of Adrian is in the process of completing an aggressive Capital Projects Program that has resulted in the following benefits:

- Realized reduced pricing in an economic environment where contractors are struggling to sustain their businesses.
- Acted as a stimulant to the local economy by directing contract work to local vendors, as well as attract increased human activity to the City's central-business district.
- Took advantage of long-term low-interest financing available in a stressed money market due to enactment of the Federal Stimulus Program.
- Complied with the Debt Management Policies, while avoiding any related tax increases.
- Enabled other private investment in the City of Adrian, such as the new McDonalds restaurant constructed at the corner of M-52 and US223, a new First Federal Bank Branch planned for the old McDonalds location, downtown façade improvements and blight reduction.

Other Funds:

Major Streets and Local Streets are budgeted to fund an aggressive road improvement program, including the following projects:

202 MAJOR STREET FUND

BENT OAK AVENUE-ENGINEERING	\$20,000
LOGAN STREET-DIVISION TO CENTER	265,172
MCKENZIE STREET-MAPLE TO MAUMEE (IF ARRA GRANT)	<u>250,000</u>
TOTAL MAJOR STREET FUND	<u>\$535,172</u>

203 LOCAL STREET FUND

W. HUNT STREET - MAIN TO TRESTLE PARK	\$76,708
OREGON ROAD - MAPLE TO WESTWOOD	106,167
HAWTHORNE ROAD - OREGON TO TRENTON	16,692
WESTWOOD ROAD - MAPLE TO MAPLE	87,929
ALLEY REHABILITATION	<u>50,000</u>
TOTAL LOCAL STREET FUND	<u>\$337,496</u>

Debt Service

Several capital projects financed through debt instruments are provided for in the FY2010-11 Recommended Budget, including the following provisions for debt service:

Omnibus Bond Financing, encompassing:

Downtown Government Complex and Refinancing of Marvin Farm Acquisition, Parks & Forestry Facility, and Taxi Building	\$449,492	
Wastewater Bonds	396,884	
Water Bonds	<u>379,678</u>	
Total	<u>\$1,226,054</u>	

Only the Debt on the Omnibus Bond Financing proposal is subject to the constitutional limitation on General Obligation Debt. The Legal Debt Margin for the City is calculated as follows:

State Taxable Value	\$442,616,703	
Ten (10%) Percent Statutory Limit	44,261,670	10.00%
Proposed General Obligation Debt	<u>449,492</u>	<u>0.10%</u>
Remaining Legal Debt Margin	<u>\$ 43,812,178</u>	<u>9.90%</u>

Utility Funds

Capital Projects for utility infrastructure total \$598,000, including \$360,000 for the Water Fund and \$238,000 for the Wastewater Fund, compared to last year's \$478,000 and traditionally over \$1.0 million. Low interest loans have been obtained for additional Utility Capital Projects funded from the State Drinking Water Revolving Loan Fund and the Sewer Revolving Loan Fund, including the following projects:

<u>Description</u>	<u>Issue Date</u>	<u>Interest Rate</u>	<u>Amount</u>	<u>Maturity Date</u>
Wastewater System Revenue Bonds	09/26/02	2.500%	\$8,920,000	2023
Water Supply System Revenue Bonds	09/26/02	2.500%	\$5,665,000	2023
Wastewater System Revenue Bonds	09/22/05	1.625%	\$2,040,000	2026
Wastewater System Revenue Bonds	12/15/05	1.625%	\$7,090,000	2026
Water Supply System Revenue Bonds	09/27/07	2.125%	\$7,890,000	2029

The FY2009-10 Recommended Budget for the Utilities Funds includes debt service amounting to \$379,678 for the Drinking Water Revolving Fund (DWRP) and \$396,884 for the Sewer Revolving Fund (SRF) for Wastewater System improvements, consistent with the City's adopted Debt Management Policy, which follows: *The City of Adrian shall only use long-term debt for capital projects that cannot be financed out of current revenues within the Revenue Policy guidelines for rate increases. Long-term debt may also be issued when the specific situation dictates that it is financially in the best interests of the City (e.g., use of State revolving loan funds at strategically low interest rates). Further, debt financing shall generally be limited to one-time capital improvement projects and only under the following circumstances:*

- *When the project's useful life will exceed the term of the financing;*
- *When the project revenue or specific resources will be sufficient to service the debt;*
- *When the project will benefit the citizens at large.*

Economic Outlook:

NATIONAL ECONOMY – Leading indicators for the U.S. economy show that the so-called Great Recession has abated, although there remains the possibility of slipping into another recession in the near future. The advance estimate for fourth quarter Gross Domestic Product (GDP) growth showed the economy expanded by an impressive 5.7 percent annualized, making for the largest quarterly growth in six years and surpassing most analysts' estimates. Growth was led largely by inventories, although net exports and fixed investment had significant effects as well. Even so, GDP shrank by 2.4 percent for the entire year of 2009, which is the worst year for growth since 1938.

Continued quarterly growth is expected throughout 2010, but it is expected that robust growth will not ensue until 2011. The official unemployment rate fell to 9.7 percent in January from 10 percent in December. This was a bigger decrease than expected as forecasts were generally in the 9.8 percent to 10.3 percent range. While this news is welcome, it is important to remember that the official figure does not take into account those who have stopped looking for work. Indeed the economy has lost 8.4 million jobs since December 2007.

For the months of December and January, consumer-related indicators were encouraging. The Conference Board index of consumer confidence rose 2.3 points to 55.9 in January from a revised 53.6 in December. Likewise, the University of Michigan consumer sentiment index rose in January to 74.4 from December's 72.5. The current conditions component of the index led the increase, suggesting that consumers are feeling more optimistic about the overall economy than they have been in the past two years. Both indices are still historically somewhat low, but consumer confidence is expected to continue to increase in 2010. Personal income increased by 0.4 percent in December, making for six consecutive months of slow but steady growth. The saving rate rose 0.1 percentage points to 4.8 percent and the core personal consumption expenditures (PCE) deflator also increased by 0.1 percent, meaning inflation is currently not a major concern. Spending has consistently increased since May, albeit at an average of just 0.2 percent per month. However small these increases are, they are a welcome change from a year ago.

Leading business indicators were also positive over the past two months. New orders for manufactured durable goods increased a modest 0.3 percent in December, but, more encouraging, orders excluding transportation were up by a healthy 11.7 percent annualized for the fourth quarter. Shipments jumped 2.9 percent in December, while core capital goods rose 2.2 percent. The Institute for Supply Management's (ISM) manufacturing index, which measures the overall manufacturing sector in the U.S. rose sharply to 58.4 in January from 54.9 in December. Anything above the 50 mark is considered to be in expansionary territory and indeed manufacturing has helped lead the fragile economic recovery.

In March, the nation added 162,000 jobs, the fastest pace in three years as factories, stores, hospitals and the census all brought workers on board – the surest sign yet that the worst employment market in a generation has finally snapped back. The unemployment rate stayed at 9.7 percent for the third month in a row. Economists actually consider that a hopeful sign because it means more people are encouraged and starting to look for work.

The housing front did not fare well at year end. Existing home sales plummeted by 16.7 percent in December, however they were up by 5 percent in the fourth quarter compared to sales in the third. Additionally, the median existing house price increased year-over-year for the first time since 2006. New home sales are down too. Sales declined 7.6 percent in December from the previous month and are down 8.6 percent below the December 2008 level. Despite a rough December, however, the housing market is not nearly as volatile as it was at the onset of the recession.

The Federal Open Market Committee (FOMC) met on January 26 and, as expected, kept the fed funds target rate at between zero and 0.25 percent. In a released statement, the FOMC reaffirmed that the rate will remain at this level for an “extended period” and also noted that it will allow some of the liquidity facilities set up in the past two years to expire as scheduled. This includes the Fed’s policy of buying of massive amounts of mortgage-backed securities.

Leading economic indicators have been positive for nine months in a row, signaling economic growth will continue during 2010. Most economists predict GDP to grow a modest 2-3% in 2010, improving to a more normal 3-4% growth rate late in the year.

STATE ECONOMY – Michigan’s employment peak of 4.7 million jobs in 2000 won’t be reached again, assuming somewhat normal job growth, until 2035, according to a forecast by the Senate Fiscal Agency. It took a decade to lose close to a million jobs. It will take at least a quarter-century to get them all back. The primary contributing factor: U.S. car sales that surpassed 17 million in 1999 plunged to about 10 million this year, with the Detroit Three’s market share dropping from 65 percent to 45 percent. As vehicle production in Michigan dropped by two-thirds, moreover, personal income – right at the national average in 1999 – plummeted to only 86 percent of the national average in 2009.

Michigan retailers began 2010 with an upswing in sales and confidence, according to the latest Michigan Retail Index survey, a joint project of Michigan Retailers Association and the Federal Reserve Bank of Chicago. The survey found that more than 40 percent of retailers increased sales in the new year to the highest level since November, 2007. Looking ahead, the seasonally adjusted outlook index is notched at 61.8, up from 57.1 in December and 41.6 in January, 2009. Index values above 50 generally indicate an increase in positive activity, while values below 50 indicate a decrease.

State and local government jobs have traditionally provided a haven during economic downturns. But as states, including Michigan, have struggled to close growing budget gaps, job cuts have spread. In Michigan, where the unemployment rate is 14.1%, highest in the nation for the past four consecutive years, government jobs at all levels fell by 5,000. They accounted for one-third of the state’s job losses. Economists are pointing to the states’ budget problems as a potential threat to the economic recovery.

Governor Jennifer Granholm has submitted her FY2010-11 Budget Recommendation. It includes incentives for more than 40,000 state and school employees to retire, benefit reductions if they don’t and requirements that workers who stay on the job contribute 3% more toward their retirement. It cuts business taxes by nearly \$1 billion annually, by the third year of a phase-in, by expanding the sales tax base while lowering the sales tax rate. In addition, lifetime health care benefits would end for state legislators; newly hired teachers and other school workers would need to enroll in both a defined benefit and defined contribution pension plan; subsidized vision and dental care services would be eliminated for both state employees and school workers; and accelerates the parole of thousands of prison inmates, assuming \$129 million in savings through the closure of five prisons.

Senate Republicans have started hearings on a proposal to require that all public employees in Michigan, including schools and local governments, be required to join a single health care plan consortium and pay at least 20 percent of the cost of their employer-provided health insurance.

LOCAL ECONOMY –

There is little sign of recovery in the year-end numbers dealing with property tax and mortgage foreclosures in Lenawee County. Foreclosure has been ordered on 582 properties with \$973,917 unpaid property taxes from 2007; there were 482 listed for the initial court hearing last year in the Lenawee County Circuit Court. The number of parcels with three years delinquent taxes at the start of the year has more than doubled since 2007, when there were 279 such properties that owed \$435,879. The houses that banks and other financial institutions are foreclosing on are also at historically high numbers: 716 and 603 were recorded in 2008 and 2009, respectively, which compares with only 246 in 2005.

The County's unemployment rate, going into the new year, was 16.6%. There were 851 fewer workers with jobs. The number counted as unemployed rose by 331 to 7,921 in a county with a workforce approximating 47,700.

On the other hand, job -creating projects in the works for Lenawee County are encouraging. Jim Gartin of the Lenawee Economic Development Corp. gave an update to the agency's Executive Committee on progress with the Consolidated Biscuit Company plant coming to Tecumseh, the Bio-dri LLC project for Blissfield and the expansion planned for the Wacker Silicones plant in Raisin Township. In fact, the Adrian area is listed as tied for seventh in the Site Selection magazine's list of the U.S. micropolitans – defined as cities with populations between 10,000 and 50,000 – with the most significant new and expanded corporate projects in 2009. And it ranks first in Michigan, with seven new projects. There are roughly 576 micropolitans in the country. The previous rankings for the Adrian area were 62nd in 2007 and 10th in 2008.

The City is constantly taking initiatives to improve the local business climate, such as aggressive use of financial incentives like the Obsolete Property Rehabilitation Act (OPRA), in conjunction with Historical Preservation Act incentives and façade grants, which are revitalizing the City's downtown district. Tax Increment Financing and Industrial Facility Tax exemptions are other economic development tools utilized by the Community Development Department to attract commerce to our area. Building off several grants for hazardous waste site assessments, the Brownfield Redevelopment Authority (BRA) is using creative financing techniques to turn abandoned and underutilized urban properties into viable productive land to locate facilities that might otherwise not be built or, instead, consume precious green-space.

New Program Initiatives

Although previous downturns have adversely impacted the City of Adrian to a lesser extent due to the cushioning effect of an abundance of governmental, educational and health care institutions residing in this County Seat, the presence of these facilities represents a double edged sword. On the one hand, they provide a more stable employment environment, however, on the other hand the property they occupy is all exempt from real and personal property taxes, placing the burden of providing government services to those facilities directly on City residents. In fact, an estimated 25 percent of the property in the City is deemed non-taxable. Based on this situation, which is aggravated by the current downturn in property values, the City Commission recently approved contracting with Plante & Moran, LLC, a CPA firm, to perform an Income Tax Feasibility Study. Their report is due later this year, at which time stakeholder meetings will be held to determine whether or not a subsequent referendum should be pursued.

Another initiative, Two-Way Traffic Circulation downtown was implemented last fall and the City Commission approved a new liner for Bohn Pool, which could extend its life an additional fifteen

years. Also, time and energy will be spent on development of prospects for the former Witt property and Marvin Farm, as well as further development of the Industrial Park. The Administration is currently exploring the possibility of expanding the Local Development Financing Authority (LDFA) to provide financial incentives for business attraction.

Lastly, the South Toledo Street parking lot is scheduled for reconstruction this coming year, which serves both the new downtown government complex and surrounding business properties. The other eight downtown parking lots are scheduled for renovation in the following construction season, depending on finalization of construction financing. The Downtown Development Authority has already committed its share of funding to the project.

Long Term Financial Planning

The electorate of the State of Michigan passed an amendment in November, 1978 to the State's Constitution that required the State to fund mandates imposed on local units of government (often referred to as the "Headlee Constitutional Tax Limitation Amendment"). The Headlee Amendment (Article IX, Section 29) states:

"The state is hereby prohibited from reducing the state financed proportion of the necessary costs of any existing activity or service required of units of Local Government by state law. A new activity or service or an increase in the level of any activity or service beyond that required by existing law shall not be required by the Legislature or any state agency of units of Local Government, unless a state appropriation is made and disbursed to pay the unit of Local Government for any necessary increased costs..."

The Headlee Amendment became effective on December 23, 1978 and has been generally ignored by the Executive and Legislative branches of government over the past thirty (30) years. In response to concerns raised by local units of government, the State Legislature established the Legislative Commission on Statutory Mandates (LCSM) through P.A. 98 of 2007, as amended by P.A. 356 of 2008 and assigned the LCSM to identify mandates and the related cost of the mandates to local units of government, along with recommendations to resolve the unfunded mandates; and

The LCSM worked with the Citizens Research Council and local units of government associations, including:

- Michigan Association of Counties.
- Michigan Municipal League.
- Michigan Township Association.
- Michigan School Business Officials and Michigan Association of School Administrators.
- Michigan Community College Association.
- County Road Association of Michigan; and

The LCSM issued a report in June 2009 entitled "Interim Report of the Legislative Commission on Statutory Mandates" that indicated, among other matters, that the State had failed to enact legislation enabling the Headlee Amendment and has not complied with the Headlee Amendment since its adoption in 1978. The LCSM completed its report in December 2009 entitled "Final Report of the Legislative Commission on Statutory Mandates" that reaffirms the Interim Report results and provides recommendations, including but not limited to:

- Drafted legislation and court rules that would mitigate unfunded mandates imposed on local units of government in the future.
- Proposed procedures that will prevent new unfunded mandates from being imposed on local units of government.
- Proposed procedures that would be corrective should unfunded mandates be imposed that include, among other requirements:
 - A submission of an action before the Court of Appeals to be heard by a special master in order to rule on whether the matter is a mandate and if the mandate is underfunded.
 - Require the Court of Appeals to rule on the above within six months of the filing.
 - Should the Court of Appeals not rule on the above within six months, the local unit of government would have no obligation to continue to provide the services until such time as the State complies with the Headlee Amendment.

The Adrian City Commission, on April 5, 2010, approved Resolution #R10-043 which supports the findings and recommendations in the interim and final reports of the Legislative Commission on Statutory Mandates and encourages the Governor, Legislature and Supreme Court to adopt and enact the recommendations cited in the final report.

Water and Sewer Services

A public service essential to the success of any community but often overlooked, perhaps because the preponderance of the infrastructure is below ground, is the water and sewer services that are required to sustain human health and sanitation. Huge increases in water and sewer bills are on the way in many places across the nation as cities and towns try to repair aging pipes and correct artificially low prices. In prior decades, the federal government played a prominent role in keeping utility rates low through the provision of grant monies for facility improvements. This practice was discontinued with the turn of the century, leaving the responsibility for financing these essential services with local governments.

The Environmental Protection Agency estimates that the nation's water and wastewater systems need an investment of up to \$1.2 trillion over 20 years. The City of Adrian has not neglected this responsibility, having undertaken several projects during this decade resulting in upgrading the Water and Wastewater Treatment Plants, as well as sewer collection and water distribution systems. In addition, due to concerns about the long-term viability of the City's primary water source, surface water from Lake Adrian, the City invested in property in Adrian Township, north of Hamilton Highway, and constructed a well to tap a groundwater aquifer that has been connected to the Water Treatment Plant and is now operational, serving as a supplement to the surface water source.

Similar to other cities, like Atlanta, Detroit, New York and Tampa Bay, as well as many of the nation's 70,000 smaller systems, including the City of Adrian, the costs of these improvements rest squarely on the shoulders of local users and ratepayers. Last year (FY2008-09), the median annual residential bill was \$554 for water and sewer services, reports the American Water Works Association. The City of Adrian's utility rates compared favorably with an annual cost per customer amounting to \$505. Nationally, the median rate increase was about 5 percent.

Many people, however, will see much larger increases because of the cost of improvements and inconsistent pricing policies. Many municipal owned systems have treated rate hikes like tax increases and avoided them for years. As a result, many communities are faced with price hikes of 50 percent to 100 percent or more. The Government Accountability Office (GAO) estimates that

29 percent of water systems and 41 percent of sewer systems charge customers less than the cost of service.

To fund the aforementioned needed improvements, the City of Adrian has issued a total of \$31.6 million in revenue bonds through the State's low-interest Revolving Fund Loan Program, with a current balance of \$25.7 million at 2.075 percent interest. Annual debt service amounts to over \$650,000. These fixed costs, which will be phased out over the next 20 years, are dependent upon committed revenues generated from the users of the system. Unfortunately, the economy is taking a toll on high-volume industrial users and plant closings are having a significant adverse effect on utility revenues, resulting in a need to spread these costs over the remaining customer base, which are primarily residential users. The Utility Department annually performs a User Rate Analysis that includes the financial impact of the existing and future debt service requirements, as well as the replacement/renovation capital projects costs. Based on that analysis, this budget recommendation includes a recommended rate increase of five (5.0%) percent for both water and sewer services.

Closing Remarks

The Finance Department, on a quarterly basis prepares a Financial Forecast projecting the financial position of the City at the conclusion of the current fiscal year. The Third-Quarter Financial Forecast will be available prior to the City Commission deliberation on this budget recommendation during the month of April.

I would like to take this opportunity to express my appreciation to all departments and staff who participated in the development of this Budget Recommendation. I believe that implementation of this financial plan will provide quality services within available resources with no increase in taxes to Adrian citizens in the near term and will continue to maintain a strong financial foundation to support future delivery of essential public services.

Respectfully Submitted,



Dane C. Nelson, City Administrator