

1550 Westfield Ave., Ann Arbor, MI 48103
734.623.8033



January 29, 2015

Budget Audit Committee
Saginaw County Board of Commissioners
County of Saginaw
111 South Michigan Avenue
Saginaw, MI 48602

Dear Commissioners:

We have concluded our work with County administration and financial management to update, extend and expand the Saginaw County multi-year budget forecast model through fiscal year 2021. As some of you may be aware, the County has used the financial model for a number of years to improve financial management practices and test the impact of various scenarios on the General Fund.

The recent update includes revisions to a number of primary assumptions, based on anticipated economic trends and in response to ongoing efforts by the County to manage costs. The five-year outlook presented in the financial model enables the County to make more effective decisions in the short-term, based on anticipated long-term revenue and expenditure expectations.

In addition to the General Fund, the model now includes the following funds, each of which have an impact on the General Fund budget:

- Road Patrol Millage Fund (205)
- Law Enforcement Fund (207)
- Friend of the Court (215)
- Health Department (221)
- Planning-Planning Commission (one budget department of fund 242)
- Special Projects-Emergency Services (one budget department of fund 278)
- Prosecutor Special Projects (282)
- Child Care (292)
- Post-Employment Health Fund (728)

This summary report on the current outlook of the General Fund and other major funds is intended to provide policy makers with an orientation to the financial model, inform you of the assumptions used to estimate future revenues and expenditures, and provide a framework for policy discussions related to the County's budget.

FINANCIAL MODEL OVERVIEW

Initially developed in 2006, the model has until now been limited to the General Fund. The inclusion of the funds noted above provides a more comprehensive assessment of General Fund finances, as each fund requires General Fund support to cover operating expenses.

The purpose of the model is to calculate and present a view of anticipated future revenues and expenditures, based on a number of assumptions. The model is not a recommended budget or a proposed financial plan. Instead, it is used to estimate future trends and provide a means to test different scenarios, which are expected to have a significant impact on the County's finances. Often, a financial model will provide a framework to evaluate whether the current course of operations is sustainable. Many governing bodies are able to use the estimates of future finances to make changes in the short-term that will allow for long-term sustainable budgets.

The model is comprehensive, meaning it includes all line items for each fund. Every line item has been estimated for a five-year period, using specific assumptions. Primary assumptions used in the model include:

Table 1

Baseline Assumptions Used in Saginaw County Multi-Year Financial Model						
<i>(reflects estimated change from prior year revenues and expenditures)</i>						
	2016	2017	2018	2019	2020	2021
Property Taxes	0.00%	1.00%	1.00%	1.50%	1.50%	2.00%
Rev Sharing	2.00%	2.50%	2.50%	3.00%	3.00%	3.00%
General Inflation	2.00%	2.50%	2.50%	3.00%	3.00%	3.00%
Wages	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Longevity	-2.00%	-2.00%	-2.00%	-2.00%	-2.00%	-2.00%
Healthcare	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%
OPEB Funding	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Admin Cost Reimb	3.6%	2.0%	2.3%	2.5%	2.8%	3.0%
Gas, Grease, Oil	2.00%	2.50%	2.50%	3.00%	3.00%	3.00%
Utilities	3.00%	3.50%	3.50%	3.50%	4.00%	4.00%
Contr-GIS Auth	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%

A significant expenditure area in the General Fund is support of other special revenue funds, primarily those noted above. The model includes separate worksheets to calculate contributions to other funds. Expected contributions from the General Fund to each of the other funds have been set at specific levels, as outlined below:

- Law Enforcement: contribution follows policy established by the Board
- Friend of the Court: County contribution established by State regulations
- Health Department: contributions have been held constant at current budget levels
- Planning Commission: General Fund is assumed to fully fund any shortfall
- Prosecutor Special Projects: General Fund is assumed to mostly fund any shortfall
- Child Care: County contribution established by State guidelines
- Post-Employment Health: contributions set at a level that should fully fund the actuarially determined ARC (annual required contribution) over a seven-year period (by FY 2022)

In addition to the worksheets used to estimate future financials, the model includes summary worksheets that present the thousands of line items in more summary form, including charts. Charts include revenues, expenditures and fund balances for each fund in the model, as well as a cash flow projection for the General Fund. These charts will be presented in the discussion below.

GENERAL OUTLOOK

Saginaw County continues to experience stagnation in its tax base. This is an improvement over the losses in taxable value that had been experienced by most governments in Michigan between 2008 and 2013. The recent changes in personal property tax legislation has extended the County's expected period of property tax stagnation. Looking forward, the County is expected to see very little change in tax base through FY 2021. As a result, the General Fund is expected to realize only a 7% increase in property taxes between the current budget and 2021.

Other revenues are anticipated to remain largely unchanged over the next 5 – 7 years. Consequently, the County could see no more than 1.8% increase in revenues at any time in the forecast period, with an average increase estimated in the area of 1.2% per year.

General Fund expenditures, on the other hand, are estimated to increase more than 2% per year. The largest expenditures impacting this outlook in the model are healthcare costs, retiree healthcare costs (OPEB), and general inflationary increases in the cost of goods and services. The base model presented in this report assumes no increases in wages, beyond the 1% included in the 2015 budget.

For the other funds included in the model, similar revenue constraints and rising costs are expected to stress finances, thereby requiring continued contributions from the General Fund to pay for operations.

BASE MODEL

Our initial estimates of future revenues and expenditures assumed "status quo" operations, meaning no change in staffing, service levels or employee benefit offerings. Also, these estimates assume no change to current taxes levied by the County. Continuing operations as they currently are allows us to create the base model for each fund.

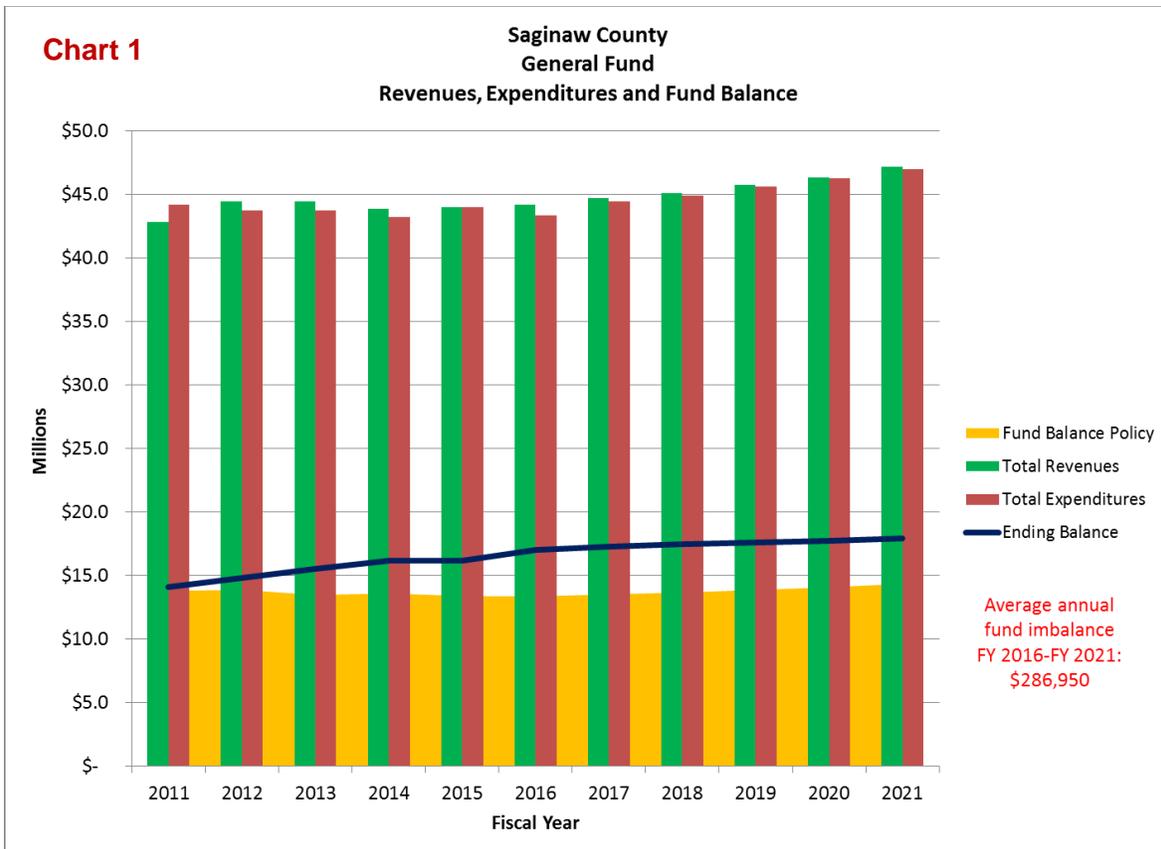
The base model does include one significant exception to status quo spending in the General Fund: contributions to capital improvements. Following years of cost cutting, the County's capital assets have seen only minimal investment. This approach to capital asset management can be employed for short periods, but if it is allowed to continue too long, assets begin to fail, which can result in costly emergency repairs and replacements, and may result in damage to property or injury to people. In recognition of the need to reinvest in capital, the model includes \$500,000 per year contribution to the Public Improvement Fund, beginning in FY 2017. This is the minimum amount that should be set aside to meet capital needs over the coming 6-year period. Additional funds may be allocated, if there is a General Fund surplus, as described in the Board's policy manual.

Contributions to other funds in future years, based on assumptions outlined above, are summarized below. You will notice that contributions to Animal Shelter, Law Library, and MSU Extension Special Projects are assumed to not continue after the current fiscal year.

Table 2

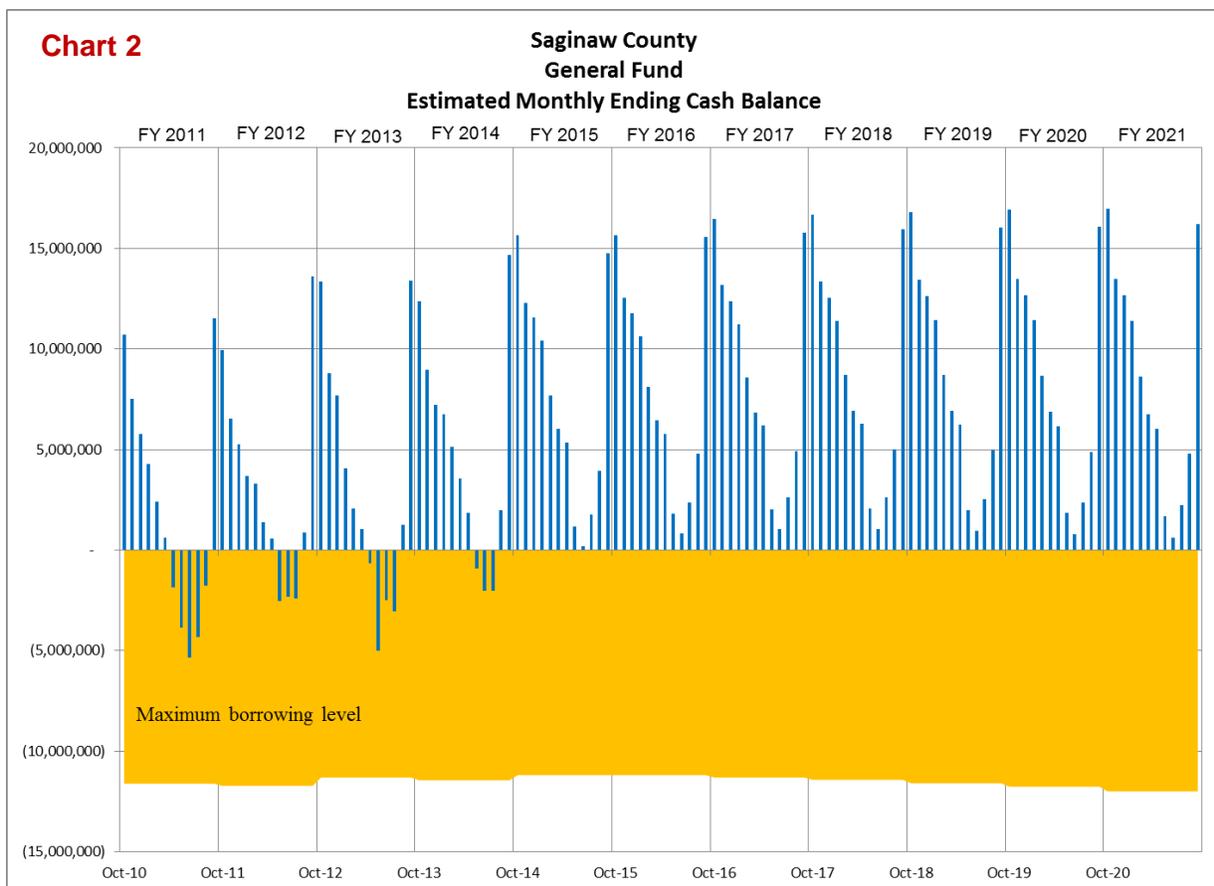
General Fund Contributions Included in the Baseline Financial Model						
ACCOUNT NAME	2016	2017	2018	2019	2020	2021
CONTR-TO OTHER FUNDS	600,000	600,000	600,000	600,000	600,000	600,000
CONTR-ANIMAL SHELTER	-	-	-	-	-	-
CONTR-LAW ENFORCEMENT	408,374	412,458	416,582	422,831	429,174	437,757
CONTR-FOC-ACT 294	1,080,723	1,092,477	1,104,911	1,118,478	1,132,712	1,147,651
CONTR-CHILD CARE-PROBATE	2,166,002	2,192,678	2,220,853	2,251,975	2,284,578	2,318,740
CONTR-CHILD CARE-WELFARE	407,750	407,750	407,750	407,750	407,750	407,750
CONTR-HEALTH DEPARTMENT	919,046	919,046	919,046	919,046	919,046	919,046
CONTR-LAW LIBRARY	-	-	-	-	-	-
CONTR-MSU EXT SPECIAL PROJECT	-	-	-	-	-	-
CONTR-EMERGENCY SERVICES	130,628	157,876	135,227	162,839	140,574	168,438
CONTR-PLANNING COMMISSION	38,185	41,777	45,556	49,762	54,176	58,809
CONTR-PUBLIC IMPROVEMENT	-	500,000	500,000	500,000	500,000	500,000
CONTR-SOCIAL SERVICES	98,800	98,800	98,800	98,800	98,800	98,800
CONTR-SOLDIERS RELIEF	15,000	15,000	15,000	15,000	15,000	15,000
CONTR-PROSECUTOR SPECIAL PROJ	340,567	344,777	281,933	285,269	288,773	292,456
CONTRIBUTION-GIS AUTHORITY	97,618	98,594	99,580	100,575	101,581	102,597
MENTAL HEALTH AUTHORITY	1,050,303	1,050,303	1,050,303	1,050,303	1,050,303	1,050,303
SAGINAW FUTURE-JOBS	200,000	200,000	200,000	200,000	200,000	200,000
TOTAL CONTRIBUTIONS	7,552,996	8,131,535	8,095,541	8,182,628	8,222,466	8,317,347

The following chart summarizes the baseline outlook for the General Fund.



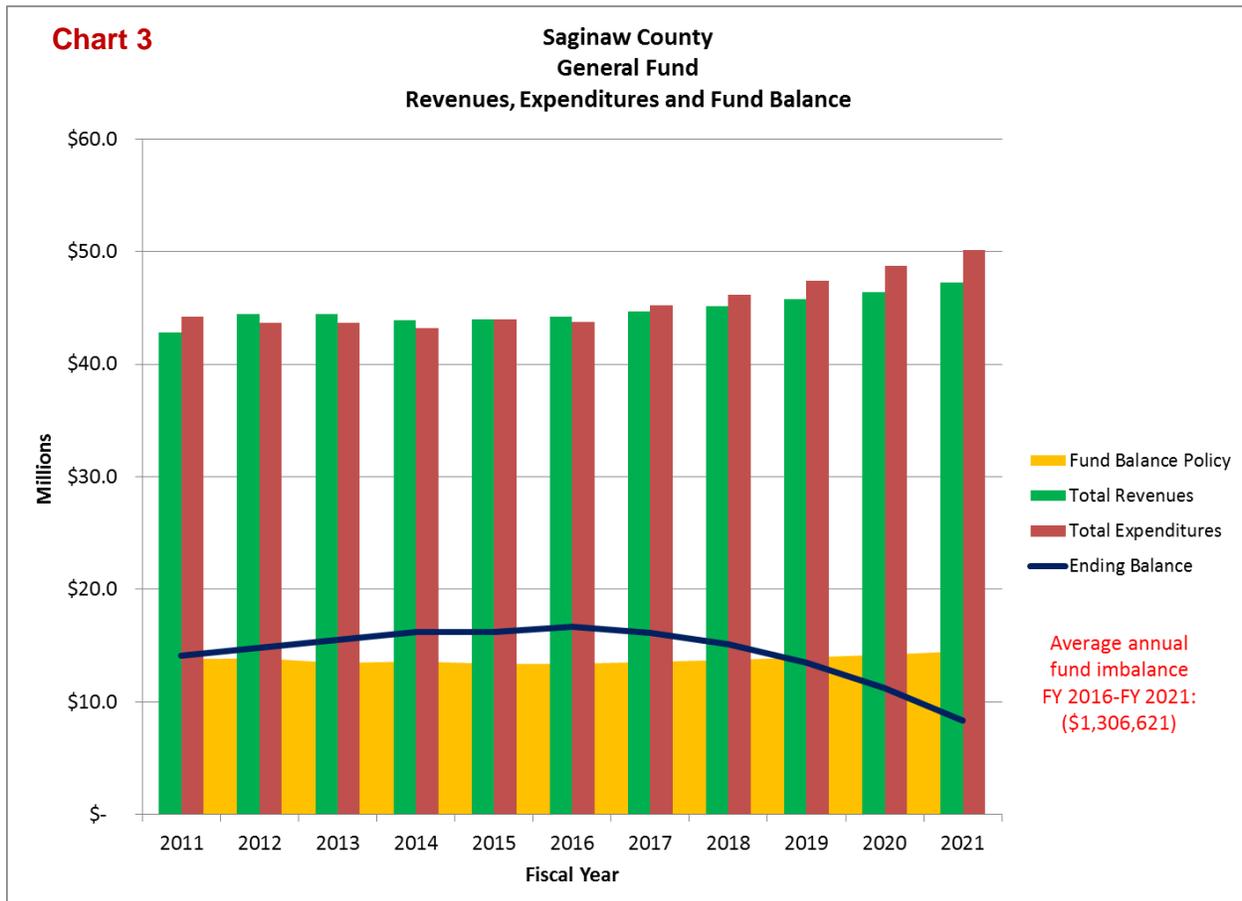
The baseline outlook for other funds in the model is included in Appendix A at the end of this report. Three funds, the Law Enforcement Fund, Health Department and Child Care, are estimated to run significant deficits using baseline assumptions. To cover the shortfalls in these funds just enough to keep reserves above zero, the General Fund could need to increase contributions by almost \$8 million over the next six years. Meeting this increased level of contributions would result in the General Fund ending fund balance in 2021 being only \$10 million, instead of the \$17.9 million shown above.

In addition to annual revenues and expenditures, it is important to consider the level of cash available to meet General Fund obligations. The County’s reserve policy is partially based on the fact that tax revenues are realized late in the fiscal year, but operating costs (the largest of which is wages and employee benefits) are payable monthly throughout the fiscal year. This misalignment of revenues and expenditures requires sufficient cash be on-hand to meet payroll and other obligations. Ever since the State changed the collection of county taxes from December to July about ten years ago, Saginaw County has had to borrow cash from other funds to meet General Fund obligations in the later months of the fiscal year (typically April – August). As Saginaw has made changes to reduce its structural deficit, borrowing has been reduced. As seen in the chart below, using baseline assumptions, the need for General Fund borrowing (blue lines that dip below zero into the yellow shaded area) could be eliminated.



OPEB FUNDING

The outlook for the General Fund in the base model looks promising, if no additional contributions are required. However, the level of spending in the fund is understated, due largely to underfunding the OPEB contribution. The chart below illustrates the impact on the General Fund of increasing the OPEB contribution each year, with a goal of fully funding the ARC by 2022.

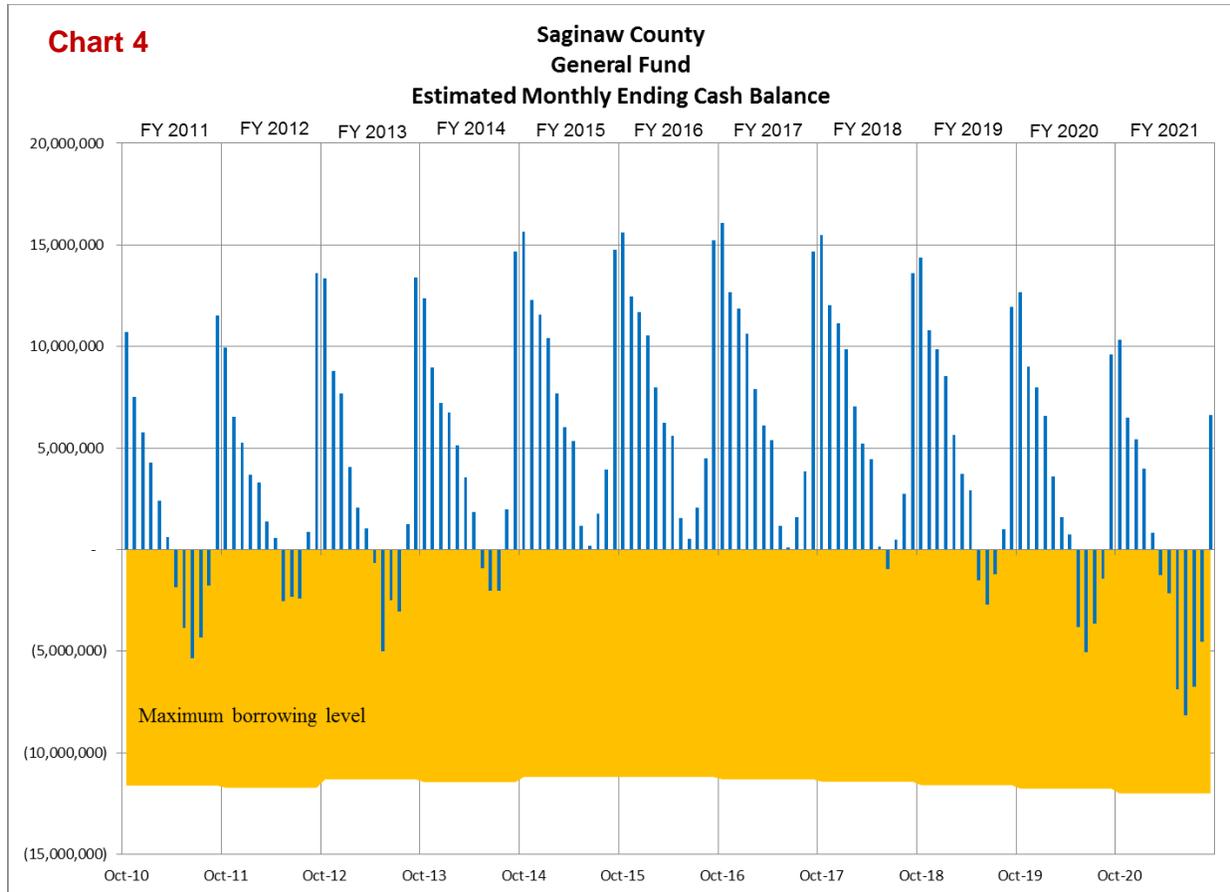


As can be seen in the above chart, making one change in assumptions, in this case the percentage of funding the OPEB liability, demonstrates how easily the trajectory can change. Currently, OPEB is funded at about 43% of ARC. Moving to 100% funding of the ARC will not erase the unfunded liability in OPEB, but it should significantly slow or stop the liability from increasing.

The chart illustrates that fully funding the OPEB ARC, even over a period of seven years, without reducing other costs or increasing revenues, is not sustainable in the long-term. If we include the potential increased contributions that could be needed to subsidize Law Enforcement, Child Care and Health Department Funds (see Appendix B), General Fund ending reserves in 2021 could be \$2 million in the negative.

Fully funding the ARC will also have an impact on General Fund cash, as can be seen in the chart below. Notice that cash reserves could be sufficient for several years, but as OPEB funding increases, there is less cash available in the General Fund. Starting as early as FY

2018, the County may be required to borrow once again from other funds to pay General Fund obligations. In just a couple of years, the small amount of borrowing could increase rapidly, reaching over \$8 million in July 2021.



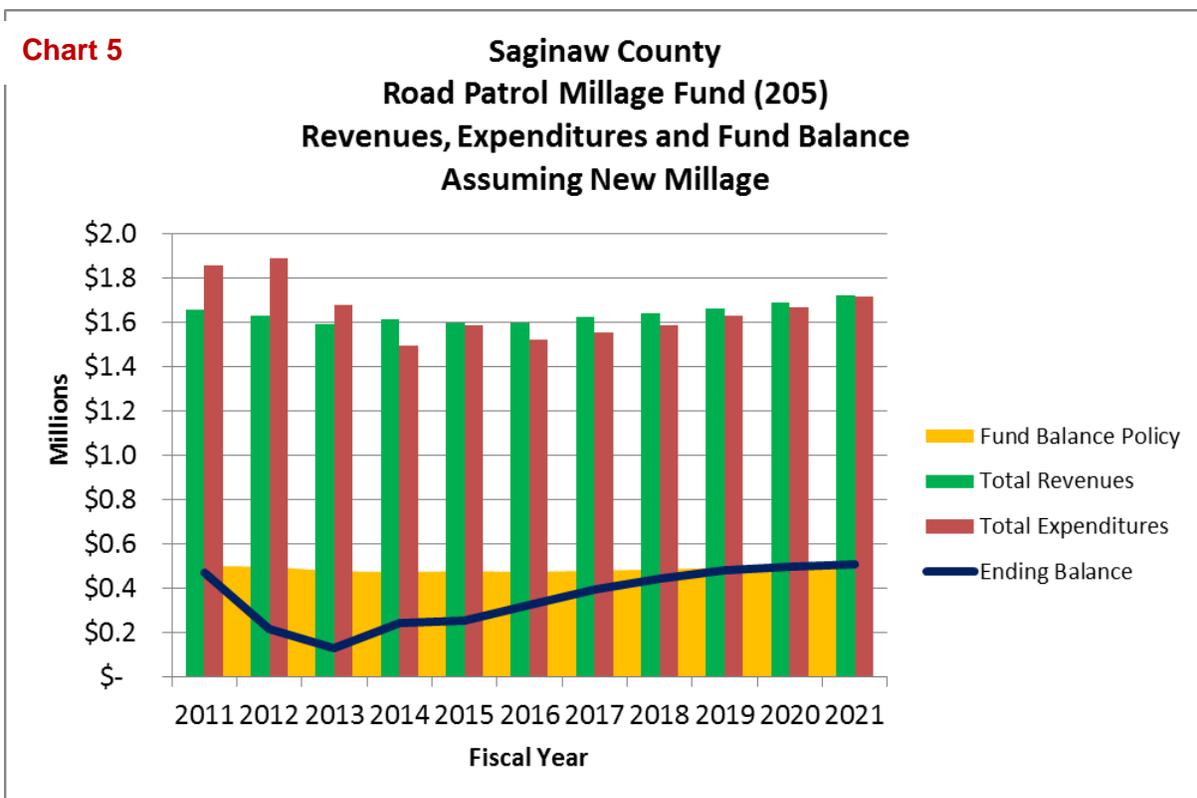
SHERIFF MILLAGES

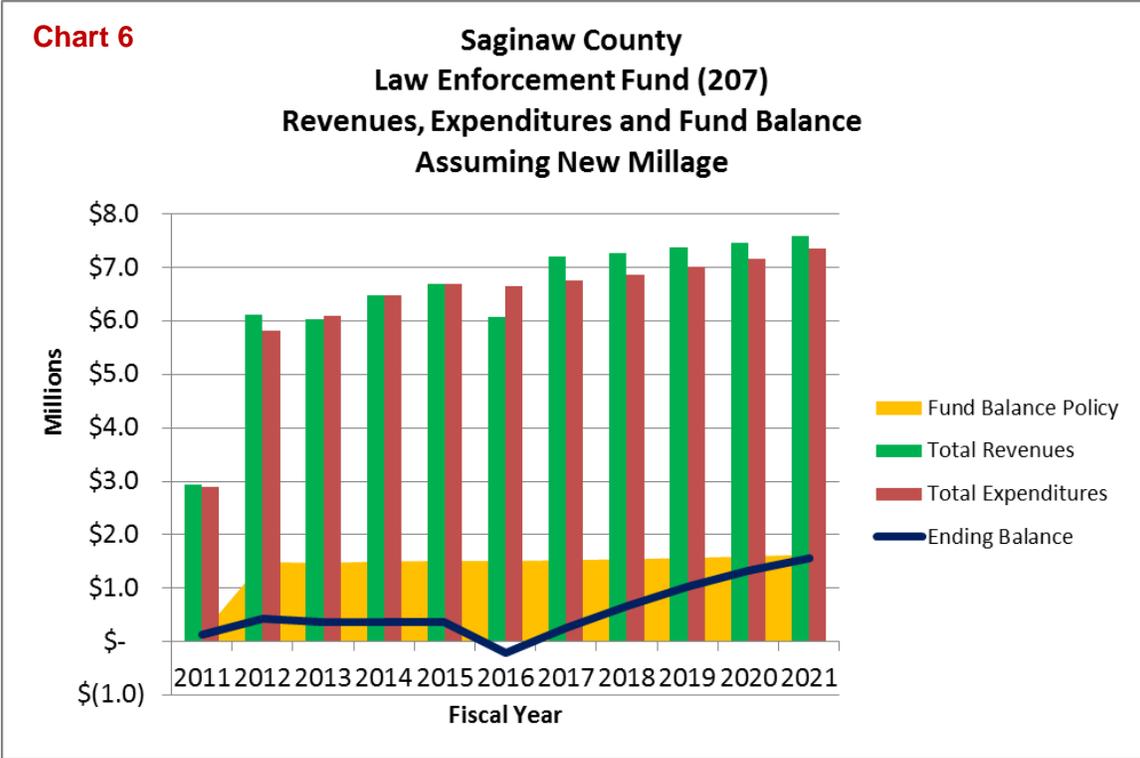
Current policy states that the General Fund should contribute to the Law Enforcement Fund just over \$400,000 a year. Actual contributions last year and this year are nearly double this amount. The model assumes contributions in future years will conform to the policy. Contributions above the policy level have been required in recent years, because the Law Enforcement Fund is unable to cover costs with the millage dedicated to the fund. The shortfall in revenue in this fund is estimated to increase each year going forward. In the base model, fund imbalances are estimated to range from \$531,000 in FY 2016 to \$599,000 in 2021. When we factor in fully funding the OPEB over seven years, shortfalls increase to \$565,000 in FY 2016 to \$910,000 in FY 2021. The millage dedicated to this fund (1.0000 mills) is due to expire after the December 2015 tax period.

At current millage levels (0.3394 mills), the Road Patrol Fund is expected to remain relatively stable over the coming six-year period. However, the millage for this fund will expire after the December 2016 levy.

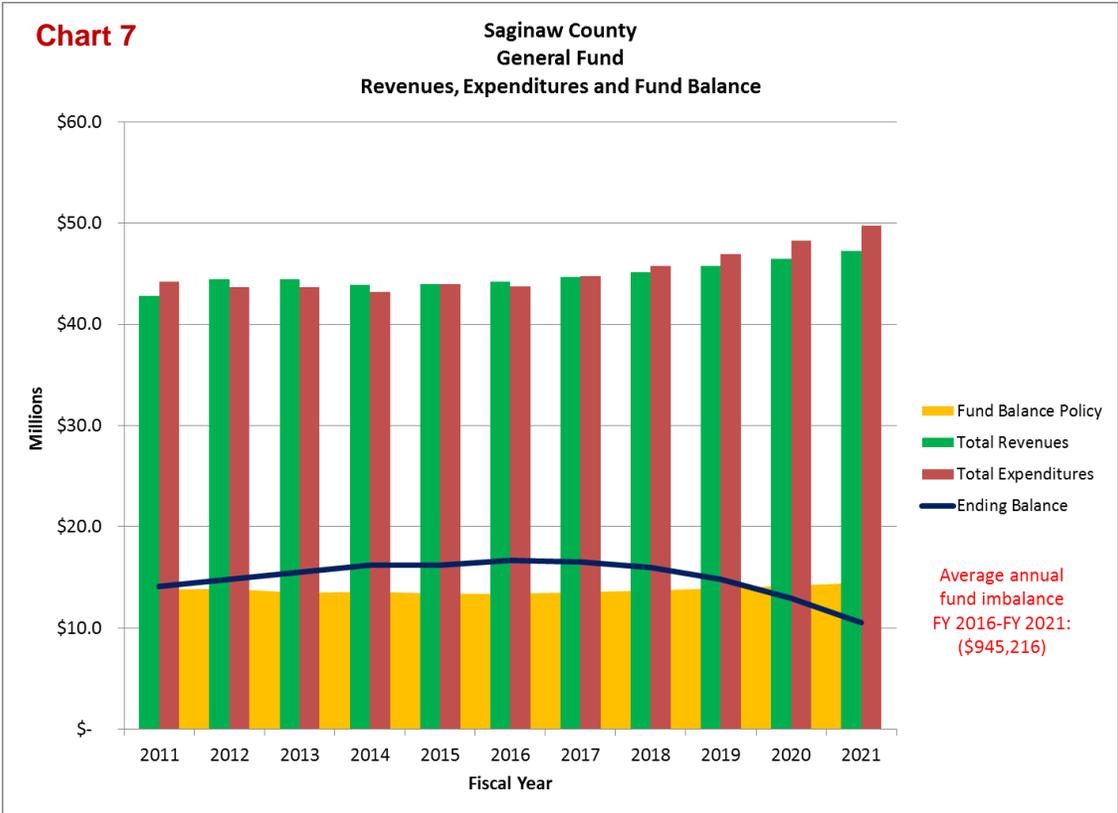
As both millages supporting these Sheriff functions are set to expire in the near future, the County is contemplating options for funding both funds for the future five years or more. The financial model has been utilized to test several scenarios related to Sheriff millages. The options include:

1. **Keep levies at current rates.** This would require continued General Fund support of the Law Enforcement millage at a level above current policy, or costs in the fund would have to be reduced to stay within revenue limits. The combined millage rate for both funds under this option would be 1.3394 mills. The impact of this option on the Road Patrol and Law Enforcement Funds, assuming no increase in OPEB funding, can be seen in Appendix A, Charts A-1 and A-2. Charts B-1 and B-2 in Appendix B illustrate the outlook for these funds if OPEB funding is increased over seven years.
2. **Ask voters to approve a higher millage level.** The goal of this option would be to eliminate General Fund subsidies of Sheriff services. An analysis of funding needs and expected tax base suggests a levy of 1.75 mills would be sufficient to cover all costs of the Road Patrol Fund and the Law Enforcement Fund, including OPEB funding at a higher level. The outlook for the two funds under this option are presented below, in Charts 5 and 6:





Regardless of the millage option chosen, the General Fund could realize a savings of over \$2 million between FY 2016 and 2021 if it was no longer required to subsidize the Law



Enforcement Fund. Chart 7 illustrates the General Fund outlook if it no longer made contributions to Law Enforcement, beginning in FY 2017. This chart can be compared to Chart 3 above, as they both assume full funding of the OPEB ARC by 2022.

SUMMARY

Saginaw County’s General Fund outlook has improved, due to a number of years of cost reductions, pension bonding, and underfunding OPEB and capital investments. The current challenges facing the fund include:

- Allocating resources to meet capital replacement needs
- Increasing OPEB funding to at least the actuarially recommended contribution level
- Stabilizing other funds to reduce their dependence on the General Fund

The County must decide how it will manage these challenges. Making efforts in all three of these areas is both fiscally prudent and necessary to ensure the long-term sustainability of the General Fund and other operating funds as well.

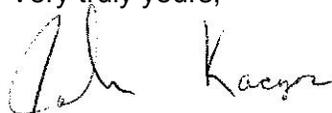
While useful as a point of comparison, we recognize the base General Fund model presented in this report is unlikely to be realized, due to:

- **Persistent imbalances in several special revenue funds**, which will require increased General Fund contributions. The General Fund would need to increase contributions by over \$11 million to cover revenue shortfalls in the Law Enforcement and Health Department Funds over the next six years.
- **A need to increase OPEB funding levels**, to ensure resources are available in the future to pay for retiree healthcare benefits already promised. A seven-year incremental approach to full funding would require an increase in expenditures of nearly \$10 million in the General Fund between FY 2016-2021.
- **A likely unrealistic assumption that wages will not increase for six years.** The County will likely have to raise wages at some point in the future to keep its pay competitive and fair. A 1% wage increase for all General Fund employees would cost \$1.3 million over six years.

We encourage Commissioners to continue exploring options to resolve these issues. The financial model can be used to test different proposals and calculate needed revenues to bring funds into balance.

We appreciate this opportunity to work with the County on this important issue, and we hope our analysis will help the County with difficult budget deliberations in the coming years.

Very truly yours,


John Kaczor
Principal

APPENDIX A

BASELINE OUTLOOK FOR OTHER FUNDS IN FINANCIAL MODEL



Chart A-1

Saginaw County Road Patrol Millage Fund (205) Revenues, Expenditures and Fund Balance

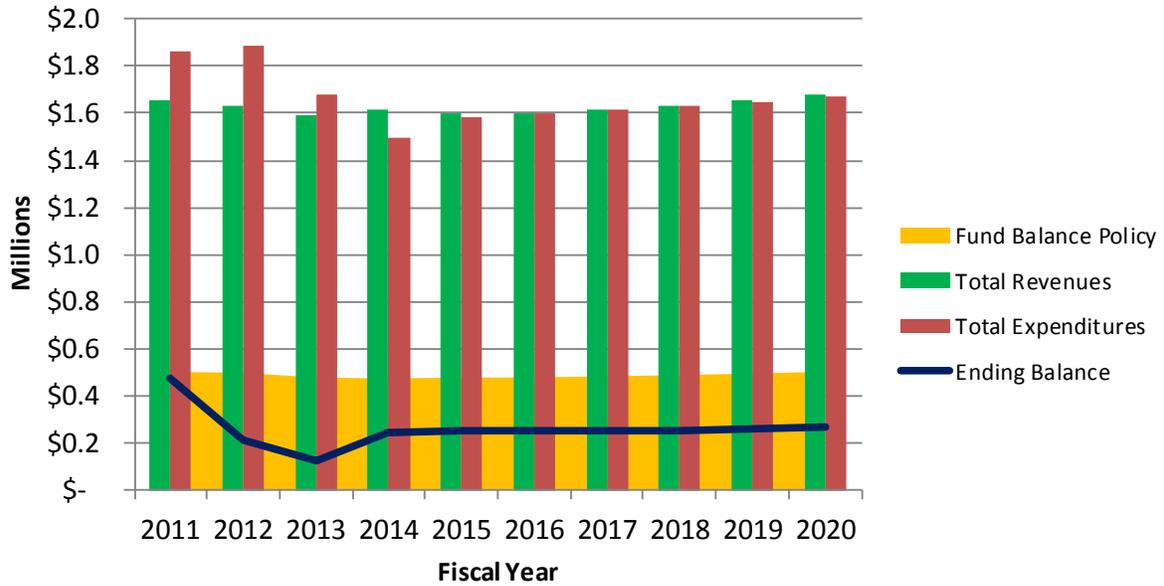


Chart A-2

Saginaw County Law Enforcement Fund (207) Revenues, Expenditures and Fund Balance

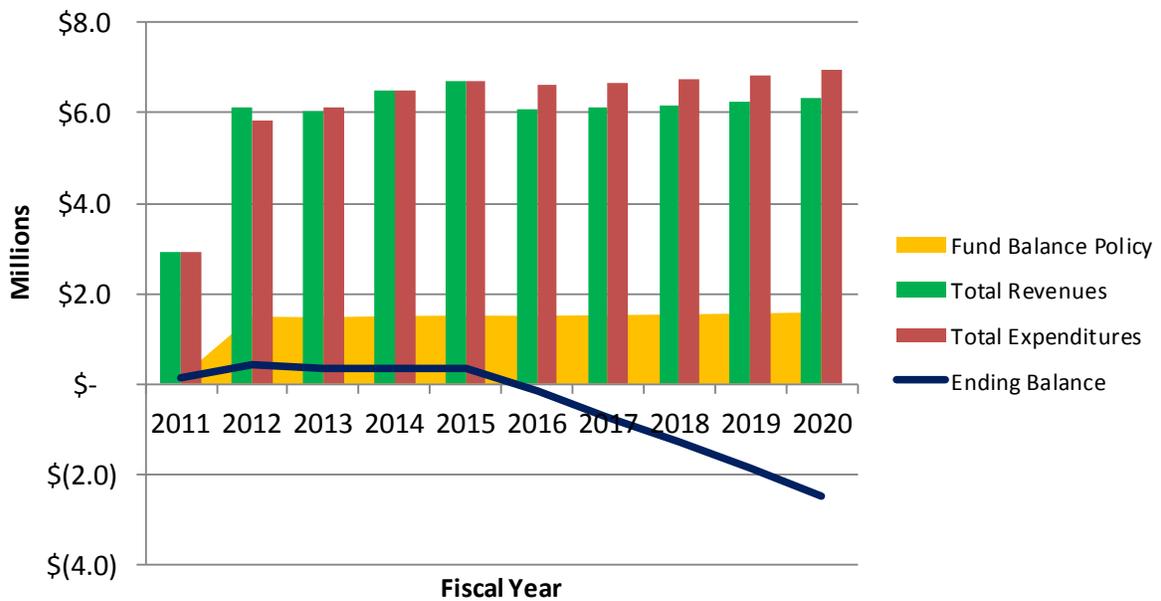


Chart A-3

Saginaw County Friend of Court Fund (215) Revenues, Expenditures and Fund Balance

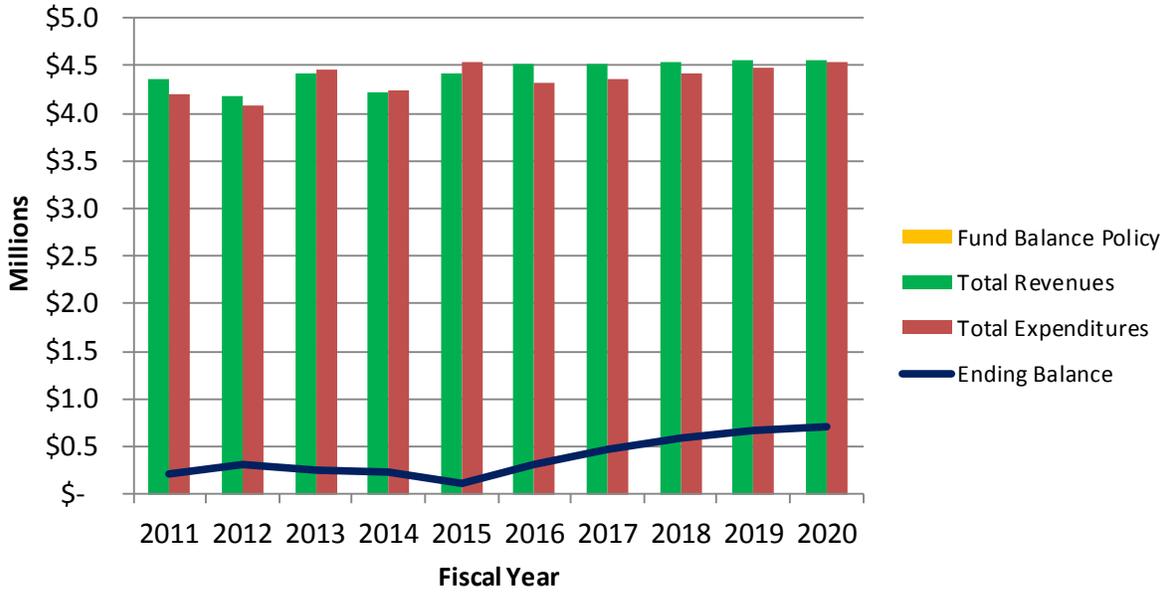


Chart A-4

Saginaw County Health Department Fund (221) Revenues, Expenditures and Fund Balance

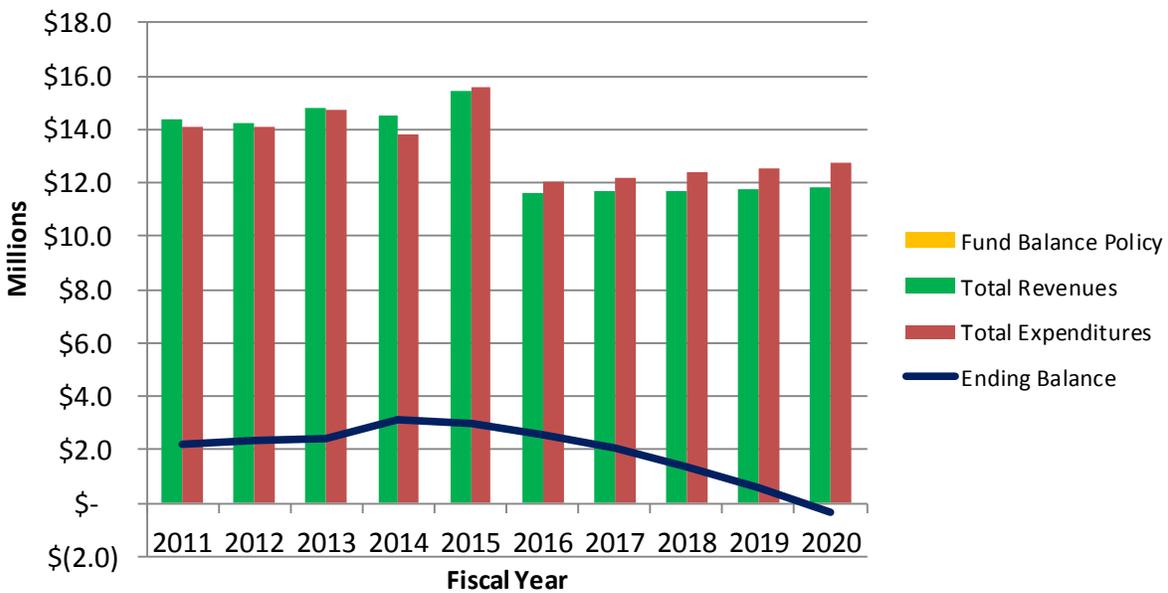


Chart A-5

**Saginaw County
Prosecutor Special Projects Fund (282)
Revenues, Expenditures and Fund Balance**

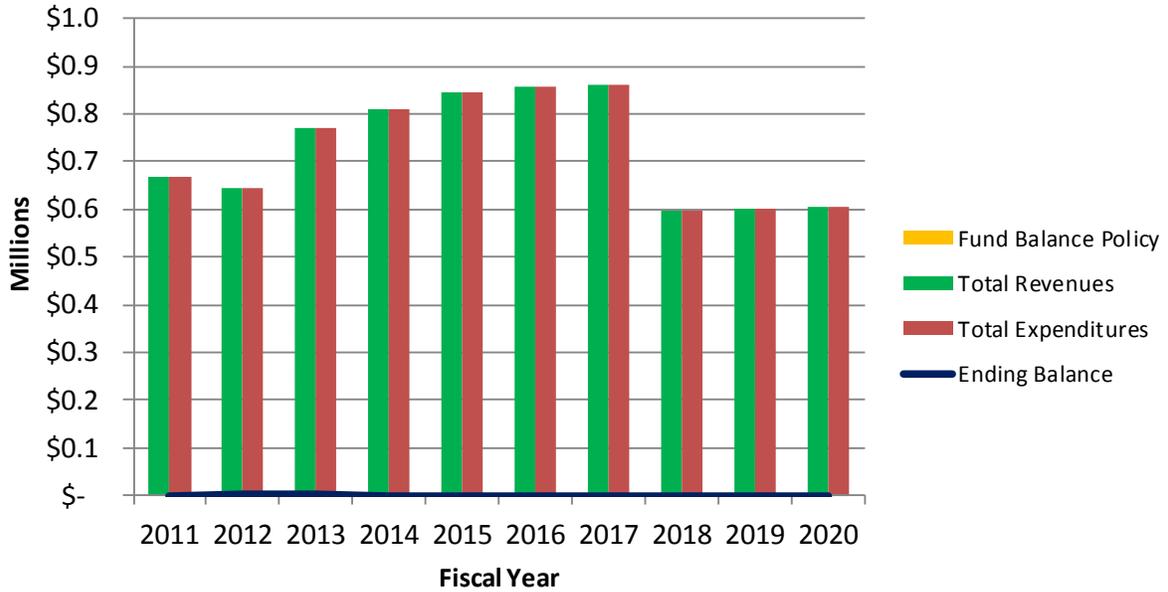


Chart A-6

**Saginaw County
Child Care Fund (292)
Revenues, Expenditures and Fund Balance**

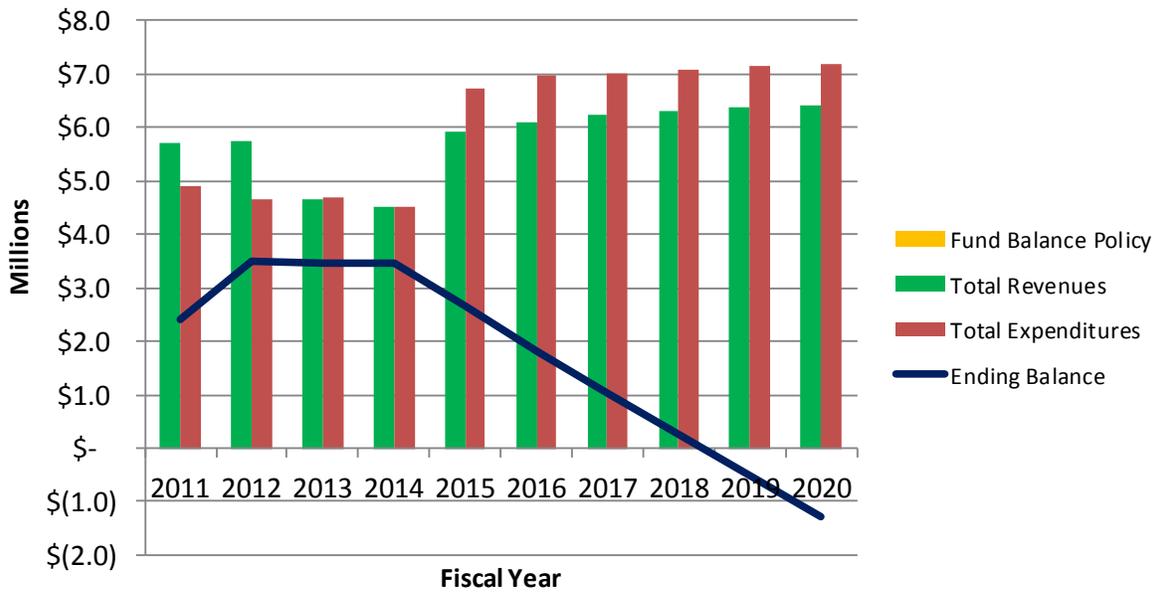


Chart A-7

**Saginaw County
Planning Commission (242-40000)
Revenues, Expenditures and Fund Balance**

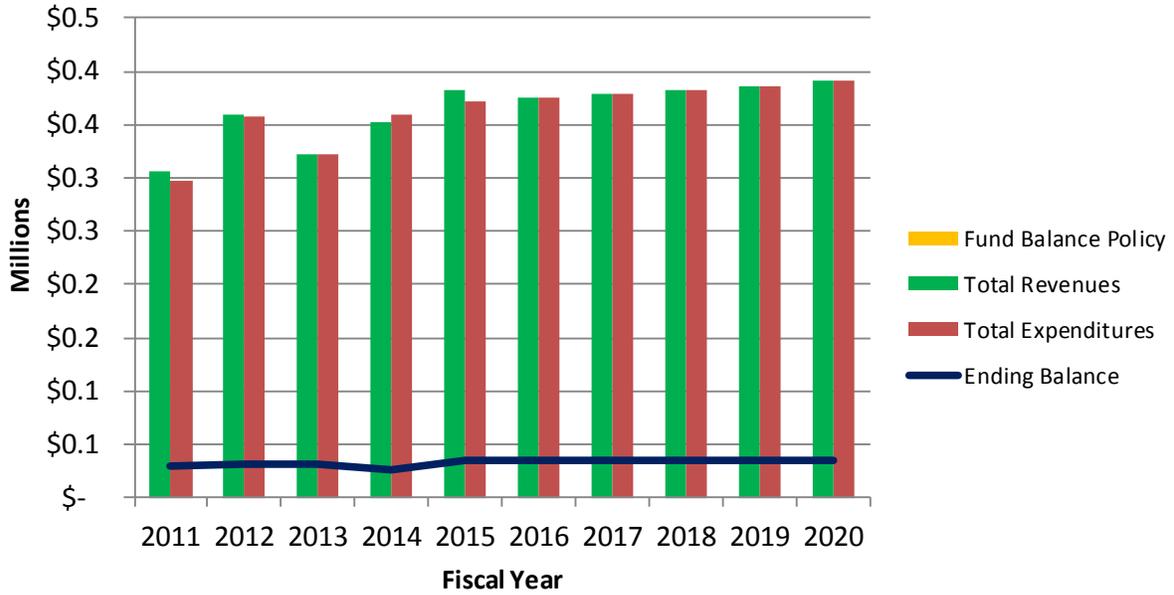
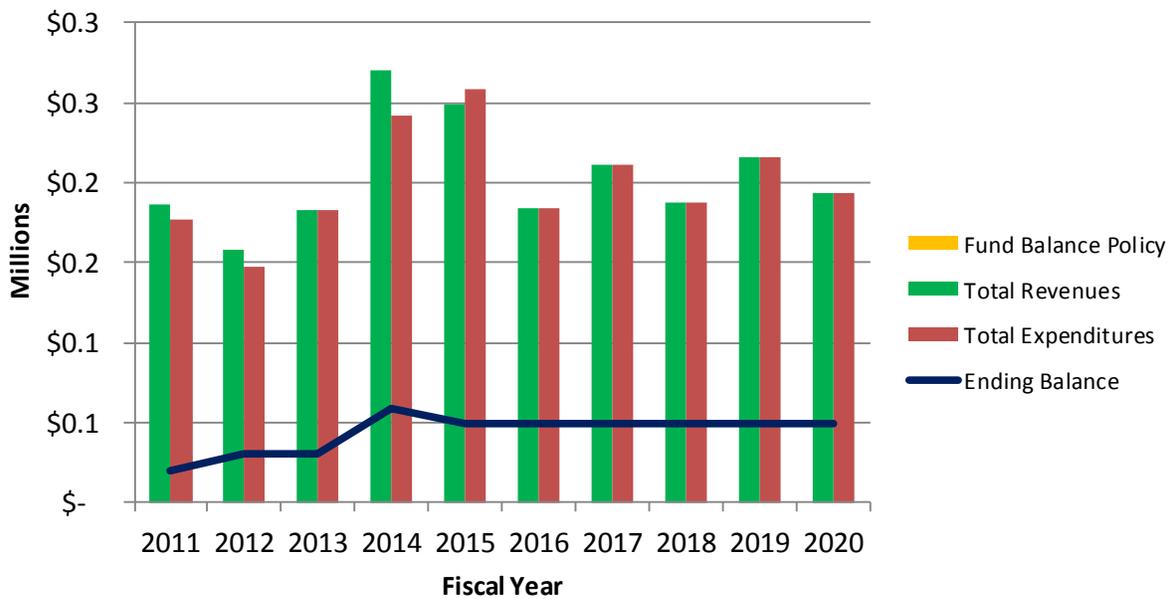


Chart A-8

**Saginaw County
Special Projects -Emergency Services (278-42700)
Revenues, Expenditures and Fund Balance**



APPENDIX B

OTHER FUNDS OUTLOOK, ASSUMING FULL OPEB ARC FUNDING OVER SEVEN YEARS



Chart B-1

**Saginaw County
Road Patrol Millage Fund (205)
Revenues, Expenditures and Fund Balance**

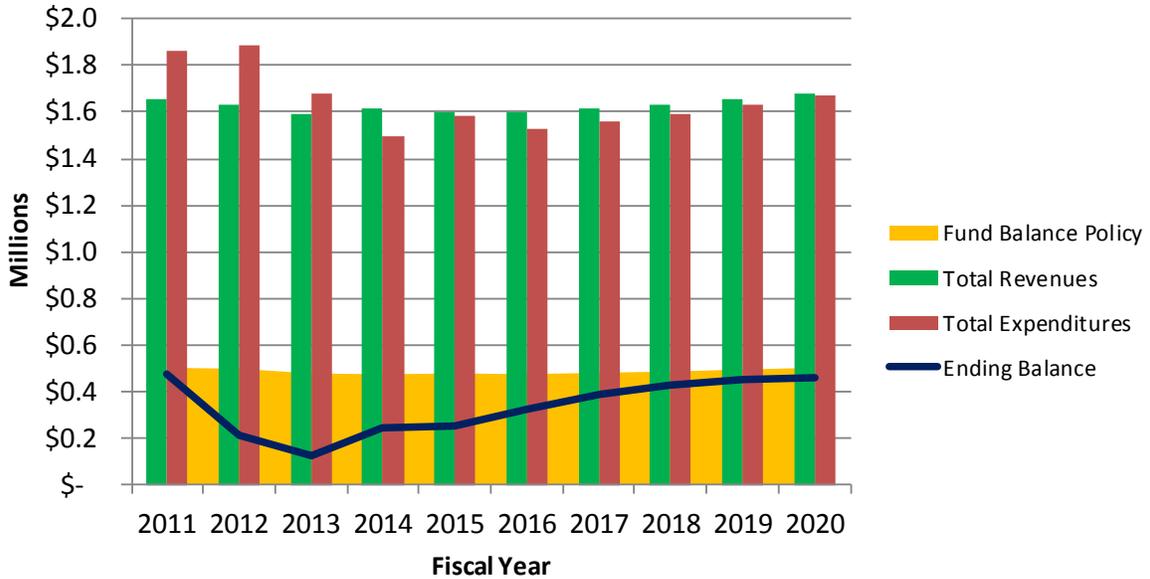
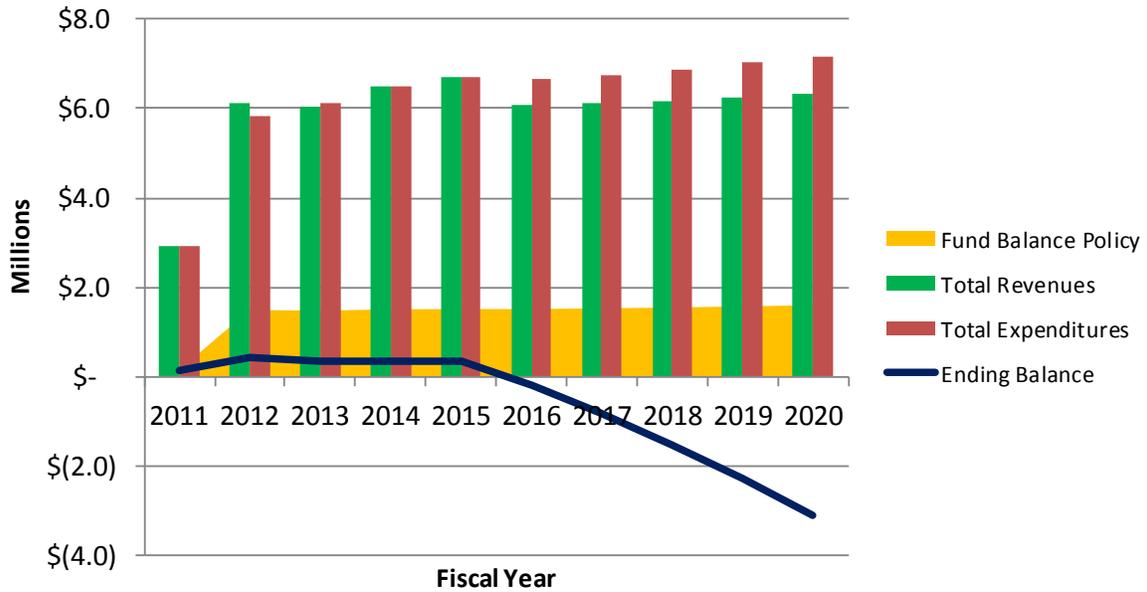


Chart B-2

**Saginaw County
Law Enforcement Fund (207)
Revenues, Expenditures and Fund Balance**



Note: Road Patrol Fund outlook improves under this scenario, due to slight change in allocation of OPEB costs, relative to status quo.

Chart B-3

**Saginaw County
Friend of Court Fund (215)
Revenues, Expenditures and Fund Balance**

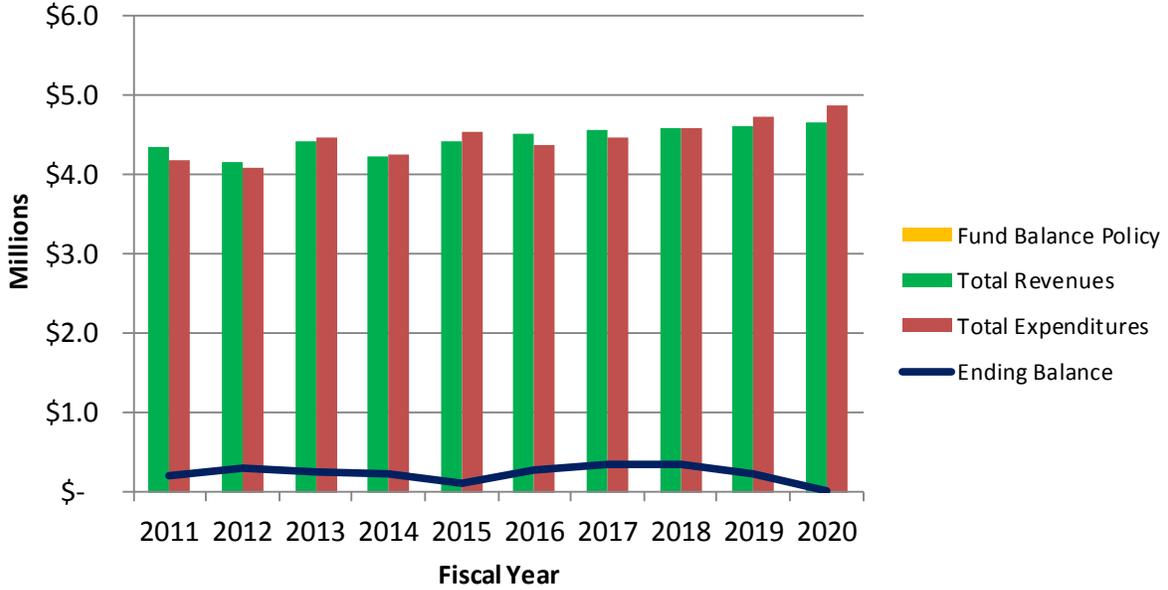


Chart B-4

**Saginaw County
Health Department Fund (221)
Revenues, Expenditures and Fund Balance**

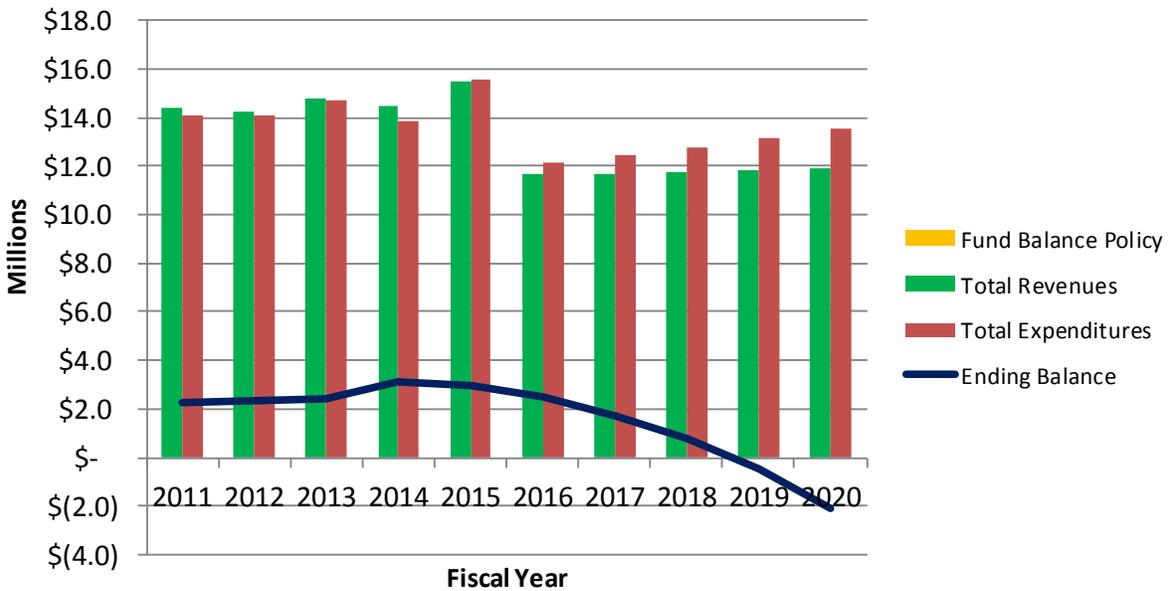


Chart B-5

**Saginaw County
Prosecutor Special Projects Fund (282)
Revenues, Expenditures and Fund Balance**

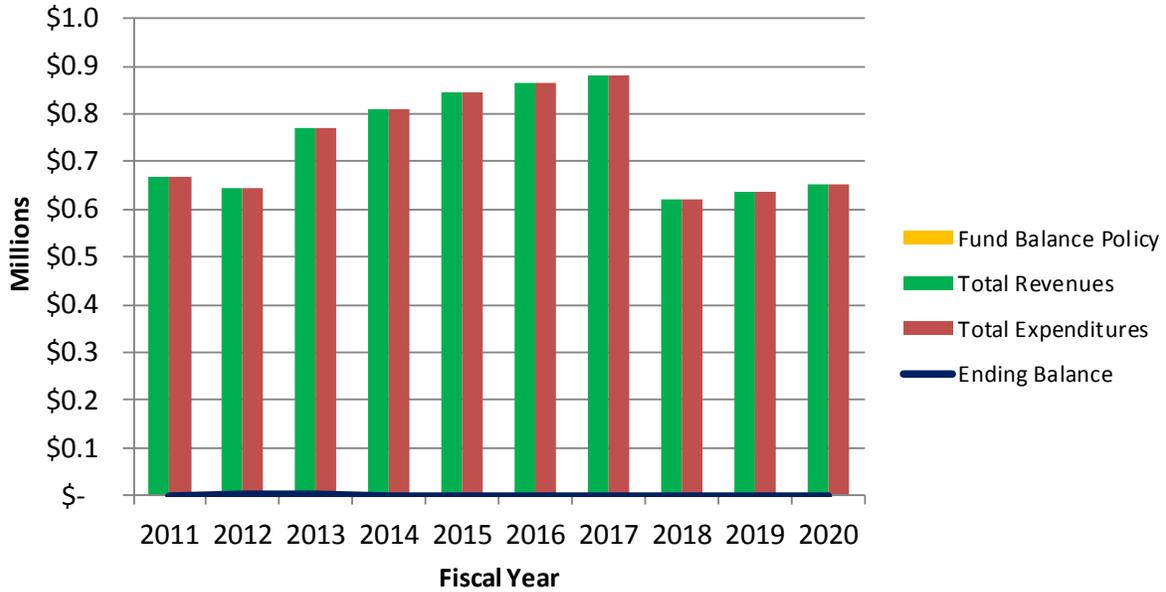


Chart B-6

**Saginaw County
Child Care Fund (292)
Revenues, Expenditures and Fund Balance**

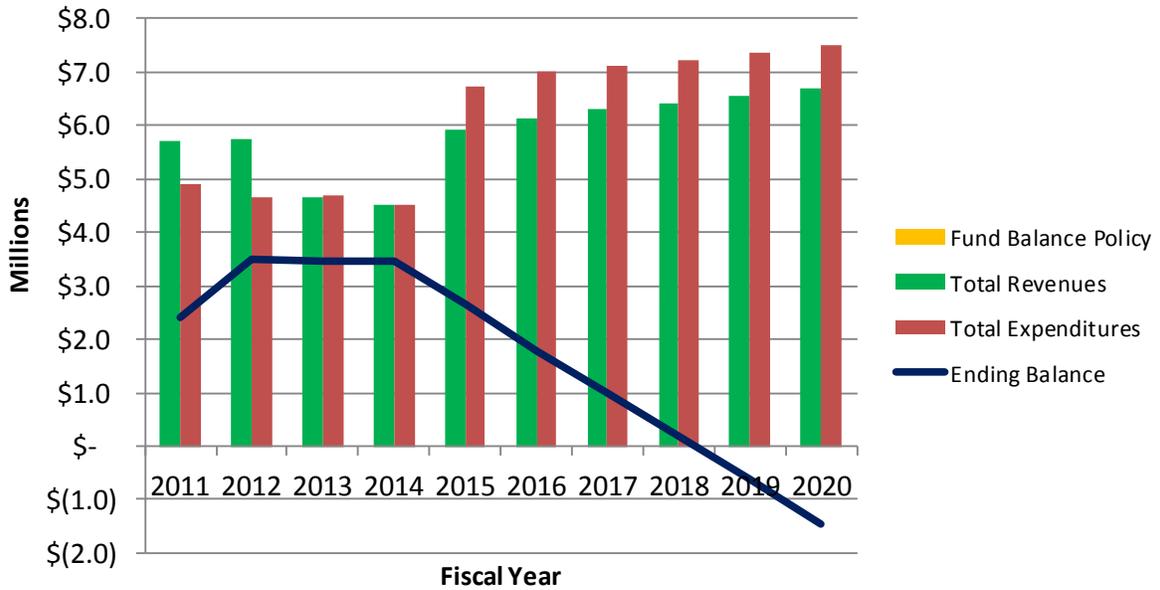


Chart B-7

**Saginaw County
Planning Commission (242-40000)
Revenues, Expenditures and Fund Balance**

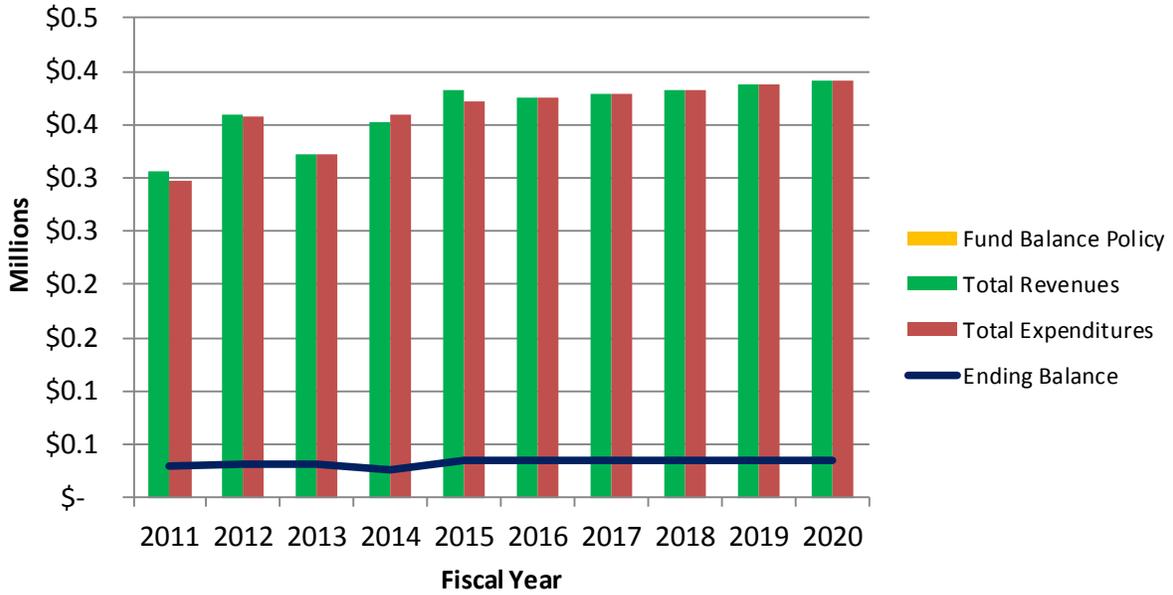


Chart B-8

**Saginaw County
Special Projects -Emergency Services (278-42700)
Revenues, Expenditures and Fund Balance**

