

CFO Local Financial Forecast

Background for
FY 2016 Budget
July 6, 2015

What is the CFO Forecast?

- First implemented during FY 2012
- Provides City Commission high-level understanding of budget issues & impacts
- Serves as the annual economic forecast upon which budget projections are based
- Identifies revenues and financial risks, including:
 - “Swan” events
 - Legislative Uncertainty/Revenue Disruption
 - Unpredictable Taxpayer Environment

Forecasting “Unknown”

“Swan Events” – Standard Financial Terminology for identifying potential or anticipated issues and risks

- Blue Swan – Management driven change

- Grey Swan – Known or anticipated external-driven change

Examples: GASB rulings, Tax Tribunal cases

- Black Swan – Surprise event or change

Example: Major employer/tax payer shuts down or moves without much notice, Extraordinary weather damage

How Does it Work?

- Iterative Process
 - Monitored throughout year
 - Performance measures/Forecast accuracy
 - Adjustments/recommendations according to changing conditions/key drivers
- Linked to Strategic Plan/Long-range Outlook
- Establishes priorities for annual capital improvements and debt management

FY2016 Economic Context and Background

- Highly Volatile Federal and State Revenue Environment
 - Unprecedented budget challenges
 - Unprecedented tax changes with negative revenue impacts
 - Substantial shifts in cost burden between government echelons
- City millage rate unchanged since 2006 – Extraordinary! However:
 - Long-term area job growth for past 20 years is negative
 - Exponential rise in income maintenance and unemployment recipients
 - Substantial rise in fixed income (I.E. retirement) residents
 - Several Significant Tax Tribunal cases are pending;
 - Personal Property Tax (PPT) reforms;
 - Substantial Healthcare Cost increases
 - SOM Minimum wage increases;
 - GASB reporting changes for unfunded pension and OPEB liabilities
- Recent City Audit demonstrates Financial Strategy is Working!
- No revenue sources are forecast to be stable during FY2016
- Uncertainty and diminishing availability of Federal and State discretionary program funding will make grant pursuits much more difficult

RESULT: FY2015 was a very challenging year, and FY2016 will offer no respite!

Federal/State Economic Context

- 2015 1st quarter national data shows a **-0.2%** economic contraction
- Global economic insecurity impacts local consumers
- Potential inflation/interest rate impacts
- Potential Healthcare Reform Impacts (Less discretionary spending)
- Potential Impacts to major area employers (I.E., Mining, Natural Resources)
- Substantial Energy sector challenges

Federal and State Budgets

- Feds believe higher inflation and less consumption are possible; State believes higher unemployment and lower inflation are possible:

	<u>Feds</u>	<u>State</u>
GDP	2.8%	2.8%
CPI	2.0%	2.1%
Unemployment	4.9%	5.2%
Inflation	2.3%	2.1%

- State forecasting wage increases in line with GDP, but also believes overall personal income increases to be substantial (same assumption as in previous years)

State Budget

- 40% of State Budget relies on Federal Funding
 - Dependent upon President/Congressional budget requests and national economic forecasts
- Michigan Governor/Michigan Congress Consensus Economic Forecast creates revenue estimate which identifies revenue sharing targets
- Revenue sharing composed of two components:
 - Constitutional – Formula
 - Statutory

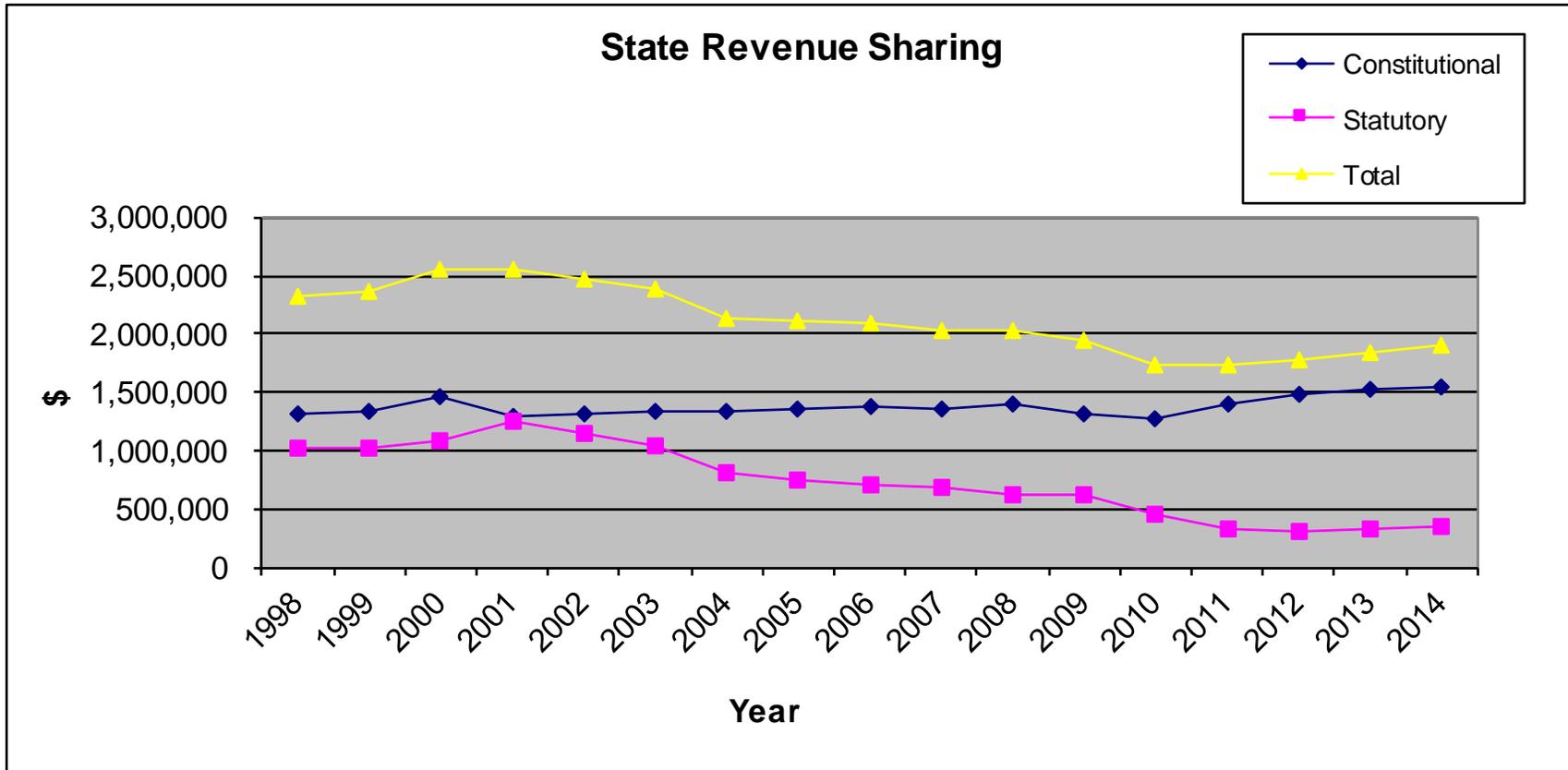
“Trickle-Down” Challenges

- If the National and State forecasts don't match, revenue gaps can occur
 - Impact to state/local revenue sharing unknown
 - Results in both Federal and State revenue sources being viewed as “volatile”
- Federal Government can deficit spend, State cannot
 - President and Congressional Budgets unreconciled for FY2016
 - Federal government currently operating on continuing resolution renewed since FY2012 – No new starts!
 - Federal PAYGO rules still in effect
- Although SOM constitutional revenue remains relatively stable, statutory revenue sharing has been in serious decline for at least 12 years

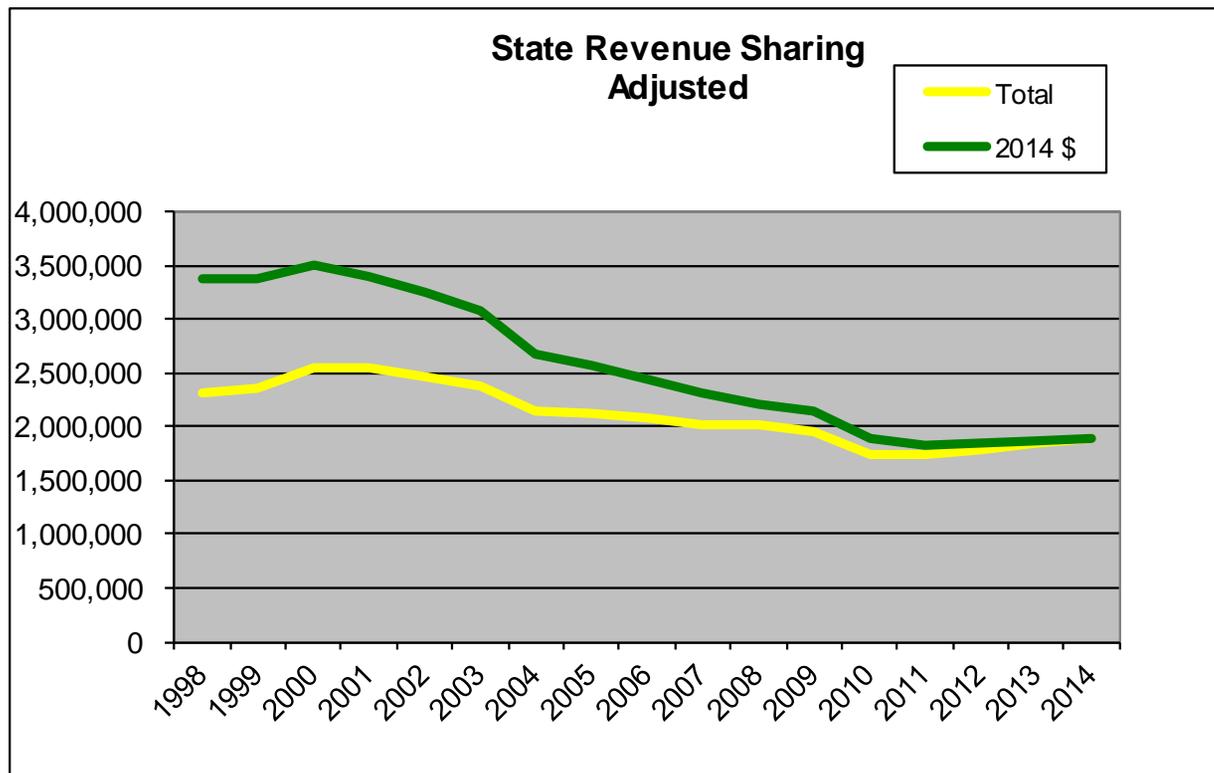
Marquette Budget

- The General Fund is based upon Real Property taxes + Revenue Sharing
 - Real property taxes are levied upon Residential and Commercial property.
 - Revenue sharing is based upon income tax growth (personal and business) and sales tax collections. These sources are considered VOLATILE.
 - Grant opportunities depend upon Federal and State budgets
- The City Commission has previously endorsed a budget strategy that does not incorporate VOLATILE revenue as part of a balanced budget
- **This will be a critical goal for the FY 2016 balanced budget**
- In order to further reduce long-term debt, the City Commission endorsed a strategy that limits issuance of new debt to the amount paid off during the previous fiscal (current) year. The ceiling for FY 2015 was established at \$2,000,000.
- **A critical goal for FY2016 is to maintain a debt ceiling of \$3,000,000, and adjust based upon iterative budget review and prevailing financial conditions**
- **It is easier to amend than cut a budget!**
 - If the economy picks up, the Constitutional portion of State Revenue Sharing allocated to the City will grow
 - Any statutory revenue received will be treated as a windfall
 - Any additional revenues received will be added to the Fund Balance, allowing for less future bond debt, as well as possible budget amendments as may be required

Marquette Revenue Sharing 1998 – Present



Financial Impact Using CY2014 as Index value



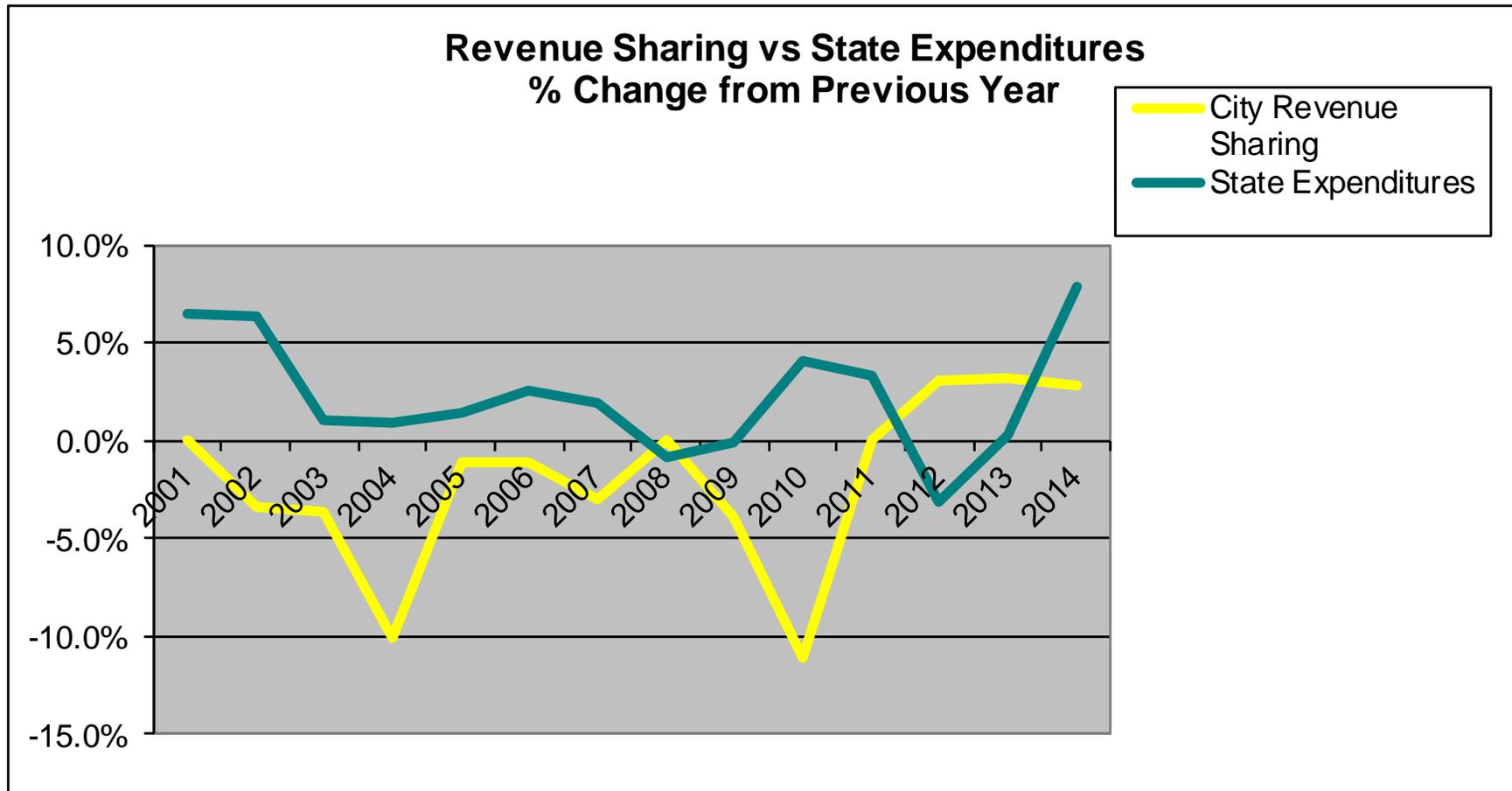
That's Equal To...

- A decline of \$11.5 million in revenue since 1999
 - When included with all other State revenue sources (I.E., State Fire Protection, Gas Tax Shared Revenue, PPT Reform, Veterans Property Tax Credit etc.), the City has endured a decline of almost \$13.2 million since 1999
- Local economic growth has not generated activity necessary to offset diminished state revenue sharing

Additional Revenue Reductions Anticipated

- Personal Property Tax (PPT) Reform
 - Change in State Law
 - Administered/Collected by the City
 - FY2015 will realize approximately \$596K
- Current deduction threshold (\$40K TV) would reduce City revenue by up to \$40K for Small Business Exemption. Supposed to be reimbursed in the next fiscal year.
- In FY 2017, Eligible Manufacturing Personal Property will be phased out thru 2023. Unable to calculate this impact at the present time. Some reimbursement from Essential Services Assessment but the amount is unknown at this time.

In Comparison ...



Other Issues

- Discussion of limiting tax advantages of municipal bonds. If amount of bond interest that can be excluded from taxable income is limited, some analysts predict it would:
 - Reduce demand in the municipal bond market
 - Increase borrowing costs for state and local governments
- Outstanding Pension and Benefit Obligations
- Other “Swans”
- Watch out for GASB’s new regulations coming soon - Unable to quantify at this time

Current Real Property Tax

FOR DISCUSSION PURPOSES ONLY.
STAFF DOES NOT RECOMMEND RAISING
TAXES!!!!!!!!!!!!

- Current Property Tax Millage is 14.9225 (Headlee Cap currently is 17.9169)
- In FY2015, 1 mill = \$677,000
- Total potential additional revenue available if raised to Headlee maximum = \$2,027,000

FOR DISCUSSION PURPOSES ONLY.
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Proposed Projects*

*not including Street/Water/Sewer Maintenance, Motor Pool, or other building maintenance requirements

All Projects currently of Equal Priority

- PI Marina \$2.9 million
 - Cliffs Dow \$1.5 million
 - Lakeshore Relocation \$9.9 million
 - Coast Guard Property \$1.0 million
 - New Fire Hall \$4.5 million
 - Misc Remediation \$800k
 - PI Playground \$700k
 - Mattson Park \$350k
 - New Senior Center \$800K
- Totals for just these projects are \$22,450,000 (FY2015 dollars)

Equivalent to 33.2+ mills of property
tax!!!!

Where Would Revenue Come From For Projects?

IF:

- Economic growth rapidly increases; **and**
- Personal Property Taxes are replaced through source provided by State; **and**
- No other Federal or State revenue impacts (i.e. requirements to absorb reductions in Senior Services, PWPL rates, reductions in County Services, changes to MAPS funding streams, etc)

THEN:

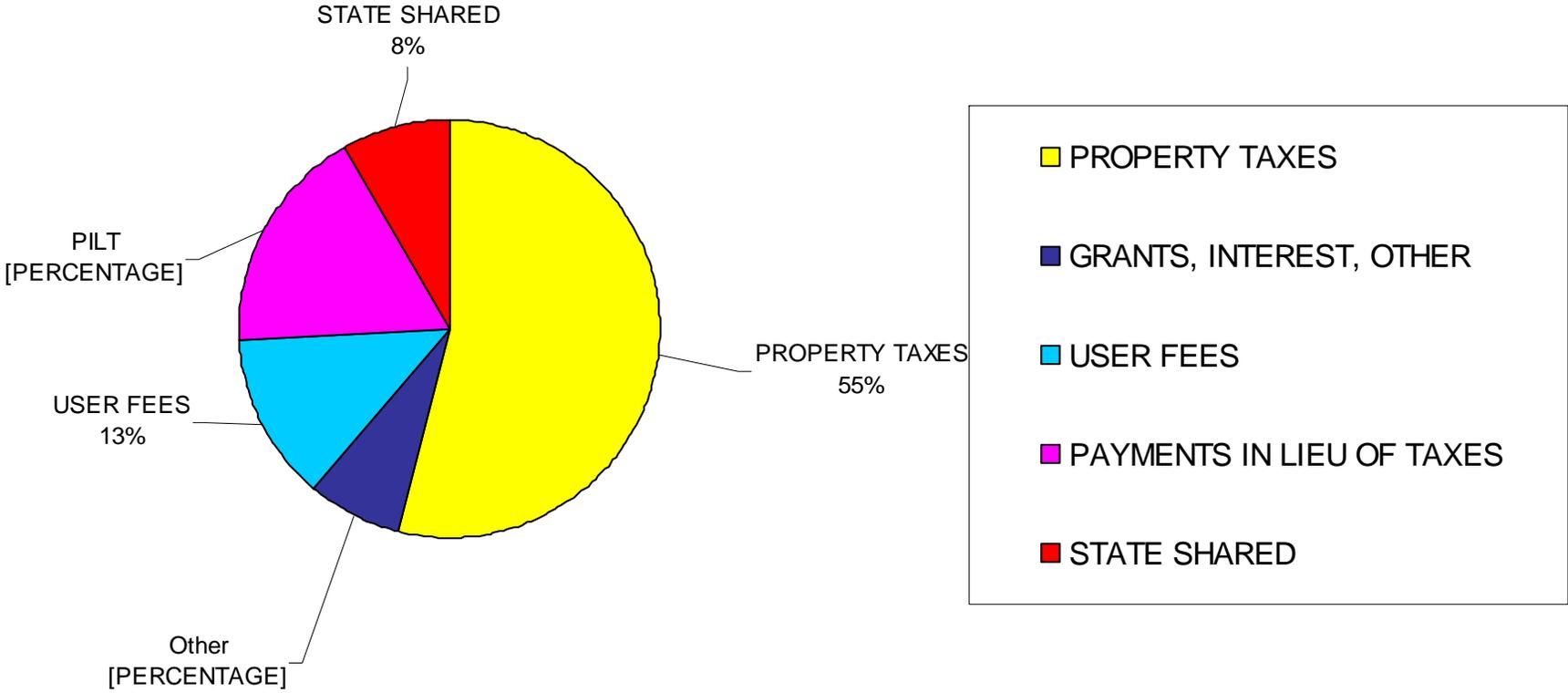
- Tax increase - NOT RECOMMENDED – UNDER HEADLEE AMENDMENT NOT EVEN POSSIBLE
- Bond for \$22.5 million for 20 years - Annual Debt Service = \$1.7 million*, **, ***

* Equivalent to 2.5 mills of property tax; current available Headlee limit allows additional 2.99 mills;

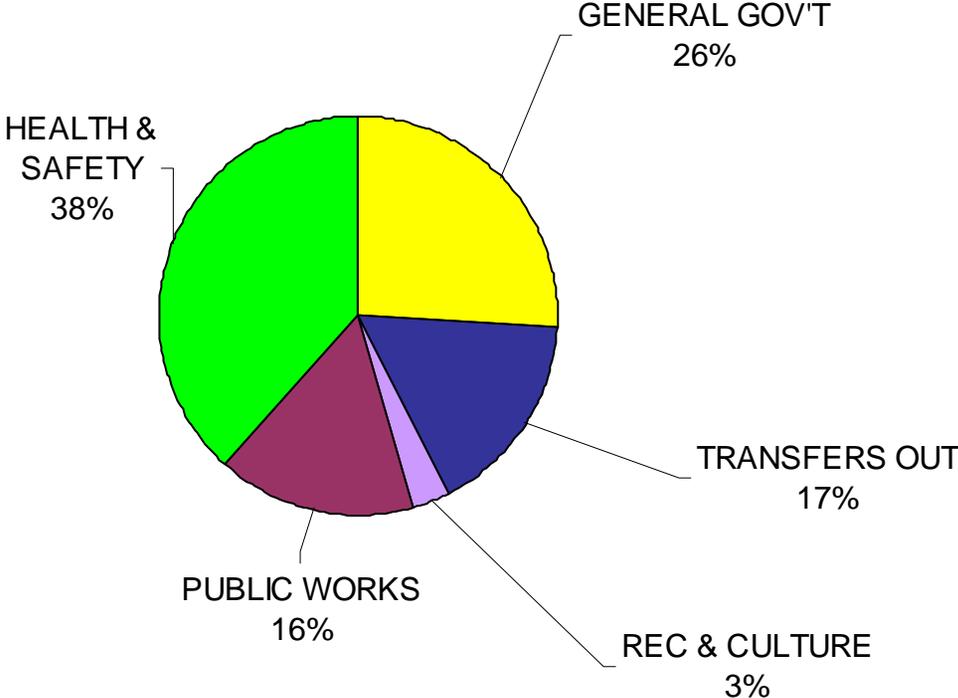
**Highly risky and irresponsible! Such a path would indebt the City “to the hilt”, and completely eliminate future ability to mitigate fluctuations in the national and state economy, unknown statutory or policy changes impacting revenue sharing; unpredictable realization of “Swan” liabilities; or other unknown negative financial impacts

***Would automatically require depletion of City Fund Balance

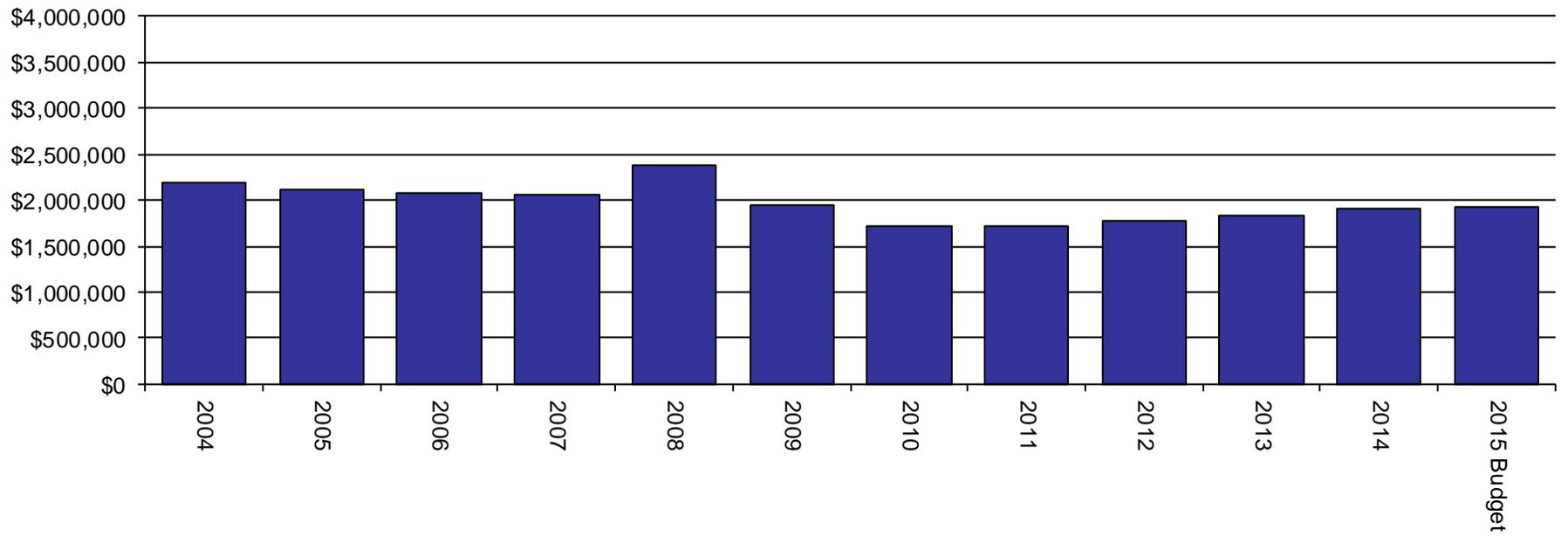
**CITY OF MARQUETTE
General Fund Revenues
Adopted FY 2015**



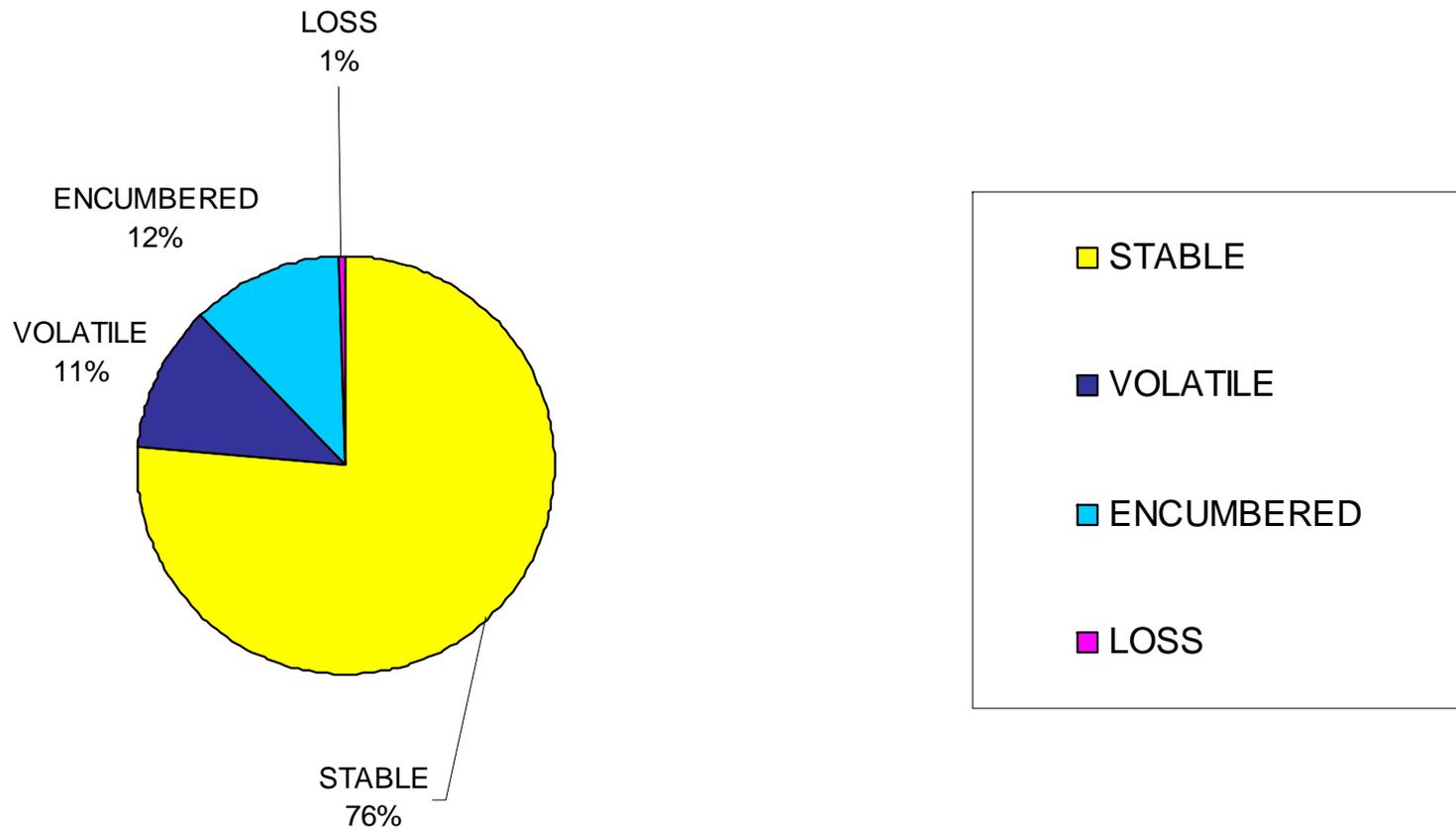
CITY OF MARQUETTE
General Fund Expenditures By Function
FY 2015



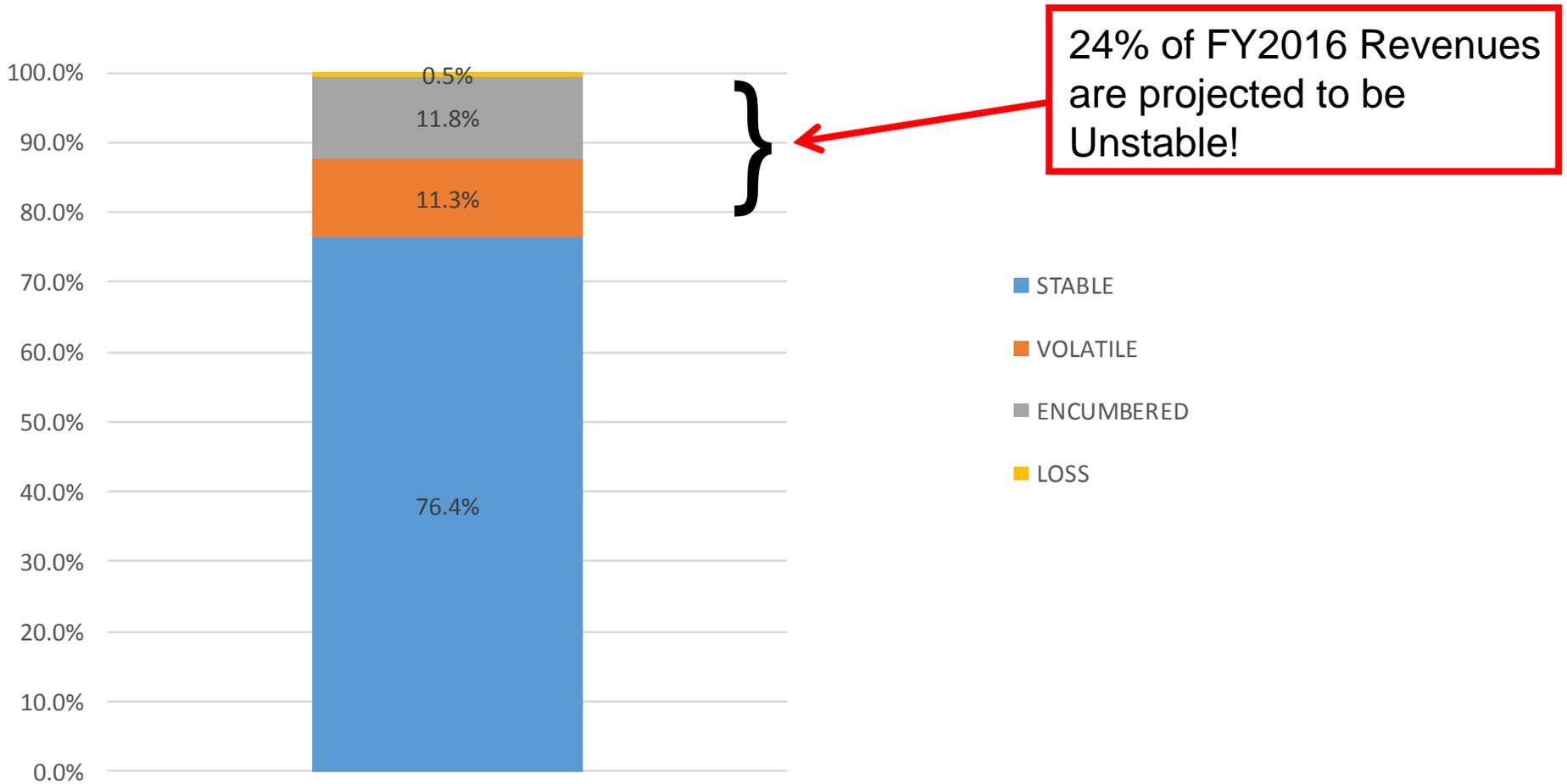
CITY OF MARQUETTE
State Shared - Sales & Use Tax
Constitutional & Statutory



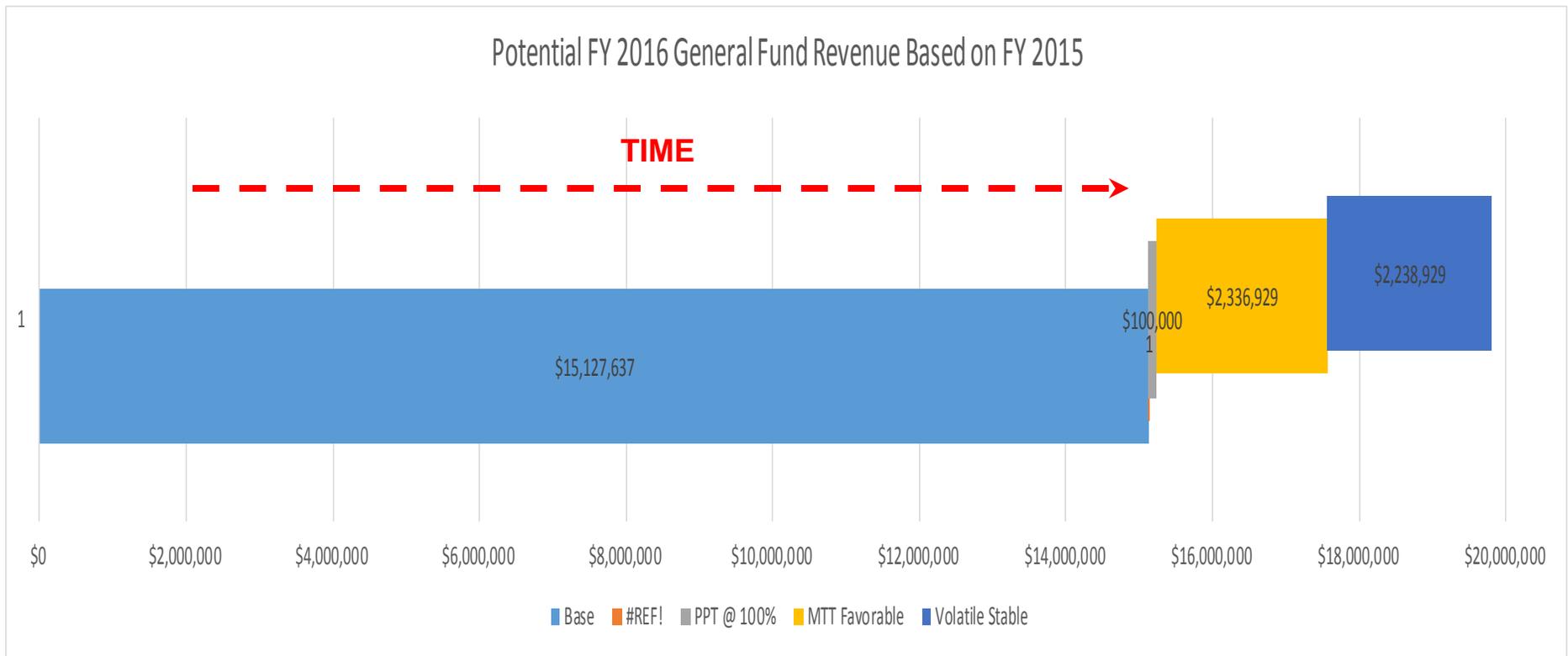
General Fund Revenues Shaping the FY 2016 Budget Based on FY 2015



General Fund Revenues Shaping the FY 2016 Budget Based on FY 2015



EXAMPLE OF ITERATIVE AMENDMENT PROCESS



Changing Business Conditions

Uncertainty regarding largest City property tax payers - Presque Isle Power Plant and Medical Center - creates extraordinary planning challenges:

- Major Tax Tribunal cases pending
- Possible relocation outside of the City
- Loss of tax base, jobs, and cascading consequences (i.e. other related businesses leaving as well)
- Restrictions placed on associated tax revenues

More Grey Swans

- Reduced demand for municipal bonds due to elimination of Federal tax advantages
- New General Accounting Standards Board (GASB) regulations for unfunded pension liabilities will take effect in 2015. The City currently has unfunded liabilities as follows:
 - MERS Pension: \$18,620,831 or 65% funded
 - Police/Fire Pension: \$9,564,468 or 75% funded
 - OPEB: \$10,953,785 or 0% funded
- Tax Tribunal Cases:
 - WE Energies
 - Schramm Properties
 - P&O Investment
 - Value Host
 - Marquette Medical Center

FINANCIAL IMPACTS OF CURRENT TRIBUNAL CASES

City of Marquette				
Summary of Tax Tribunal Cases				
Tax Revenue				
	General Fund		Senior Services	
WE Energies	\$2,245,886		\$52,676	
Mqt Medical Center	63,149		1,481	
Schramm Properties	22,460		527	
P&O Investment	2,947		69	
Value Host	2,385		56	
Total	<u>\$2,336,827</u>		<u>\$54,809</u>	

Impact to other entities

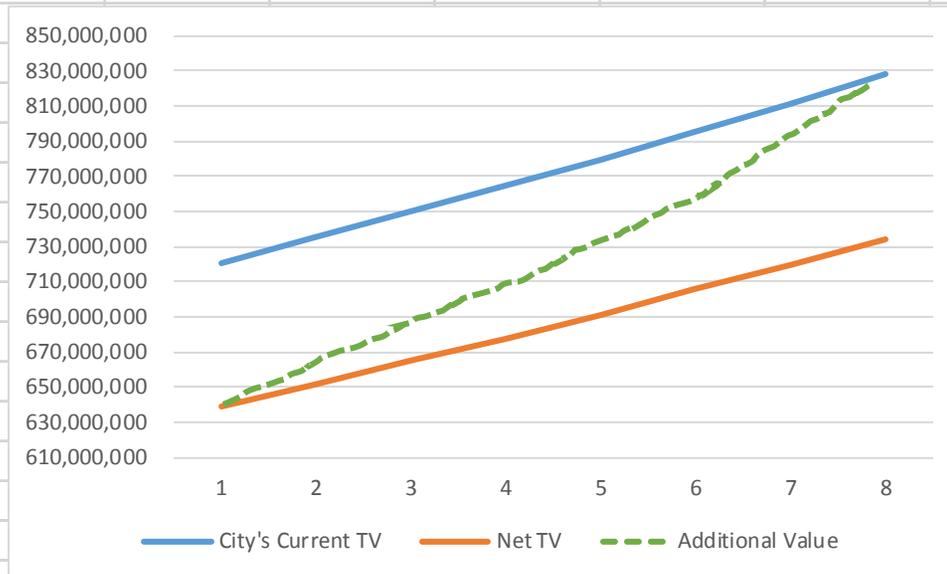
Other Taxing Jurisdictions:

Totals (all years)	PWPL	County	Special Ed	Heritage Auth.	MAPS	State Ed
WE Energies	282,916	1,140,197	331,830	30,101	2,866,615	903,020
Schramm Properties	2,829	11,403	3,319	301	28,665	9,031
P&O Investment	370	1,492	435	40	3,705	1,185
Value Host	300	1,216	352	32	3,121	959
Marquette Med. Ctr.	7,955	32,206	9,330	846	82,647	25,391
	294,371	1,186,513	345,266	31,320	2,984,753	939,586

Impact on all Taxing Jurisdictions:	
General Fund	\$2,336,827
Senior Services	54,809
PWPL	294,371
County	1,186,513
Special Ed	345,266
Heritage Trails	31,320
MAPS	2,984,753
State Ed	939,586
Total	<u>\$8,173,445</u>

Taxable Value In Contention								
Inflation Factor	2.0%							
WE Energies	76,303,233							
Mqt Medical Center	4,231,800							
Schramm Properties	760,140							
P&O Investments	42,600							
Value Host	159,800							
Tribal Trust Property	305,685							
	<u>81,803,258</u>							
City's Current TV	720,543,026	734,953,887	749,652,964	764,646,024	779,938,944	795,537,723	811,448,477	827,677,447
		Year						
		1	2	3	4	5	6	7
Net TV	638,739,768	651,514,563	664,544,855	677,835,752	691,392,467	705,220,316	719,324,722	733,711,217

If all MTT's are lost, this graph shows the impact on TV utilizing normal growth. In reality, the only way for the two lines to intersect is for improvements that add taxable value, property is sold and uncapped, and/or additional property added to the tax roll. This is why we must defend these cases as rigorously as we can.



CFO Moral of the Story

- LOTS of uncertainty and unknowns currently at both the Federal and State levels which could flow down to the City
- Goal for the FY 2016 Budget is to stick to the strategy – and continue to focus on critical priorities
- Address unprecedented Federal and State revenue volatility by balancing the budget without use of Fund Balance or Statutory Revenue Sharing.
- Carefully manage unfunded liabilities.
- Do NOT Recommend Increasing Total Bond Debt
- Do NOT Recommend Increasing Taxes
- Easier to Amend than Cut the Budget!
- As always - Plan for the Worst, Hope for the Best!!