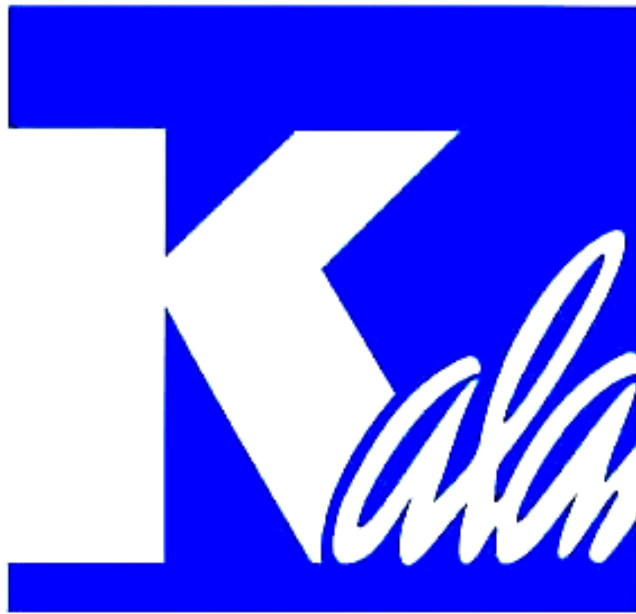


FY 2010 BUDGET
SECOND QUARTER
REPORT

THE CITY OF



alamogordo

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Summary

ECONOMIC CONDITIONS

Consumer Confidence (page 7): The most recent setback indicates that the public is expecting a low/slow recovery at best, or possibly retrenching for a double-dip recession.

Unemployment (page 11): The W.E. Upjohn Institute's 2010 First Quarter Outlook forecasted a drop of 1.2% in employment compared to 2009 levels for the 2010 forecast. This forecast appears to be still on track, despite the improvement in unemployment due to an overall decline in the Michigan workforce.

Unemployment levels ended the second quarter of 2010 at 11.8% and positioned the Kalamazoo-Portage Metropolitan Statistical Area as the third best labor market in the state according to the WE Upjohn quarterly report. Leading indicators suggest that the economy is gaining positive momentum and while the numbers still point negative in the near term. The job losses seem to have slowed and businesses have been adding new jobs.

Auto Sales (page 17): The data suggest the recovery isn't as strong as it appeared earlier in the year. The auto sales increase during the first five months was driven by higher sales to commercial fleets—not sales to consumers. Retail customers are showing signs of pessimism about the economy and tempered interest in buying new cars.

Consumer Price Index (page 18): Deflation has dropped from the list of likely scenarios, leaving potential inflation or stagflation:

1. Inflation: this has not yet emerged quantitatively as a problem, however the economic recovery, when it occurs, will likely cause inflationary pressures that will require corrective action from the Federal Reserve in raising their discount rate;
2. Stagflation: if the Federal Reserve does not time or scale their response to the economic recovery properly, the result could be both rapidly rising interest rates and inflation, known as Stagflation.

Stock Market (page 20): The current assumption is that domestic and global equities are now more than 1 year into a sustained growth cycle. The recent correction and historical price-to-earnings ratios may suggest that equity pricing as of June 30th is close to the “new normal”.

Construction Activity (Page 23): The economy has been expanding since the 3rd Quarter of 2009, but construction activity is still lagging. Construction is generally a “coincident” indicator of economic activity, so this seeming disconnect may be an indicator of weak economic growth and/or latent and leftover overcapacity in industrial, commercial and housing facilities from the last economic cycle.

Mortgage Rates (page 25): The pending sunset of federal tax credits for first-time homebuyers accelerated purchases while lenders increased mortgage rates, as seen in the long range graph. Mortgage rates will be artificially suppressed as long as the Federal Funds rate is maintained at near zero levels. However, the combination of traditionally high lending standards and low property values will also suppress the supply of new and refinanced mortgages.

Pension (page 29): With a 7.5% Rate of Return, the City would be required to contribute more than \$1.7 million to the Pension Trust Fund in 2015, and \$2.6 million in 2016. This amount would continue to

increase indefinitely. Changes in asset smoothing is not advisable at this time, although we will revisit this issue periodically.

REVENUE

General Fund Total Revenue, end-of-year 2009: the final pre-audited revenue for 2009 is \$52.5, as opposed to the \$52.9 million projected for establishing the beginning fund balance for FY 2010 – 11. This is a \$411 thousand loss versus the FY 2010 – 11 Budget fiscal plan.

General Fund Total Revenue, 2nd Quarter 2010: the amount of revenue for the first half of 2010, net of interfund transactions, was \$6.6 million. The revenue for the same period in 2009 was \$5.9 million.

Projected General Fund Total Revenues for 2010: \$51.59 million, which is roughly \$200 thousand less than the FY 2010 budgeted amount of \$51.79 million. In addition to the items outlined below, we are also anticipating \$100 thousand of new CDBG grant dollars for the construction of LaCrone Park, which would offset programmed General Fund dollars for that project to finance part of the Summer Youth Program.

Projected General Fund Total Revenues for 2011 is \$51.73 million, which is roughly \$260 thousand more than the FY 2010 budgeted amount of \$51.47 million.

Property Taxes (page 31): Thus, the overall reduction in 2010 General Fund property tax revenues, as compared to the FY 2010 – 11 Adopted Budget is currently \$385 thousand.

The FY 2011 property tax revenue forecast summary:

- 2011 Residential: decrease Taxable Value by -0.4% or \$60 thousand of General Fund tax revenue when compared to the FY 2010 Budget as adopted;
- 2011 Commercial/Industrial: a decrease in Taxable Value by -0.5% or \$70 thousand of General Fund tax revenue when compared to the FY 2010 -11 Budget as adopted;
- 2011 Personal Property: annual depreciation of personal property assets will create a projected loss of \$7 million of Taxable Value. At this time, we are not projecting any offset based on new equipment purchases. This would amount to a \$150 thousand loss of General Fund revenue in 2011 when compared to the FY 2010 -11 Budget as adopted;
- Appeals: as indicated above, the impact of existing determinations regarding assessment appeals will result in a reduction in General Fund property taxes of \$30 thousand in FY 2011 when compared to the FY 2010 -11 Budget as adopted.

The projection for FY 2011 is for a decrease of roughly \$310 thousand in tax revenue when compared to the FY 2010 - 11 Budget as adopted by the City Commission in January 2010.

State Shared Revenue (page 37): Given the recent legislative outcome in the U.S. Senate, the State's FY 2010 – 11 Budget appears to have a significant but surmountable shortfall. This would support the use of Scenario #2, resulting in a gain of \$78 thousand for the City's FY 2010, and a gain of \$574 thousand for FY 2011 over FY 2010 – 11 Adopted Budget projections.

Act 51 Revenue (page 40): A shortfall of roughly \$73 thousand in Act 51 revenue in the Major Streets Fund in FY 2010 as compared to the FY 2010 Adopted Budget. Shortfalls in the road funds would have to be made up by reductions in road service levels and/or additional appropriations from the General Fund.

Interest Income (page 40): The General Fund should be on target to receive the budgeted amount of interest earnings in 2010 versus the Adopted 2010 Budget consistent with prior year posted earnings.

EXPENDITURES

General Fund Total Expenditures, end-of-year 2009: the final audited expenditures for 2009 total \$53.3, as opposed to the \$52.9 million projected for establishing the beginning fund balance for FY 2010 – 11. This is a \$324 thousand negative variance versus the FY 2010 – 11 Budget fiscal plan.

General Fund Total Expenditures, 2nd Quarter 2010: expenditures for the first half of 2010, net of interfunds, was \$22.06 million. The expenditures for the same period in 2009 was \$22.71 million.

Projected General Fund Total Expenditures for 2010: the current projection for General Fund expenditures is \$52.45 million, compared to the FY 2010 -11 budgeted amount for FY 2010 of \$52.68 million, a \$223 thousand net decrease. This includes current projected operational savings listed below of roughly \$640 thousand offset by an increase of \$150 in the Summer Youth Initiative. Personnel costs are also estimated to be \$733 thousand less than budgeted. The budgeted positive variance of \$1 million has been added back as an expense to net against these projected savings, which when added all together equals the \$223 thousand of positive variance for FY 2010 indicated above.

Projected General Fund Total Expenditures for 2011: the current projection for General Fund expenditures for FY 2011 is \$52.8 million, as compared to the FY 2010 – 11 budgeted amount for FY 2011 of \$53.2 million. This is based on projecting the combined vacancy variance of \$733 thousand and the positive operational variance of \$640 thousand for FY 2010 into FY 2011, totaling \$1.373 million of positive budgetary expenditure variance. The budgeted positive variance of \$1 million has been added back as an expense to net against these projected savings, which when added all together equals the \$373 thousand of positive variance for FY 2011 indicated above.

Health Care (page 42): Mandating participation among KPSA and KPSOA retirees in the federal Medicare Part B program (which is currently optional in the respective collective bargaining agreements for these groups) could realize savings of 5% of the City's accrued retiree health care liability.

Energy (page 43): Energy expenditures total \$979 thousand for the General Fund for the first half of 2010. This represents a 10% increase versus the first half of 2009. If the second half of 2010 experiences the same rate of consumption as the first half, the General Fund would spend \$269 thousand less than the budgeted amount for 2010. If the same dollars for energy are spent as were spent for the last two quarters of 2009, the General Fund would spend \$139 thousand more than the budgeted amount for 2010.

Overtime (page 43): If the last two quarters see the same percentage reduction as the first two, the projected overtime for 2010 would total \$529 thousand less than the budgeted amount for 2010. If Public Safety spends the same dollars in overtime as it did for the last two quarters of 2009, it will spend \$94 thousand less than budgeted in 2010.

Travel/conferences (page 44): If the second half of 2010 experiences the same percentage reduction as the first half of 2010, expenses for 2010 would total \$170 thousand less than the budgeted amount for 2010. If the same dollars are expended in the second half of 2010 as was spent in the second half of 2009, expenses for 2010 would total \$134 thousand less than the budgeted amount for 2010.

Telephones (page 44): If the second half of 2010 experiences the same percentage reduction as the first half of 2010, then expenses for 2010 would total \$128 thousand less than the budgeted amount for 2010. If the same dollars are expended in the second half of 2010 as was spent in the second half of 2009, then expenses for 2010 would total \$103 thousand less than the budgeted amount for 2010.

Personnel Costs (non-overtime) (page 44): If the percentage of the budgeted amount for personnel expended in the second half of 2010 is the same as it was in the second half of 2009, personnel expenditures would total \$733 thousand less than budgeted in FY 2010 for the General Fund.

NET REVENUE

Net revenue for the 1st Quarter of 2010 is \$5.5 million.

Net projected revenue for 2009 is negative \$725 thousand, as compared to the \$0 net revenue in the FY 2010 – 11 Adopted Budget for FY 2010. This is a net change of negative \$725 thousand.

Net projected revenue for 2010 is negative \$874 thousand, as compared to the negative \$891 thousand in the FY 2010 – 11 Adopted Budget for FY 2010. This is a net change of positive \$17 thousand.

Net projected revenue for 2011 is negative \$1.07 million, as compared to the negative \$1.7 million in the FY 2010 – 11 Adopted Budget for FY 2011. This is a net change of positive \$630 thousand.

Total net projected revenue for 2009 – 11 is negative \$2.66 million, as compared to the negative \$2.6 million in the FY 2010 – 11 Adopted Budget for FY 2011.

The above analysis totals to a net revenue change of negative \$70 thousand for FY 2009 – 2011, as compared to the FY 2010 – 11 Fiscal Plan.

RESERVES

GENERAL CIP RESERVES

\$2.2 million of capital reserves, comprised of:
 \$1.575 million in capital bond reserves;
 \$625 thousand in capital cash reserves.

GENERAL FUND RESERVES

\$2.2 million of health care savings accumulated in the Insurance Fund due to the General Fund.

\$1.95 million of Budget Stabilization and Capital Contingency reserves.

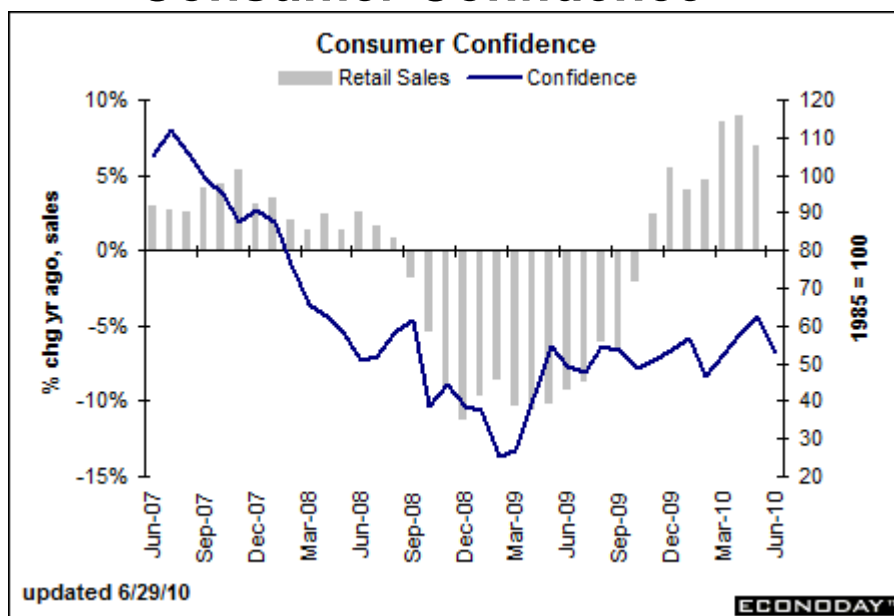
\$900 thousand of fund balance beyond the 13% minimum Commission policy requirement.

TOTAL UNENCUMBERED RESERVES AVAILABLE TO THE GENERAL FUND AS OF 1/1/2010: \$7.3 MILLION

These amounts have been programmed in the FY 2010 – 11 Budget to stabilize against unforeseen circumstances, as well as to “smooth” the budget as it approaches the new fiscal “normal”, in order to maintain service levels to the greatest degree practicable.

Consumer Indicators

Consumer Confidence



<http://mam.econoday.com/showimage.asp?imageid=19375>

Source: Econoday.com

Table 1 Description

The Consumer Confidence Survey is based on a representative sample of 5,000 U.S. households. Questions focus on respondents' outlook on their economic condition, the general economic condition, the business environment and employment. This is a lagging indicator.

Expert Testimony

The Conference Board's consumer confidence report is a major disappointment, falling dramatically and showing regional weakness tied no doubt to the Gulf spill. The consumer confidence index fell to 52.9, in a nearly 10 point decline the size of which usually corresponds with an economic shock.

Consumers are now showing much more concern over the jobs market and over their income prospects, with the latter reading arguably the closest to the consumer psyche. On the future income question, the unprecedented negative spread deepened between the optimists, now at 10.6 percent vs. May's 11.4 percent, and the pessimists, now at 17.2 percent vs. 16.4 percent.

Buying plans fell back sharply led by autos and including appliances. Buying plans for homes, already badly depressed, fell back some more. A slip in inflation expectations, the result of soft gasoline prices, is the report's only positive, at least a positive for the interest-rate outlook.

- Econoday.com, June 29, 2010

Says Lynn Franco, Director of The Conference Board Consumer Research Center: "Consumer confidence, which had posted three consecutive monthly gains and appeared to be gaining some traction, retreated sharply in June. Increasing uncertainty and apprehension about the future state of the economy and labor market, no doubt a result of the recent slowdown in job growth, are the primary reasons for the sharp reversal in confidence. Until the pace of job growth picks up, consumer confidence is not likely to pick up."

Consumers' appraisal of present-day conditions was less favorable in June. Those saying conditions are "good" decreased to 8.0 percent from 9.7 percent, while those saying business conditions are "bad" increased to 42.4 percent from 39.5 percent.

Consumers' assessment of the labor market was also less favorable. Those claiming jobs are "hard to get" increased to 44.8 percent from 43.9 percent, while those saying jobs are "plentiful" decreased to 4.3 percent from 4.6 percent.

Consumers' short-term outlook, which had improved significantly last month, turned more pessimistic in June. Those anticipating an improvement in business conditions over the next six months decreased to 17.2 percent from 22.8 percent, while those expecting conditions will worsen rose to 14.9 percent from 11.9 percent.

Consumers were also much less optimistic about future job prospects. The percentage of consumers anticipating more jobs in the months ahead decreased to 16.0 percent from 20.2 percent, while those anticipating fewer jobs increased to 20.8 percent from 17.8 percent. The proportion of consumers anticipating an increase in their incomes declined to 10.6 percent from 11.4 percent.

- *Conference-Board.org, June 29, 2010*

Americans, worried about jobs and the sluggish economic recovery, are losing confidence, causing a widely watched index to tumble in June and raising concerns about consumer spending in the critical months ahead.

June's reading marked the biggest drop since February, when the index fell 10 points. The index had risen for three straight months since then.

Both components of the index — one that measures how consumers feel now about the economy, the other that assesses their outlook over the next six months — dropped. The Present Situation Index decreased to 25.5 in June from 29.8 in May. The Expectations Index declined to 71.2 from 84.6.

The index had been recovering fitfully since hitting an all-time low of 25.3 in February 2009. Still, the reading was far below what's considered healthy. A reading above 90 indicates the economy is on solid footing; above 100 signals strong growth.

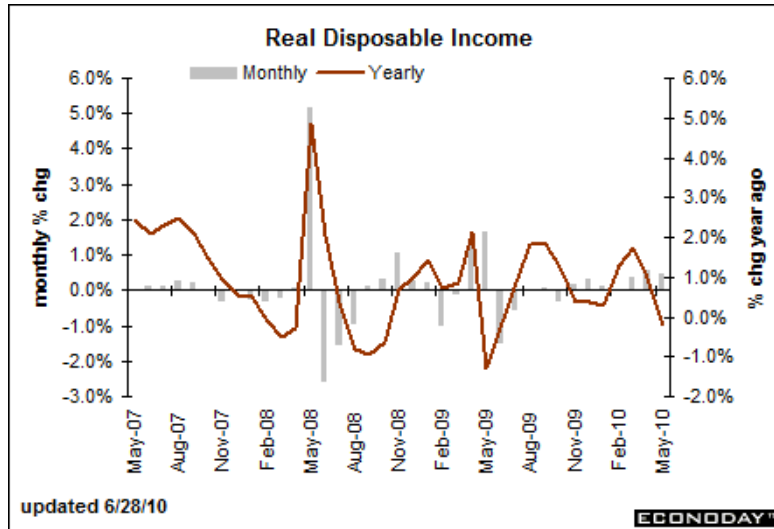
"We're concerned about the strength of the economic recovery from here," said Richard Hastings, macro and consumer strategist with Global Hunter Securities.

-ANNE D'INNOGENZIO, Associate Press – *Consumer confidence tumbles in June* - Jun 29, 2010
<http://www.google.com/hostednews/ap/article/ALeqM5jslILP-jUnVlwDKXJfeEyTrbBlmQD9GL27TO0>

Looking Ahead

Overall advances over the last year have been slow and uneven. As a lagging indicator, consumer confidence will not show gains into positive territory (over 80) until the public feels that the recovery is well underway, which will likely be after business investment and jobs begin recovering in a sustained and consistent manner. This most recent setback indicates that the public is expecting a low/slow recovery at best, or possibly retrenching for a double-dip recession.

Disposable Income



Source: Econoday.com

Table 2 Description

Changes in taxes or social security cost of living adjustments can cause some sharp variations in monthly disposable income growth. However, on the whole, monthly changes in disposable income fluctuate less than monthly changes in personal consumption expenditures.

Expert Testimony

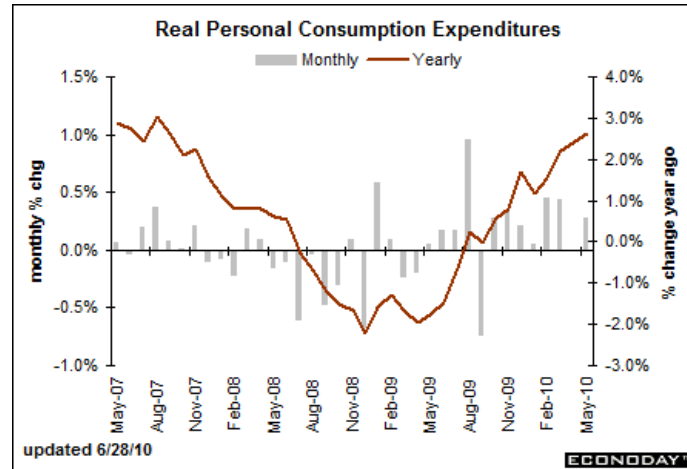
The consumer sector got another boost with a jump in spending power in May. Consumer spending was sluggish but mainly related to a drop in gasoline prices. Personal income in May rose a solid 0.4 percent, following a 0.5 percent advance in April. Analysts had called for a 0.5 percent increase in personal income for the latest month. The wages & salaries component gained 0.5 percent, matching April's improvement.

A jump in auto sales helped offset softness in gasoline and other nondurables. Overall, personal consumption rose a modest 0.2 percent, following no change in April. The May figure equaled the market forecast for a 0.2 percent increase.

Overall, the consumer sector is slowly gaining strength in terms of spending power. Purchases have been a little erratic due to off and on auto incentives and consumer caution in general. Overall, the consumer sector took one step forward in May, helping the recovery continue.

- Econoday.com, June 28, 2010

Consumer Spending



Source: Econoday.com

Table 3
Description

Monthly changes in personal consumption expenditures are usually skewed by large changes in spending on durable goods. Spending on nondurable goods and services tend to be less volatile from one month to the next.

Expert Testimony

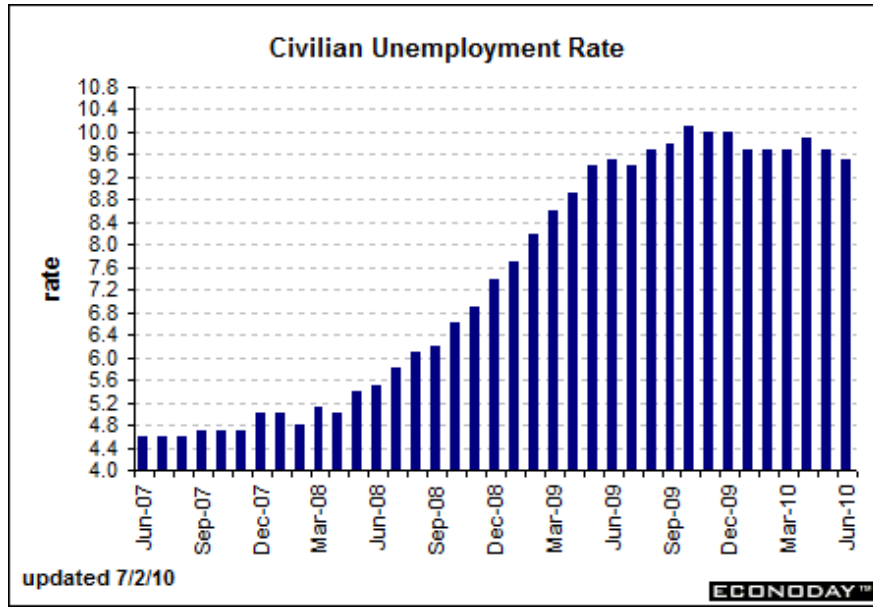
Consumers are cautious, facing high unemployment, tight credit and a slumping housing market. If consumption remains sluggish, the economy may not grow fast enough to generate jobs.

Consumers haven't been driving the current recovery. Instead, it has depended more on business spending and exports. In the four quarters following the steep 1981-82 downturn, consumer spending rose by an average of 6.5 percent per quarter. By contrast, even as the economy has grown for the past three quarters, consumer spending rose an average of only 2.5 percent per quarter.

Many analysts expect the economy will grow at about 3 percent in the current quarter. Still, some worry growth may slow in the second half of the year as the impact of government stimulus efforts fades.

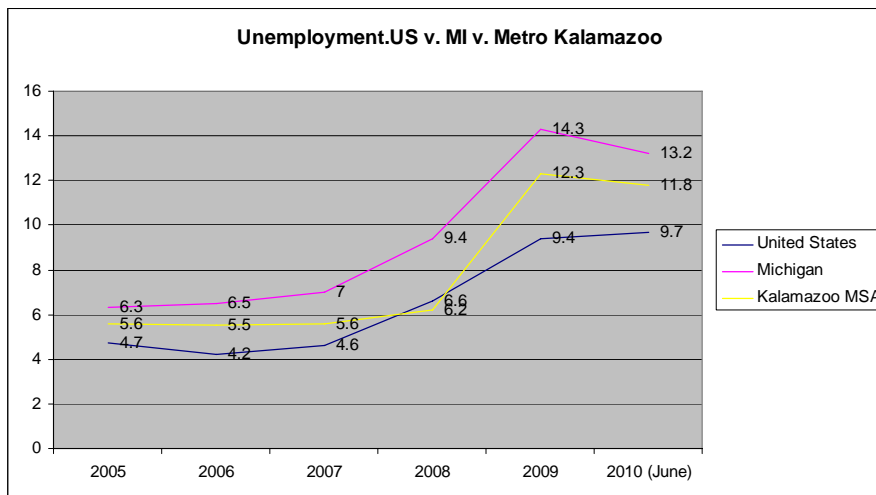
-MSNBC.com, 6/28/2010

Unemployment



Source: Econoday.com

Table 4



Sources: 2005- Mar 2010: Bureau of Labor Statistics; June 2010 estimate: <http://forecasts.org/unemploy.htm> and <http://www.upjohninst.org/regional/mar%202010%20busout.pdf>

Table 5
Description

The civilian unemployment rate is a lagging indicator. The Bureau of Labor Statistics counts as unemployed “those who were not employed during the reference week (based on the definition above), had actively looked for a job sometime in the 4-week period ending with the reference week, and were currently available for work...as a percentage of the labor force.” <http://www.bls.gov/news.release/metro.tn.htm>

Expert Testimony

The jobs picture in June was quite mixed as temporary Census workers were laid off and private hiring was positive but moderate. Also, the unemployment rate continued to dip even as the workweek slipped. Overall payroll jobs in June fell back 125,000 after spiking a revised 433,000 in May and after a 313,000 jump in April. The June decrease matched the market forecast for a 125,000 decline.

Looking beyond the temporary effects of Census hiring and firing, private nonfarm employment increased 83,000, following a 33,000 rise in May. The latest figure fell short of analysts' projection for a 105,000 advance in private payrolls.

The good news at face value in the June report was that the unemployment rate to 9.5 percent in June from 9.7 percent in May. However, the decrease was due to a sharp drop in the labor force.

Overall, the June jobs reports points to a softening in the labor market. Private employment continues to grow, but at a more moderate pace.

– *Econoday.com*

“The state's shrinking labor force does mean the Michigan employment situation is starting to get more competitive for workers,” said Dana Johnson, chief economist for Comerica.

“If your population is shrinking and your labor force is shrinking, then just holding jobs steady is rebalancing the labor market, in terms of it getting easier to find a job and there being less competition for the new jobs that are emerging,” Johnson said. “That's the silver lining in an otherwise dark [picture](#) of labor in Michigan.”

“For now, ‘people are voting with their feet and balancing the labor market that way,’ he said.”

Brian J. O'Connor - *Michigan's jobless rate dips as work force shrinks* -The Detroit News, July 15, 2010

Looking Ahead

The W.E. Upjohn Institute's 2010 First Quarter Outlook forecasted a drop of 1.2% in employment compared to 2009 levels for the 2010 forecast. This forecast appears to be still on track, despite the improvement in unemployment due to an overall decline in the Michigan workforce.

Unemployment levels ended the second quarter of 2010 at 11.8% and positioned the Kalamazoo-Portage Metropolitan Statistical Area as the third best labor market in the state according to the WE Upjohn quarterly report. Leading indicators suggest that the economy is gaining positive momentum and while the numbers still point negative in the near term. The job losses seem to have slowed and businesses have been adding new jobs.

Housing Starts and Existing Home Sales

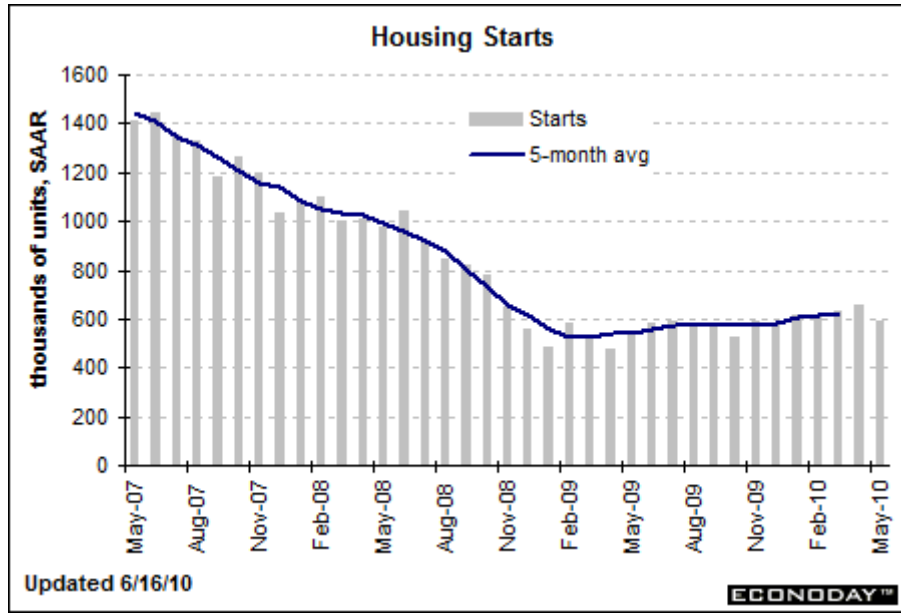
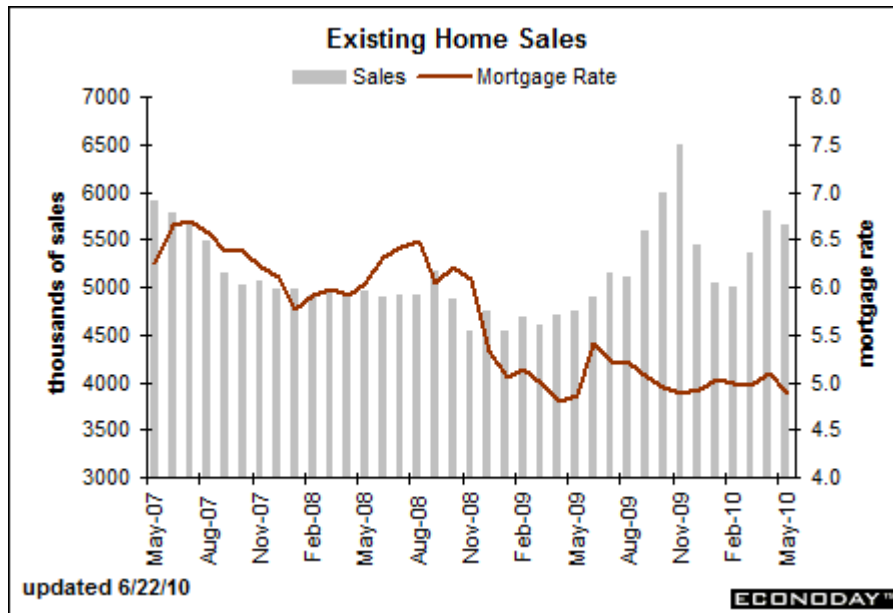


Table 6



Source: Econoday.com

Table 7
Description

This table shows a change in the historical pattern involving mortgage rates and home sales, with home sales increasing while mortgage rates are holding at a historically low level.

The disconnect between mortgage rates and demand for housing may be caused by the reintroduction of traditional mortgage lending standards. Many banks now will not offer mortgages with principal amounts above 80% of the property's value, whereas just two years ago it was possible to obtain jumbo loans for 95% or more of the property's value.

Expert Testimony

Homebuilders are playing it cautiously after the close of the special tax credits program. Housing starts in May fell back 10.0 percent, following a 3.9 percent boost in April. May's annualized pace of 0.593 million units came in well below the market projection for 0.650 million units and was up 7.8 percent on a year-ago basis.

Existing home sales fell 2.2 percent to a lower-than-expected annual sales rate of 5.66 million (April revised higher to 5.79 million). A weak headline is not the only disappointment as the drawdown in supply has slowed. Supply on the market fell slightly in May and is very heavy at 8.3 months and compares with seven-month supply during the buying surge, fed by first-round stimulus. High supply will continue to pressure prices which did firm 4.2 percent in May for both the median (\$179,600) and average price (\$226,400).

This report tracks closings and is inflated to a significant degree by second-round stimulus in which contracts had to be signed by April 30. Closings can take quite a while and Democrats in Congress are talking about extending a June 30 deadline to prevent as many as 180,000 contracts from missing out on tax credits which are worth up to \$8,000.

New home sales, data that track signings not closings, will get no lift at all from second-round stimulus and will offer a more certain picture of the post-stimulus housing market. New home sales, which will be posted tomorrow, are expected to plunge to a 400,000 rate from April's stimulus-fed 504,000 rate. The stock market is moving off opening highs following today's report.

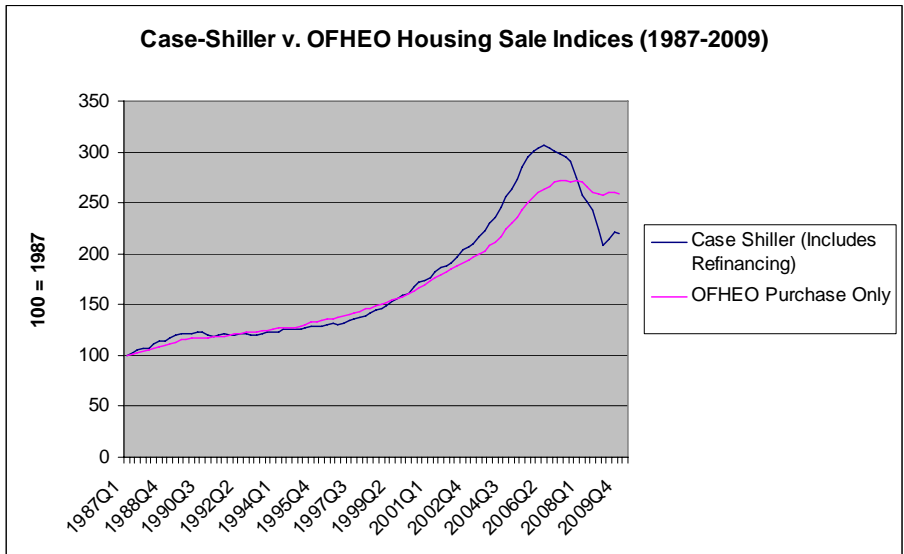
– *Econoday.com*

Looking Ahead

The decline in property investment reflects tightened credit markets and a sense of austerity.

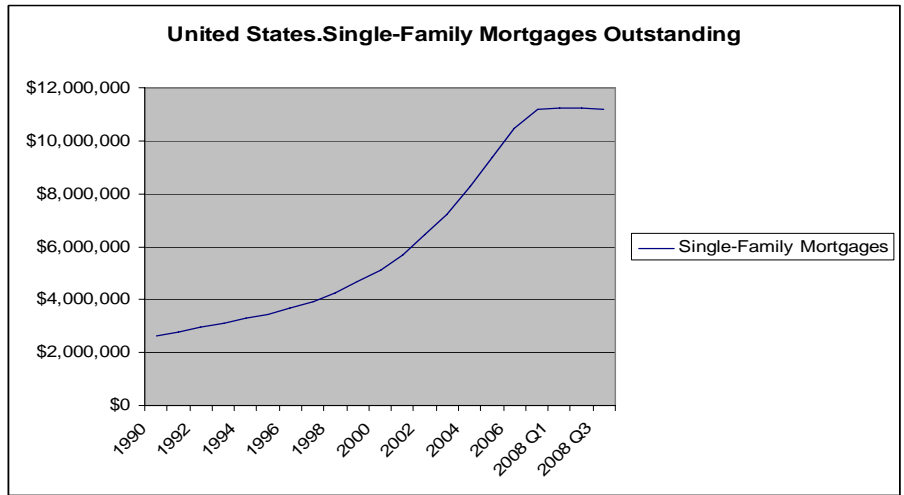
The Federal Reserve continues to holding lending rates low to counteract the onset of a second recession.

However, the rate easing has not coincided with improved demand for housing. Despite the easing of interest rates based on the recession, tightening of mortgage requirements at financial institutions has held sales volumes down with the recent upticks in October and March likely attributable to the federal stimulus.



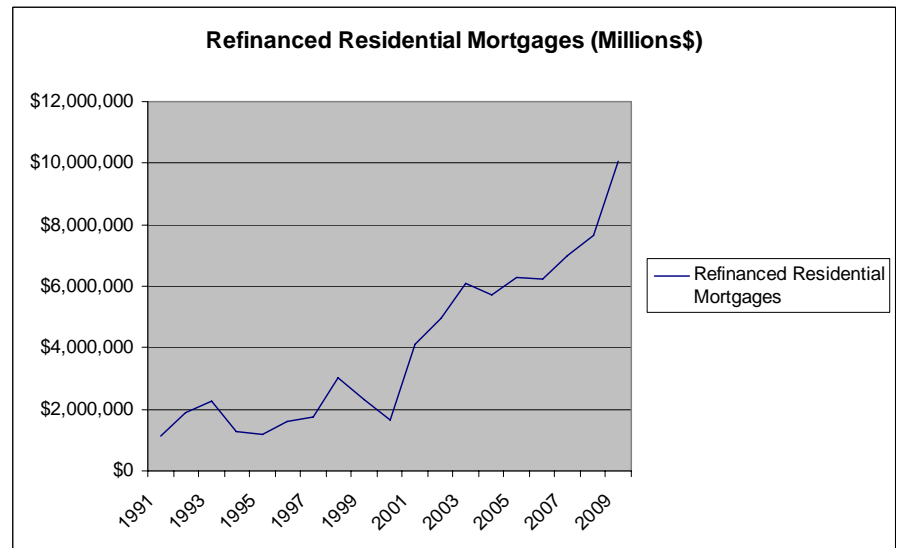
Source: <http://www.standardandpoors.com/indices/sp-case-shiller-home-price-indices/> and <http://www.fhfa.gov/webfiles/15452/finalHPI22510.pdf>

Table 8



Source: fhfa.gov

Table 9



Source: fhfa.gov

Table 10

Analysis (Tables 8 – 10)

The Case-Shiller index measures the value attached to residential property. It includes sales and financing. By contrast, the OFHEO Purchase-Only index only includes sales. The presence of appraised values used for refinancing mortgages most likely caused the recent bubble in the Case-Shiller curve.

Staff recently completed a sampling of 50 randomly selected foreclosed residential properties from 2006-2008, in order to assess their current status and estimate how much excess foreclosed inventory may still be awaiting a post-foreclosure sale (which would directly impact future residential sales studies).

As of October 1, 2009, 6 of the selected 50 properties remain with the foreclosing organization. Given that there have been roughly 500 foreclosures above the norm in the last four years, it suggests that there may be 50 properties in the City at this time that are “holdovers” from previous foreclosure processes and awaiting disposition. As these are recycled into the normal marketplace, they will likely cause some drag on the sales study – however, this is not a large enough number to cause major concern at this point.

The resetting of adjustable-rate (ARM) subprime mortgages under the current “traditional” tight mortgage standards (the vast majority of which were initiated under relaxed credit standards prior to the 2008 financial crisis) represents another potential supply of future residential foreclosures.

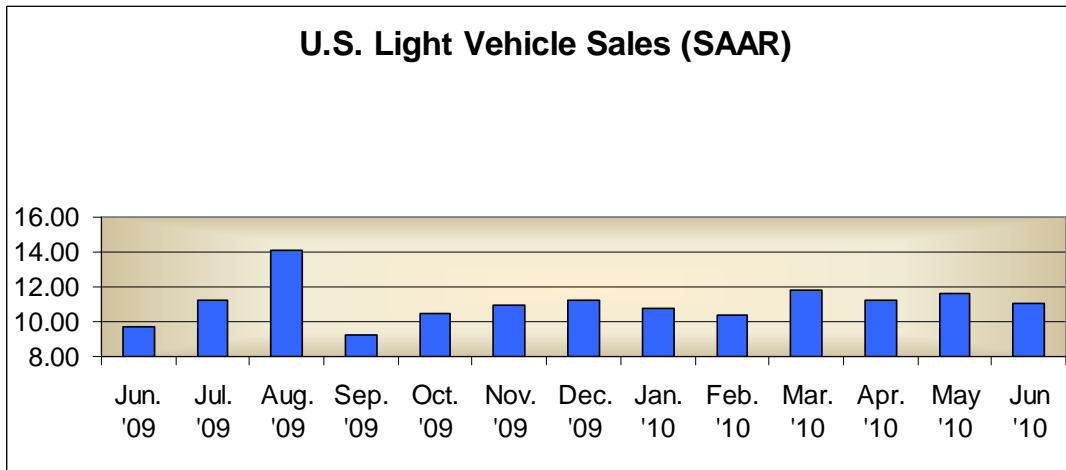
As of the January 2009, subprime ARMs represent about 1% of all housing units in the United States, and about ½ of those were behind in their payments or in foreclosure. A similar percentage of residential properties are due to have their loans reset by the end of 2010. Translated to Kalamazoo, given that there is a higher level of subprime mortgages, this would suggest that there are several hundred properties that face a realistic danger of being in foreclosure due to resetting subprime ARMs by the end of 2010.

According to a study done by at the end of 2009 and published in the *Federal Reserve Bank of St. Louis Review*, economist Rajdeep Sengupta, Alt-A ARMS represented approximately 48% of the market in housing loans at the end of 2007 with nearly 90% of those loans Owner Occupied. Because newer mortgages have a higher default rate, the resets for mortgages may increase the number of foreclosures and/or so-called “short sales”, where a buyout of the owner by the lending institution is negotiated at a steeply discounted price.

The above samplings seem to indicate that there will continue to be higher-than-normal foreclosure levels for at least another year or two (through 2012) in Kalamazoo, although the potential for a major spike in foreclosures seems unlikely as banks are holding back inventory so as not to further undercut the value of their own assets, which are steeply and irrationally discounted by the nature of foreclosures, particular as it relates to property damage and the carrying costs associated with bank-held properties.

It would appear at this point that the residential price pressures caused by foreclosures have largely abated in Kalamazoo and the surrounding areas.

Auto Sales



Source: motorintelligence.com

Table 11

Description

This chart represents unit sales of domestically produced cars and light duty trucks (including sport utility vehicles and mini-vans). Individual manufacturers usually report sales on the first business day of the month. Motor vehicle sales are good indicators of trends in consumer spending.

Expert Testimony

Vehicle sales were weak in June in an indication that retail sales may prove disappointing for a second month in a row. Unit sales of domestic-made cars and light trucks came in at an 8.4 million annual rate vs. May's 8.9. Adding in imports shows an 11.1 million rate vs. 11.6 in May for a 4.5 percent decline. - *Econoday.com*

John Hoffecker, a managing director at AlixPartners LLP, a consulting firm that surveyed consumers as part of its study of auto-industry trends. "We're still waiting for consumers to come back into dealerships."

In the year's first five months, auto sales rose 17% from a year earlier to 4.6 million cars and light trucks, according to Autodata Corp. But the rise has been fueled by commercial customers that had all but stopped buying last year and are now restocking their fleets. Fleet sales are up 32%, while sales to individual customers at dealerships have increased just 13%.

Since 1992, retail customers have reliably accounted for sales of at least 10 million cars and light trucks a year in the U.S. That string ended last year amid the recession. According to analysis by AlixPartners, this year's sales may not surpass 10 million, either.

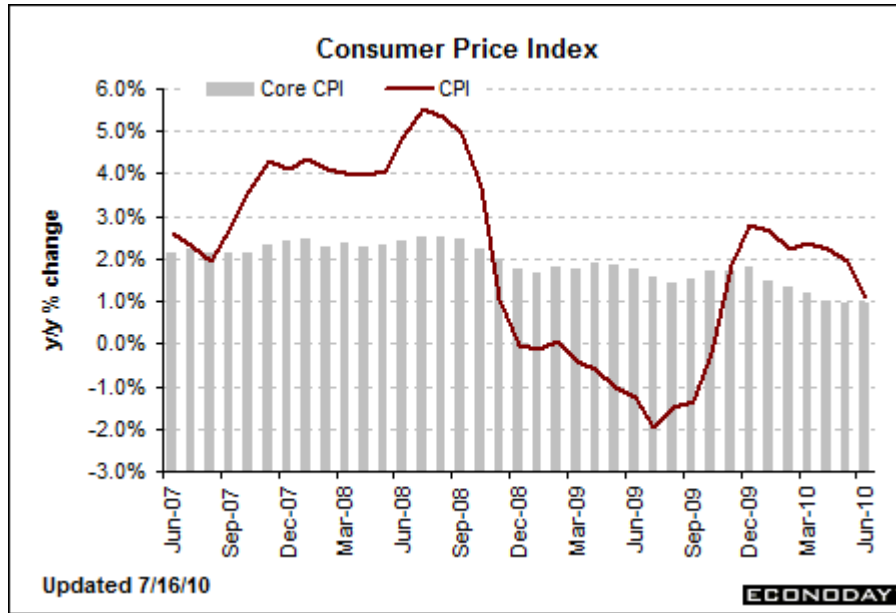
- *Sharon Terlep, Wall Street Journal*

Looking Ahead

The data suggest the recovery isn't as strong as it appeared earlier in the year. The auto sales increase during the first five months was driven by higher sales to commercial fleets—not sales to consumers. Retail customers are showing signs of pessimism about the economy and tempered interest in buying new cars.

Economic Indicators

Consumer Price Index



Source: Econoday.com

Table 12
Description

The Consumer Price Index is a measure of the average price level of a fixed basket of goods and services purchased by consumers. Monthly changes in the CPI represent the rate of inflation.

Expert Testimony

Lower energy costs tugged down on the consumer price index in June, resulting in a third consecutive decline. In June overall CPI inflation dipped 0.1 percent, following a 0.2 percent decline in May. The latest month matched the projection for a 0.1 percent decline. Excluding food and energy, the CPI edged up to 0.2 percent after a 0.1 percent uptick in May. This was higher than analysts' forecast for a 0.1 percent rise.

By components, energy component dropped 2.9 percent, equaling the May decrease. Gasoline fell 4.5 percent after a 5.2 percent decrease the previous month. Food prices overall were flat for the last two months.

Year-on-year, overall CPI inflation eased to 1.1 percent (seasonally adjusted) from 2.0 percent in May. The core rate in June remained at 1.0 percent. On an unadjusted year-ago basis, the headline number was up 1.1 percent in June while the core was up 0.9 percent.

- *Econoday.com*

There has been considerable concern about the recent increase in the money supply affecting inflation. However, the money supply has constantly lagged inflation for almost 50 years, rather than leading it. (<http://wfhummel.cnchost.com/inflationgraph.html>)

Both inflation forecasts that staff identified (forecast.org and cxoadvisory.com) indicated that inflation would remain well in check for the next 18 months, below 3%. Traditionally, cyclical activity in economic production, as expressed by movements in the Producer Price Index and seasonal cycles, has been seen as the keys to forecasting inflation.

Looking Ahead

Concern about inflation has hovered for years due in large part to the consistently large account balance between the United States and large exporting nations like China, Japan and India, and also because of the enormous amount of Treasury debt held by the Chinese Japanese governments.

Deflation has dropped from the list of likely scenarios, leaving potential inflation or stagflation:

- 1. Inflation: this has not yet emerged quantitatively as a problem, however the economic recovery, when it occurs, will likely cause inflationary pressures that will require corrective action from the Federal Reserve in raising their discount rate;**
- 2. Stagflation: if the Federal Reserve does not time or scale their response to the economic recovery properly, the result could be both rapidly rising interest rates and inflation, known as Stagflation.**

Stock market

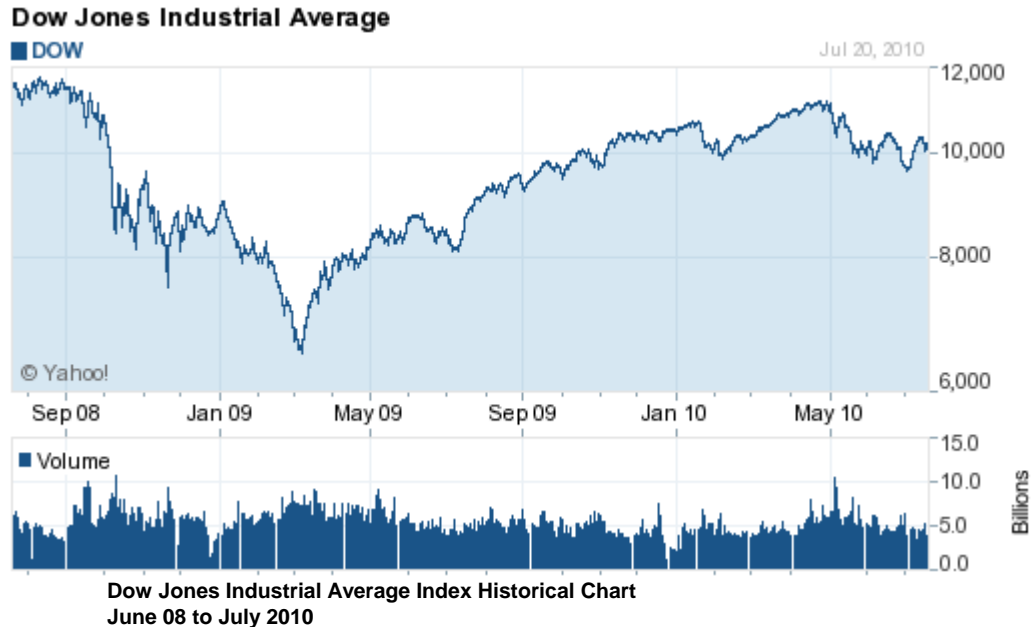


Table 13

Expert Testimony

"[There will be a] bear market trend into mid July 2009. However it is increasingly unlikely that DJIA 6,600 will hold and therefore the bear market is targeting a trend towards a break of the lower target of 6,000."
- *Dow Jones Stock Market Index Forecast 2009 – Update 1*, Nadeem Walayat, fxstreet.com, Feb. 25, 2009

"We are in a stocks stealth bull market that has already delivered a powerful 35% gain to date, so whilst a stock market correction is expected into the end of June, it is still just a correction against the trend."
- *Stocks Stealth Bull Market Quick Update*, Nadeem Walayat, <http://www.marketoracle.co.uk/Article11074.html>, June 3, 2009

"Today's Market Lesson - Do not THINK too MUCH! Don't get lost in reasons of why the market must move, rather focus on what the market is doing on the price charts! AS you are trading the PRICE CHART and NOT the fundamental DATA! They can and DO move in OPPOSITE DIRECTIONS! Funnymentials are a RED HERRING that continue to sucker both the professionals and the inexperienced, whereas they should amount to no more than 10% to 20% of the your decision making process when trading rather than the over inflated 80% or more that many weight towards in depth Funnymentials studies into for instance corporate earnings forecasts. Your swing trading analyst is not too interested in what the funnymentials suggest."
- *Stocks Bull Market Correction Continues*, Nadeem Walayat, <http://www.marketoracle.co.uk/Article13947.html>, October 4, 2009

"The economies are continuing to improve in terms of GDP growth as a consequence of unlimited money printing and stimulus, this will continue throughout 2010 and into 2011, which continues to paint a favorable stocks picture for the current year at least, therefore continues to support the stocks bull market target of 12,500 for this year as a consequence for the need for risk as a consequence of negative real interest rates." – *Stock-Markets / Stocks Bull Market*, Nadeem Walayat, Mar 23, 2010

"Seems like every day there is talk about black swans, what about white swans? Positive developments to the upside? Since the Stock market has not crashed, collapsed, evaporated into perma- bear abyss targets,

it clearly is discounting something positive? Whilst bears focus on the doom and gloom of double dip recessions, depressions, armageddon's, focusing wholly on the 15% downtrend price action since the April peak, though conveniently forgetting the 70% advance before it. So I will leave Nassim Taleb to See Black Swans everywhere as an excuse for poor analysis rather than anything of any actionable value. I mean Taleb says forecasts are irrelevant but then prances about in the mainstream media issuing economic depression forecasts, perhaps he should read his own book? Doom merchants are usually at their most influential right at the end of cyclical low points. I would happen a guess at Taleb having a perma-doom mindset that makes money during crisis but then gives much of it back during the booms. In a nutshell, Taleb's strategy is to basically to keep betting on a crash "Black Swan" until it eventually happens. You don't have to be genius to follow a strategy of buying far out of the money Puts! That 99% of the time expire worthless." - *Stock Market and Gold Summer Correction, Remember White Swans Out Number Black Swans*, Nadeem Walayat, July 11, 2010

"Even if the rally is destined to continue, it is likely that we will experience a short-term pull-back as the market prepares to break through the resistance." – *Bear Market Rally*, Carl Swenlin, decisionpoint.com, Mar. 27, 2009

"Cracks are beginning to appear in the medium-term picture, and any correction should not be fully embraced as positive until it is clear that it is over." - *Another Ascending Wedge*, Carl Swenlin, decisionpoint.com, June 15, 2009

"I hear that a number of people are expecting a crash, but I see no evidence that would make me anticipate anything more than a normal correction." - *Support Still Holds Correcting Prices*, Carl Swenlin, decisionpoint.com, October 2, 2009

"The S&P 500 is still above the overvalue limit with a P/E of 23. By the end of the year, earnings are expected to improve, but still not enough to get valuations anywhere near fair value (15). If prices continue to advance, the market will remain extremely overvalued." – *More Normal Earnings Picture*, Carl Swenlin, decisionpoint.com, April 1, 2010

"Based upon a 3/1/2010 Thrust/Trend Model buy signal, our current intermediate-term market posture for the S&P 500 is bullish." - *Another Ascending Wedge*, Carl Swenlin, decisionpoint.com, April 16, 2010

"Summary: While raw volume continues to be a problem, looking below the surface shows that advance-decline volume relationships and behavior are normal, and in general support a bullish outlook." -*New Long-Term Sell Signal Generated*, Carl Swenlin, decisionpoint.com, July 10, 2010.

"the estimated S&P 500 price-to-earnings ratio dropped to its lowest level since late in the first quarter of 2009, which is when the historic 13 month stock index futures advance first began. A newly released Bloomberg survey showed analysts were increasing earnings estimates for S&P 500 companies. The survey said profits will increase 34% in 2010, which compares to the 27% increase that was projected on March 29. This is the quickest rate of improvement since 2004. Although many economists believe that there will be a double dip in the economy, our analysis suggests that the recovery is intact. Contrary to what appears to be a mainstream view, especially last week, we believe that the recovery in the economy has not peaked. Our analysis also suggests that corporate earnings will be stronger than the analysts' estimates." - *Stock Index Futures, Europe, Interest Rates and Earnings*, Alan Bush, Insidefutures.com, July 15, 2010
<http://www.insidefutures.com/article/161766/Stock%20Index%20Futures,%20Europe,%20Interest%20Rates%20and%20Earnings.html>

Looking Ahead

As was discussed in previous Quarterly Reports, traditional chart analytics have suggested that the market has entered a new long-term trend/cycle. However, severe volatility has emerged in the face of the

sovereign debt crisis in Europe, which has been the “damned if you do” part of the massive stimulus policy enacted over the last 18 months.

While the crisis in Greece seems to have been abated somewhat by the infusion of credit from the European Union, nevertheless the specter of wide-spread governmental default from Portugal to Spain, and even Great Britain has bond holders very nervous.

The “damned if you don’t” part of the policy equation is that the specter of major budget cut-backs has the stock investors concerned that such a move at this time would deteriorate demand and cause another recession.

The following analysis serves as a counterpoint to the recent hysteria over sovereign debt:

“The euro has continued to be supported by the growing belief that we have seen the worst of the sovereign debt problems in the euro zone. This positive feeling was reinforced after the relatively well received recent debt offerings from Germany, Portugal, Greece and Spain. This week Greece was able to auction 1.63 billion euros of six-month Treasury bills at a yield that was below the benchmark interest rate of 5% that the European Union charged for their bailout funding. This successful auction suggests that there is a more optimistic feeling toward the financial condition of Greece. In addition, late this week, the government bonds sold by Spain attracted stronger than anticipated demand from investors. All of a sudden, one of the main reasons that analysts were bearish on stock index futures, the financial problems in Europe, has been greatly reduced.” - *Stock Index Futures, Europe, Interest Rates and Earnings*, Alan Bush, Insidefutures.com, July 15, 2010

<http://www.insidefutures.com/article/161766/Stock%20Index%20Futures,%20Europe,%20Interest%20Rates%20and%20Earnings.html>

Charts for 2008 through 2009 show a classic inverted head-and-shoulders curve from 9,200 in October 2008 down to 6,500 in March 2009 and back to 9,200 in August 2009, and continuing to rise to the 11,000 point mark in mid April 2010 resulting in a 13 month span climb back up again. Searching for the beginning point of the new normal has been the goal for each of these quarterly reports.

The historical ratio of earnings divided by the price of shares in the S & P Index (known as the p/e ratio) has been roughly 15:1. As of the First Quarter 2010 Report, it was indicated that future price-to-earnings ratios were in excess of 18, which prompted the caution that a correction might be in the offing. As if on cue, a correction occurred in the second quarter which brought prices back into line with earnings expectations.

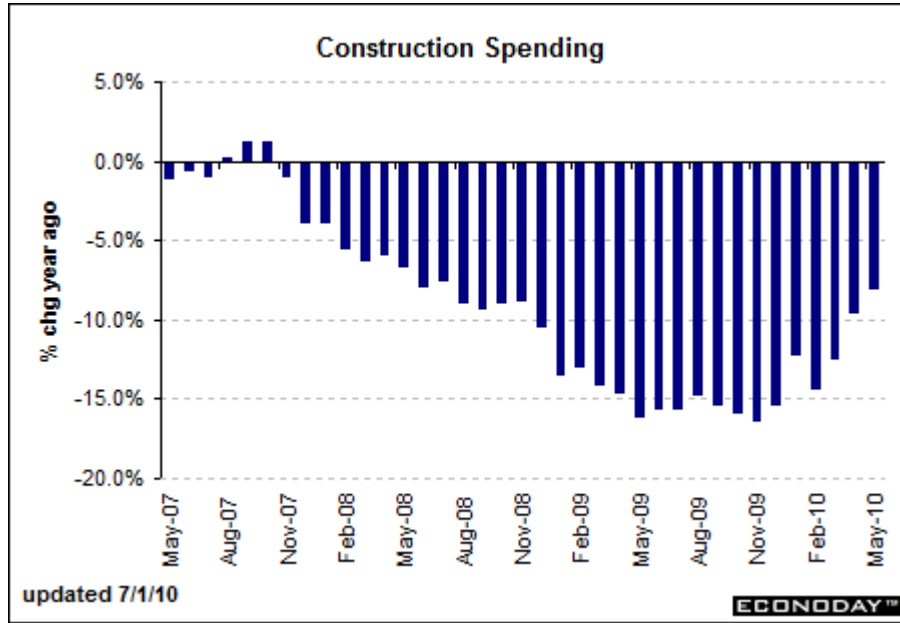
Standard and Poor’s published the 6/30/2010 p/e ratio of 16:1 in their June 15, 2010 report. That same report showed that the future estimated ratio (for corporate earnings as of 6/30/2011) is 15.37. In short, there is no indication of overvaluation as of June 30, 2010.

Potential major policy changes in monetary policy, banking, global trade and the environment are being pushed in Congress. These changes have been met with skepticism by the market, however in the wake of health care reform passage, the market has responded with steadiness rather than disruption.

The current assumption is that domestic and global equities are now more than 1 year into a sustained growth cycle. The recent correction and historical price-to-earnings ratios may suggest that equity pricing as of June 30th is close to the “new normal”.

Please see the Pension section of this report for more discussion on this topic.

Construction Activity



Source: Econoday.com

Table 14
Description

“Construction spending” represents the dollar value of new construction activity on residential, non-residential, and public projects. This is a coincident indicator of economic activity, meaning that it moves with the economy as a whole.

Expert Testimony

Despite the bad news on home sales, actual construction spending is holding up well. Construction outlays in May fell back only 0.2 percent after jumping 2.3 percent in April. Analysts had forecast a 0.5 percent decline for the latest month.

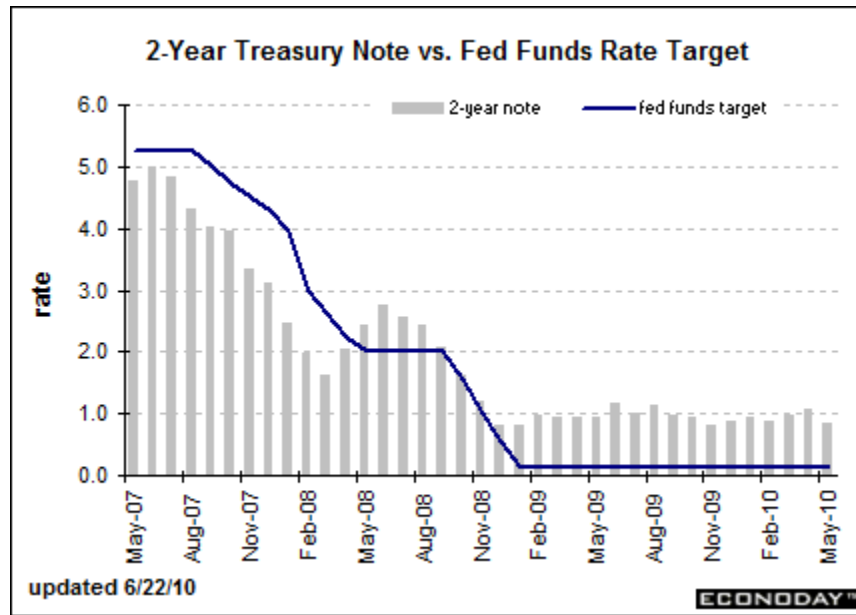
Actual building activity is not as volatile as sales numbers. Companies have taken the earlier surge in home sales with a grain of salt and have not had to pull back dramatically, yet. On a year-ago basis, overall construction outlays improved to minus 8.0 percent in May from minus 9.5 percent in April.

- *Econoday.com*

Looking Ahead

The economy has been expanding since the 3rd Quarter of 2009, but construction activity is still lagging. Construction is generally a “coincident” indicator of economic activity, so this seeming disconnect may be an indicator of weak economic growth and/or latent and leftover overcapacity in industrial, commercial and housing facilities from the last economic cycle.

Treasury Indices



Source: Econoday.com

Table 15
Description

Treasury notes are sold at regularly scheduled public auctions. Competitive bids at these auctions determine the interest rate paid on each Treasury note issue.

Analysis

Traditional monetary policy has been exhausted by the near zero federal funds rate. As stated in the previous reviews, there is a danger of extending cheap interest rates too far and encouraging risk in the bond market in response, much like what occurred in the development of the exotic credit instruments that have appeared on the market and are now the subject of much regulatory and legislative scrutiny.

Mortgages and Mortgage Rates

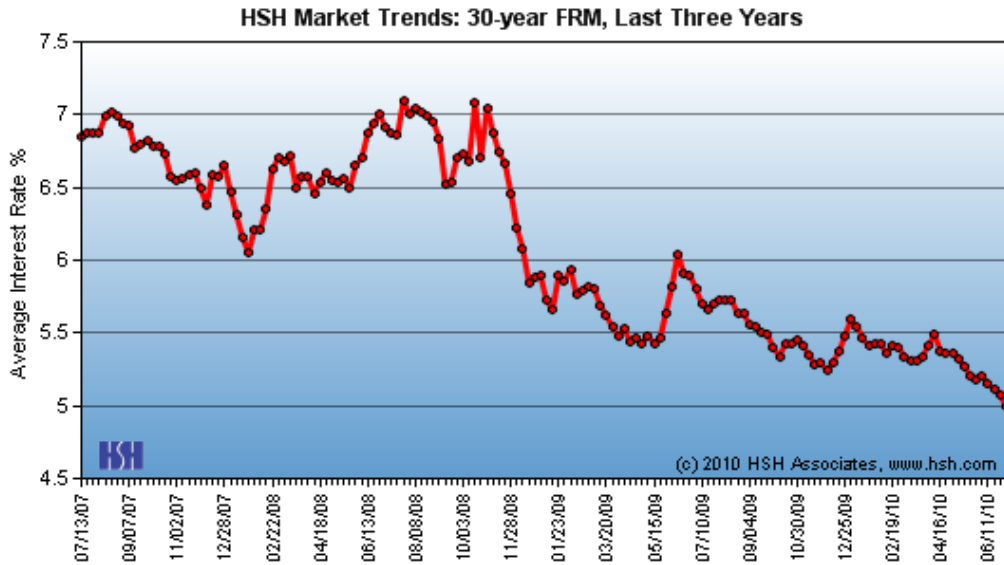


Table 16
Description

HSH's Fixed-Rate Mortgage Indicator (FRMI) averages 30-year mortgages of all sizes nationwide, including conforming, the new expanded conforming, and jumbo.

Expert Testimony

Mortgage rates continued their record fall. The average 30-year fixed-rate mortgage edged down 1 basis point, to 4.74 percent. A basis point is one-hundredth of a percentage point. The rate marks a new low in the nearly 25-year history of the weekly Bankrate survey.

Mortgage applications rose a seasonally adjusted 6.7 percent when compared to a week earlier, according to the Mortgage Bankers Association. Refinance applications shot up 9 percent and are at 13-month highs. By contrast, applications for new purchase dipped 2 percent and have fallen in eight of the last nine weeks.

In other mortgage news, pending home sales fell 30 percent in May when compared to a month earlier, according to the National Association of Realtors. Sales were also down 15.9 percent year over year.

-- Chris Kissell. <http://www.bankrate.com/finance/mortgages/interest-rate-roundup-for-july-8-2010.aspx>

Looking Ahead

The pending sunset of federal tax credits for first-time homebuyers accelerated purchases while lenders increased mortgage rates, as seen in the long range graph.

Mortgage rates will be artificially suppressed as long as the Federal Funds rate is maintained at near zero levels. However, the combination of traditionally high lending standards and low property values will also suppress the supply of new and refinanced mortgages.

Water Shut-Off Notices and Actual Shut-Offs

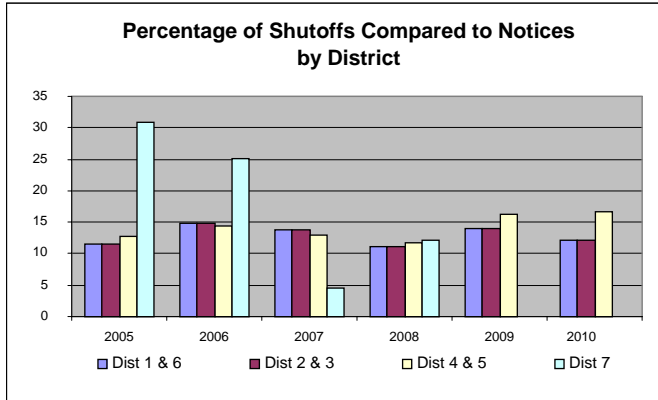


Table 17

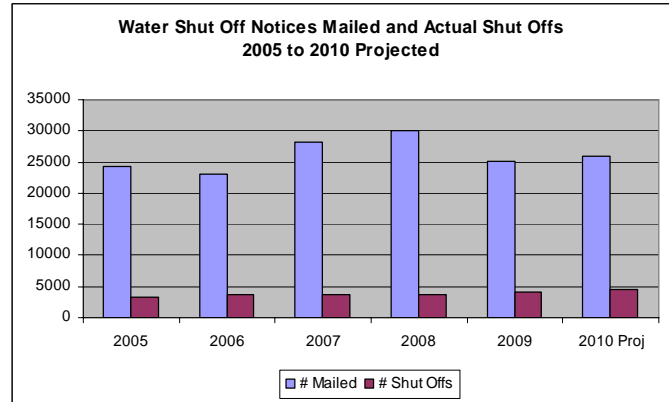


Table 18

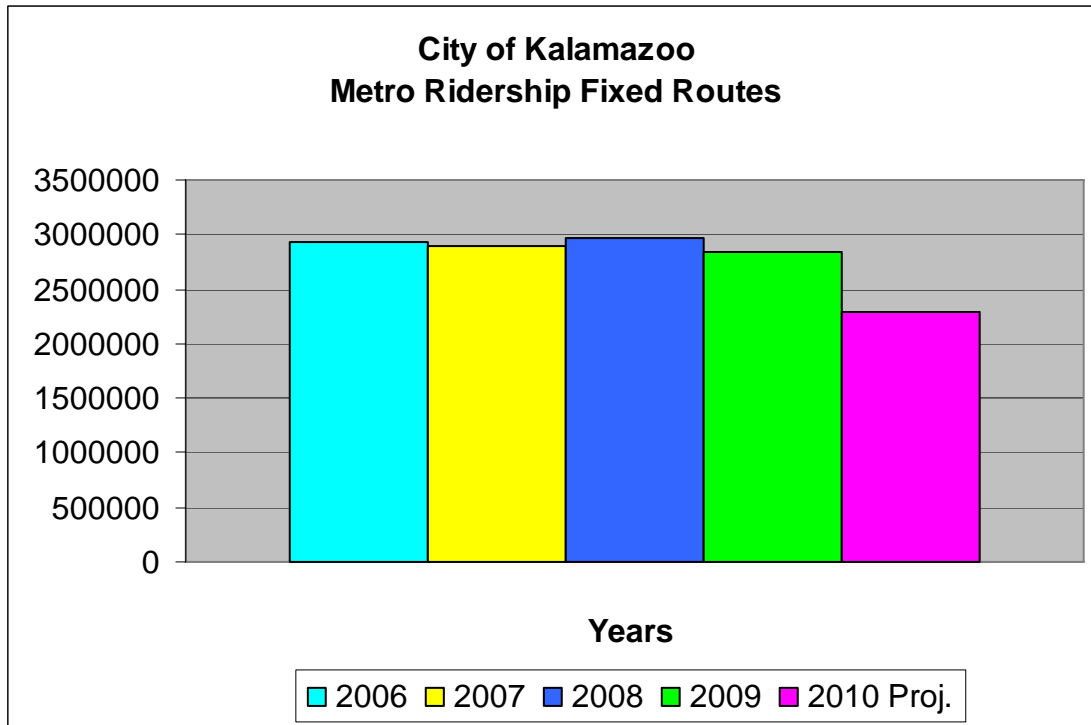
Description

This index serves as a proxy for cash-on-hand, particularly among the more economically distressed. Typically, 91.3% of shut-off are made current within 24 hours and within a 5 days, 99% are current.

Table 17 shows the percentage of shut-offs compared mailed bills over several years and segregated by district. **Table 18** summarizes the same data by year. While the number of Final Notices mailed out in Jan 2010 was higher than 2009, this is due to some catch-up activity after the implementation of the new Utility Billing software in the 4th Quarter.

The shut-off data does not suggest a higher-than-normal level of economic stress among utility users.

Bus Ridership



**Table 19
Description**

Table 19 represents ridership for all routes in the Metro Transit system, and is a proxy for overall economic activity.

Prior to 2008, ridership had been fairly stable. Rising gas prices in 2008 caused a spike in ridership, rather than an increase in economic activity.

The first quarter of 2010, which is the data made available to-date, shows a significant decline of roughly 20%.

Some routes are down by nearly 30% year over year including Portage, Alamo, Burdick, Shaver and Specialized Services. The Centre Street routes were alone with an increase of over 20%.

Potential causes for the decline in ridership may include: increases in fares enacted in 2009, less overall economic activity, warmer weather experienced in the 1st Quarter of 2010 vs. 2008 and 2009, and relatively cheap gas prices.

FY 2010-11 Budget Highlights

- **FY 2009-10 Budget Cost Containment:** Over \$500 thousand of cost reductions have been realized independent of reductions in staff and service level.
- **5-Year Fiscal plan:** this is the fourth Budget that contains a detailed projection of General Fund balances for five years beyond the target fiscal period.
- **2-Year Budget framework:** we have lengthened the budgeting perspective and shortened the fiscal perspective to align with uncertainty. This has provided for “smoothed” cuts in FY2009 and FY2010 that will hopefully minimize cuts for balancing the FY2011 budget.
- **Health Care cost containment:** the City negotiated agreements with our labor units that have saved the City approximately \$7 million in health care costs during FY2006 – FY2008. Savings realized since FY 2007 has created an unencumbered balance of \$4 million in the City’s internal Insurance Fund.
- **Budget Stabilization Fund:** by adding \$1.3 million in FY2009, this fund has a balance of \$1.6 million as of the end of FY2009;
- **Capital Contingency Fund:** this is estimated to have a balance of \$300 thousand by the end of FY 2009, to assist in the repair/replacement of unexpected City property damage and loss.
- **Tax Installments:** enactment of Public Act 512 by the Governor shortens the City Tax Installments from 12 payments to 6 payments (due December 31st).
 - The Summer 2009 tax billing cycle was a major success, accelerating current tax payments by over \$2.5 million, allowing the City to reduce TANs borrowing. The City will receive it’s first delinquent settlement check from the County Treasurer in June 2010 for 2009 delinquencies. The County Treasurer will also collect tax year 2000 – 2008 delinquent real property taxes, which will further accelerate delinquent tax payments. In 2009, delinquent tax payments were accelerated by over \$2 million, closing the difference between the City’s “GAAP” and “non-GAAP” General Fund unreserved balance.
- **Bond Ratings:** due to the quality of the City’s fiscal management, our bond rating has been renewed at AA with a stable economic outlook by both Fitch and Standard and Poor’s. The City realized savings of over \$160 thousand of debt service payments for each of the next 15 years on the 2009 Capital Improvement Project Bond, based both on the federal American Recovery and Reinvestment Act (ARRA) or “stimulus package”, which provided over \$1.27 million in capital grants to the City to reduce planned bonded indebtedness, but also low coupon rates of 4.06%, which were at least 25 basis points below expectations.
- **Tax Anticipation Notes:** due to the renewed bond ratings, the City realized savings of \$63 thousand of interest costs for 2010 TANs based on 0.48% interest rates from the competitive bid process, as well as the reduced TANs borrowing of \$3 million in FY2010.

Pension Funding

December 31, 2008: Historic losses of \$150 million in 2008 (representing approximately 29% of the Pension Trust Fund market value) will have to be recognized over a five-year “smoothing” period. As of December 31, 2008, the Pension Fund had approximately \$368 million in market assets, and an actuarial value estimated at \$506 million.

Experience in 2009: A steep slide of an additional \$90 million of market value losses left the Pension Trust Fund at around \$280 million of market asset value as of March 1st. However, the market has recovered dramatically, and as of December 31, 2009, the Pension Trust Fund was at \$448 million of market value of assets, or about 24% higher than it was on January 1, 2009.

Experience in 2010: after a very strong 1st Quarter, which saw the Pension Fund increase from \$450 million of market value to \$481 million, global markets were shaken badly by the sovereign debt crisis in Greece, and the potential repetition on a larger scale in Portugal, Spain, and even Great Britain. This has caused a reduction in assets to \$435 million by June 30th, 2010.

Projections: 2010 – 2029: The Michigan Constitution requires that the normal cost of the benefits be paid to the Pension Trust Fund of the municipality each year. In application, the normal cost is adjusted up or down by an amortized portion of the current funded level to determine the actual contribution.

The normal cost of benefits is the value accrued in benefits by employees from a year of service. For the year ending 2009, the net normal cost for all active employees totaled a little more than \$6 million (net of roughly \$1.5 million of employee contributions).

For the purposes of comparison, it has been assumed that the Pension Trust Fund’s market value will achieve a rate of return of 7.5% for the balance of 2010, resulting in the Pension Trust Fund balance being 1 percent lower on December 31, 2010 (net of more than \$16 million in expenses) than it was on December 31, 2009, giving it an actuarial value of roughly \$503 million. The actuarial (smoothed) funding level would fall from 142% to 134%.

The following rate of return scenarios are based on a range of reasonably foreseeable outcomes in the market over the next 20 years. It must be noted that level-percent rate of return assumptions are simplified scenarios for the purposes of problem identification:

- **5% Rate of Return:** the City would be required to contribute approximately \$600 thousand to the Pension Trust Fund in 2013, and \$2 million in 2014. This amount would continue to increase indefinitely.
- **7.5% Rate of Return:** the City would be required to contribute more than \$1.7 million to the Pension Trust Fund in 2015, and \$2.6 million in 2016. This amount would continue to increase indefinitely.
- **10% Rate of Return:** At 10%, the City would not be required to make any contribution for the foreseeable future.
- **12.5% Rate of Return:** At 12.5%, the City would not be required to make any contribution for the foreseeable future.

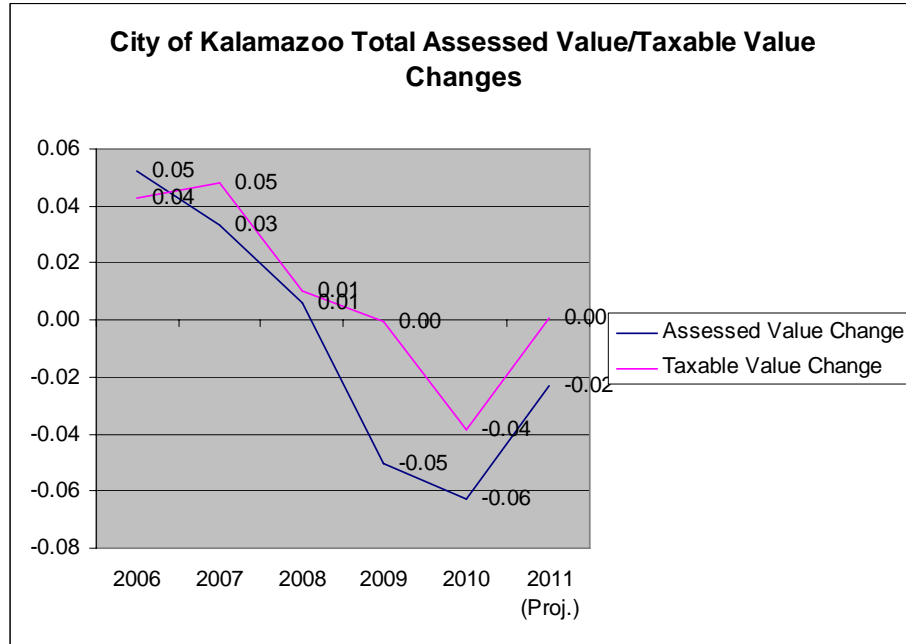
- **Average History:** this is a completely different approach of estimating returns. It involves using the “slope” of past recoveries during the 25 year history of the Retirement Investment Committee. There have been four stock market drops followed by recoveries over that period of time. Each year of recovery, from the first to the fifth, has been averaged to come up with a normal scenario. Using the approach, the City would avoid making contributions.

Smoothing recognition of gains/losses to assets (5 years vs. 10 years): The City has the option of changing the smoothing period for recognition of gains and losses in the portfolio. They currently utilize a 5-year smoothing period, which means that gains and losses are cut into 5 equal units and spread over a 5-year period. The vast majority of public pension systems utilize smoothing periods between 5 and 10 years.

Changes in asset smoothing is not advisable at this time, although we will revisit this issue periodically.

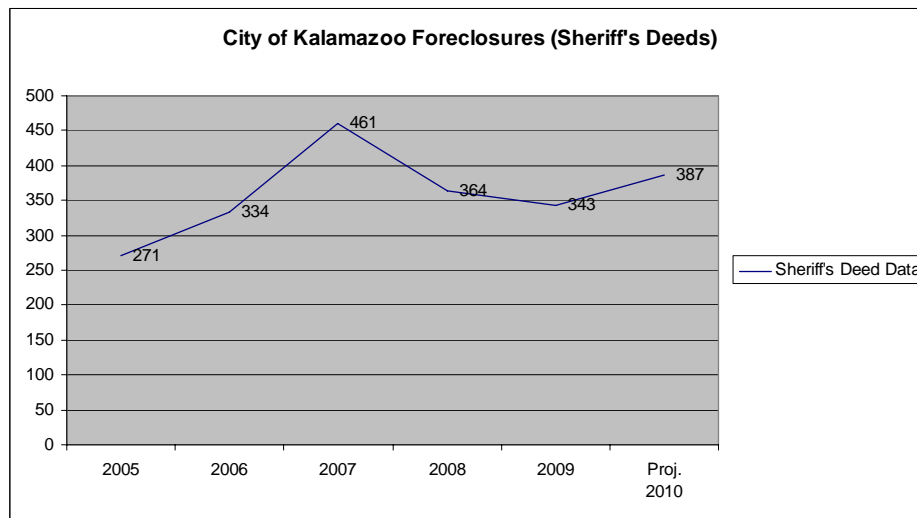
Revenues

Property Taxes



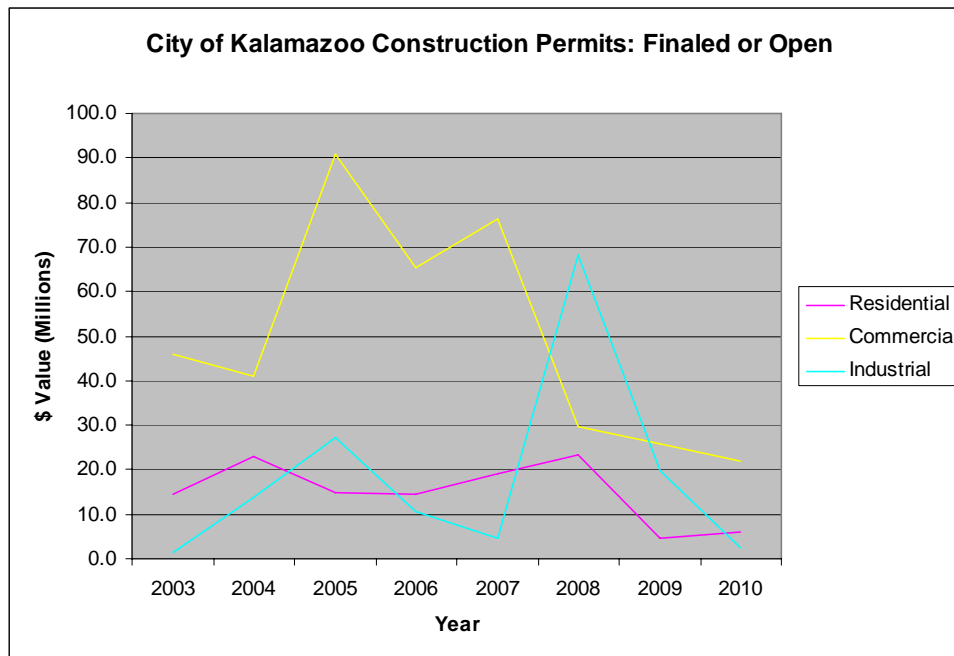
Source: City of Kalamazoo Assessor's Office

Table 20



Source: City of Kalamazoo Assessor's Office

Table 21



Source: City of Kalamazoo Assessor's Office

Table 22
Description (Tables 20 – 22)

2008 and prior: Table 20 shows that City of Kalamazoo total assessed value (which is based on property sales and industrial appraisal studies, and moves with the market value of property) had been rising steadily at 5% (which is the City's historical average for the last 15 years), but increased only 3% for the 2007 roll and only 1% for the 2008 Assessment Roll.

2009: The 2009 Assessment Roll utilized a study period of October 1, 2007 – September 30, 2008, which showed a substantial loss of 5% compared to the previous Assessed Value. Because there was a substantial gap between the Assessed Value and the Taxable Value for most properties, this change did not cause a downturn in Taxable Value for 2009. In combination with inflation, the Taxable Value for the City's properties stayed relatively flat for 2009.

2010: The 2010 Assessment Roll was determined for Residential and Commercial property by utilizing sales data for the period of October 1, 2008 – September 30, 2009. The overall result is a drop in Assessed Value of roughly 6%, and a drop in Taxable Value of 4%.

The 4% drop in Taxable Value compares to the projected loss of 3% of Taxable Value from the Third Quarter 2009 Report, which was used to formulate the property tax revenue for the FY 2010 – 11 Budget. This unprojected negative difference (equal to roughly \$17 million of Taxable Value) was caused primarily by the following factors, all of which emerged in 2010:

- Net unanticipated reductions of \$4 million of Taxable Value in the personal property roll. Personal Property is valued based on affidavits filed by property owners in February -- in this case, February 2010. Based on the historical steadiness of Personal Property value (this amount has changed by less than 2% for each of the past 5 years, and has not lost value in recent history), budget projections have assumed no change in Personal Property value – this practice had resulted in a slightly conservative estimate, until this year.
- Net additional reductions of \$7 million of residential Taxable Value, beyond the reductions projected in the Third Quarter 2009 Report. This negative difference was due to a significant

unanticipated reduction in the final ratio of residential value as compared to historical residential value outcomes.

- A \$5 million reduction of Taxable Value in the March Board of Review. This was due to an error in the City's records involving Payments In Lieu of Taxes (PILOTs). The records indicated that a PILOT was expiring in 2009, which would return \$5 million of taxable value back to the Assessment Roll in 2010. The property owner was contacted in September 2009 to verify the expiration, according to standard procedure, but the property owner failed to notify the Assessor that the PILOT was not expiring. The mistake was not discovered until the property owner filed a March Board of Review claim. Therefore, the \$5 million had already been mistakenly placed on the ad valorem Assessment Roll for the purposes of setting the FY 2010 – 11 Budget estimate. As a result of the March Board of Review correction, the \$5 million had to be removed.

Residential sales study: Using the available data for sales from October 1, 2008 through September 30, 2009, the final number of qualified residential sales was a little over 350, down from the previous projection of 400.

For 2010: In the First Quarterly Report for 2009, it was reported that sales prices for October 2008 through February 2009 were slightly ahead of 2009 Assessed Values.

In the Second Quarterly Report for 2009, it was reported that residential sale prices dropped significantly to an average of 8% lower than 2009 Assessed Values for the Second Quarter.

In the Third Quarter Report for 2009, the final Residential Sales Study (which was validated later by the County Equalization Department) moderated the decline in Residential Value to 3.5% in Assessed Value, for a 1.5% drop in Taxable Value.

When the aforementioned unprojected reduction is factored in, Residential Assessed Value dropped by a total of 4.7%, while Taxable Value dropped by 2.5% versus 2009. The extra 1% loss in Taxable Value amounted to a loss of nearly \$140 thousand in annual revenue versus the FY 2010 budgeted amount.

For 2011: Residential sales for the first nine months of the sales study year (October 2009 – June 2010) projects a drop of roughly 2.7% of Assessed Value for Residential Properties. This is fairly close to the 3.5% drop indicated by the first nine months of sales data over the same time last year.

The above decline in Assessed Value would be offset by the return of nominal inflation, which would:

- increase Taxable Value by 0.8% or \$130 thousand of General Fund tax revenue when compared to the 2010 Assessment Roll as confirmed by the City Commission in June 2010;
- decrease Taxable Value by -0.4% or \$60 thousand of General Fund tax revenue when compared to the FY 2010 Budget as adopted by the City Commission in January 2010;

Commercial sales study (net of Industrial value estimates):

For 2009: Commercial real property (land and buildings) taxable value had increased from the 2008 to the 2009 Assessment Roll by 1.5%.

For 2010: the 1-year sales study produced a roughly 13% drop in Assessed Value for commercial property, and an 8% drop in Taxable Value. The amount of unprojected losses for commercial and industrial values of \$5 million equaled \$100 thousand of lost revenue for the General Fund versus the FY 2010 budgeted amount.

For 2011: sales of commercial property for the first nine months of the study period (October 2009 – September 2010) are very close to 2010 values, a slight decrease of 0.9%.

The above decline in Assessed Value, net of estimated changes in Industrial property value, would also result in:

- a slight increase in Taxable Value or \$20 thousand in General Fund tax revenue when compared to the 2010 Assessment Roll as confirmed by the City Commission in June 2010;
- a decrease in Taxable Value by -0.5% or \$70 thousand of General Fund tax revenue when compared to the FY 2010 Budget as adopted by the City Commission in January 2010;

Table 21 shows that in 2007 a seemingly temporary spike in residential mortgage foreclosures occurred (as represented by Sheriff's Deeds). Historically we have seen 250-300 foreclosures a year. In 2007 we experienced nearly 450, after rising to 330 in 2006.

In 2008, the number of residential mortgage foreclosures fell to 365.

At the end of March 2009, Federal agencies Fannie Mae and Freddie Mac ended their moratorium on foreclosures, which has resulted in an industry-wide increase in foreclosures in April, May and June.

The pace of foreclosures fell in the second half of 2009, resulting in 343 foreclosures for 2009.

Foreclosures indicate a somewhat higher projected pace (385) for 2010, as compared to 2008 and 2009.

While excess residential inventory will likely remain on the market for some time, the pace seems to have stabilized.

Table 22 shows that the City experienced five strong years of combined construction from 2004 - 2008 totaling over \$470 million of value. Annual totals varied between \$77 million and \$121 million, driven primarily by commercial construction.

In 2009, Commercial construction began at a much higher pace than 2008, primarily because of the \$4.7 million Catheterization Lab project at Bronson Hospital. In the second half of 2009, permit activity slowed considerably, leaving 2009's \$25 million at less than ½ of the previous 5-year average of \$60 million.

Residential construction came to a screeching halt in 2009, with \$4.7 million representing only 1/4th of the previous 5-year average of \$19 million.

The total permit value for 2009 of \$50 million was only about ½ of the previous 5-year average.

In the 1st Quarter of 2010, permit value has started at a very slow pace in all three sectors:

- Residential has perked up a bit to an annualized projection of \$8.7 million for 2010, roughly double the 2009 pace, but still only about ½ of the previous 5-year average.
- Commercial permits are projected at \$21 million for 2010, less than the \$25 million pace in 2009, and 40 percent of the previous 5-year average.
- Industrial permits are projected at \$2 million for 2010, which would be very low compared to the \$11 million average of 5 of the last 6 years (excluding 2008, which was an extraordinary outlier year with \$68 million of industrial permits).

- Total permits for 2010 project to a moribund \$30 million, about 60% of the 2009 pace, and not even 1/3rd of the previous 5-year average.

Looking Ahead

Housing prices in the City have been dropping since 2007, and foreclosed residential properties continue to represent excess low-price inventory that will dampen values for some time. The foreclosure situation seems to have stabilized, and should eventually return to normal, with home prices presumably following the same trend.

For the purposes of revenue generation, 2010 was the first year in at least 25 years with a negative inflation rate, which contributed to a decrease in 2010 Taxable Values. The inflation rate for 2011 projects to be nominally positive, which will help to offset a projected decline in residential values due to sales.

- 2009: The “shift” in taxable value from the General Fund to the Brownfield Redevelopment Authority mentioned above has caused a drop in General Fund revenue of \$250 thousand versus what was budgeted for 2009.
- 2010 Residential: Residential Assessed Value dropped by a total of 4.7%, while Taxable Value dropped by 2.5% versus 2009. The extra 1% loss in Taxable Value amounted to a loss of nearly \$140 thousand in annual revenue when compared to the FY 2010 -11 Budget as adopted by the City Commission in January 2010;
- 2010 Commercial/Industrial: the 1-year sales study produced a roughly 13% drop in Assessed Value for commercial property, and an 8% drop in Taxable Value. The amount of unprojected losses for commercial and industrial values of \$5 million equaled \$100 thousand of lost revenue for the General Fund when compared to the FY 2010 -11 Budget as adopted by the City Commission in January 2010;
- The 2010 Assessment Roll was certified by the City Commission in June 2010, creating an additional \$290 shortfall in tax revenues when compared to the FY 2010 -11 Budget as adopted by the City Commission in January 2010;
- Appeals: The number and size of property assessment appeals have increased in recent years. These are filed with the Michigan Tax Tribunal. The City Assessor and City Attorney are responsible for defending the City’s assessments, as well as approving settlements prior to judgment. Since the City Commission certified the 2010 Assessment Roll, there have been a total of \$95 thousand of judgments made and settlements offered which are adverse to the City, inclusive of changes made to the 2010 Assessment/Tax Roll, as well as for prior tax years.

Thus, the overall reduction in 2010 General Fund property tax revenues, as compared to the FY 2010 – 11 Adopted Budget is currently \$385 thousand.

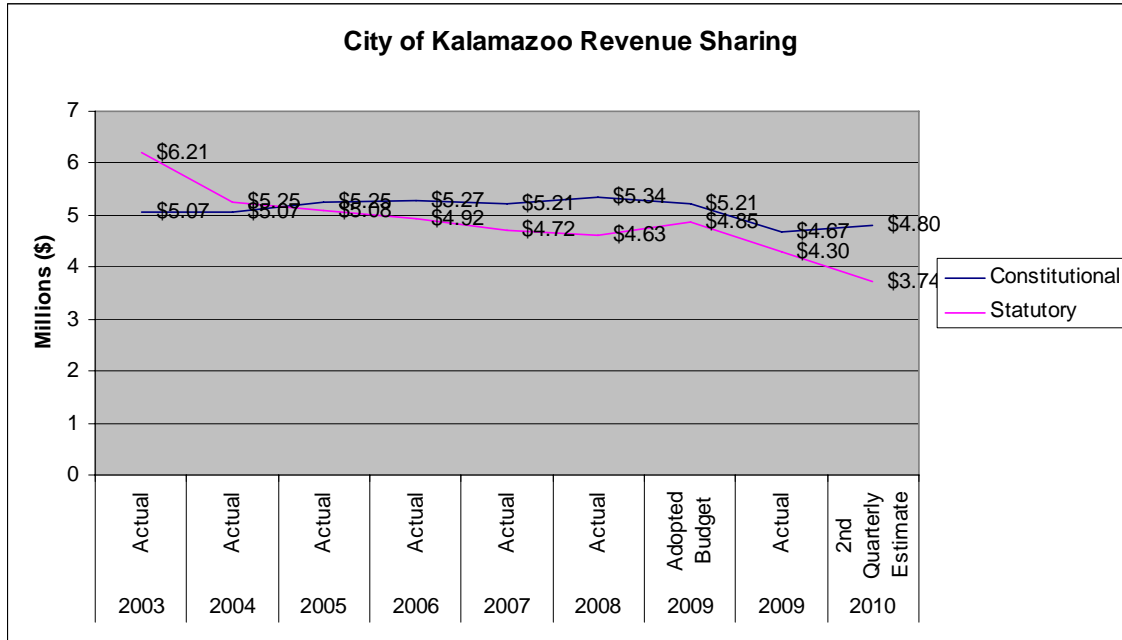
The FY 2011 property tax revenue forecast summary:

- 2011 Residential: decrease Taxable Value by -0.4% or \$60 thousand of General Fund tax revenue when compared to the FY 2010 Budget as adopted by the City Commission in January 2010;
- 2011 Commercial/Industrial: a decrease in Taxable Value by -0.5% or \$70 thousand of General Fund tax revenue when compared to the FY 2010 -11 Budget as adopted by the City Commission in January 2010;

- 2011 Personal Property: annual depreciation of personal property assets will create a projected loss of \$7 million of Taxable Value. At this time, we are not projecting any offset based on new equipment purchases. This would amount to a \$150 thousand loss of General Fund revenue in 2011 when compared to the FY 2010 -11 Budget as adopted by the City Commission in January 2010;
- Appeals: as indicated above, the impact of existing determinations regarding assessment appeals will result in a reduction in General Fund property taxes of \$30 thousand in FY 2011 when compared to the FY 2010 -11 Budget as adopted by the City Commission in January 2010.

The projection for FY 2011 is for a decrease of roughly \$310 thousand in tax revenue when compared to the FY 2010 - 11 Budget as adopted by the City Commission in January 2010.

State Revenue Sharing



Source: Treasury.gov and Michigan Department of Treasury

Table 23

REVENUE SHARING ESTIMATES		
(Thousands \$)	Scenario #1: 5% Cut in State's FY 2010 – 11 Budget = change vs. City's FY 2009 – 2011 Estimated & budgeted Amounts.	Scenario #2: 10% Cut in State's FY 2010 – 11 Budget = change vs. City's FY 2009 – 2011 Estimated & budgeted Amounts.
2009	-\$271	-\$271
2010	+\$187	-\$129
2011	+\$874	+\$300
Total	+\$790	-\$100

Table 24

<http://www.senate.michigan.gov/sfa/Publications/BudUpdates/OverviewGovsRecFY11.pdf>

Analysis

According to the Michigan Department of Treasury, the latest numbers from the May 2010 Revenue Estimating Conference show that sales tax collections for the state are expected to be down roughly 3.4% vs. the State's FY 09-10 budgeted amount. The State Treasury currently estimates that the August 2010 "catch-up" distribution will net the same amount of Revenue Sharing that was estimated for FY 2009 and budgeted for FY 2010 in the City's General Fund according to the FY 2010 – 11 Budget.

Looking Ahead

The City FY 2010 – 11 Budget estimates a 10% cut in Revenue Sharing effective for FY 2011, which would be a combination of four payments from the State's FY 2010 – 11 Budget and two payments from the State's FY 2011 – 12 Budget.

State's FY 2009 – 10: The May 2010 State of Michigan Revenue Estimating Conference resulted in projected surpluses in the School Aid Fund, as well as a balanced budget for the State's General Fund in FY 2010 – 11. In fact, revenues have come into the State better than the May projections.

State sales tax collections for the entire twelve-month period that will be applied to funding FY 2009-10 State Revenue Sharing (July 2009 – June 2010) shows a decline of only 2.65% vs. the same period for FY 2008-09, which exceeds the estimates from the May 2010 Revenue Estimating Conference.

A \$300 million gap has opened in the State's General Fund Budget for FY 2009 – 10. This is a 4% deficit, which must be closed by the State Legislature by September 30, 2010. Given that most of the State's Fiscal Year is already over, an annualized 4% cut at this point could be devastating.

Contacts in the Senate and House Fiscal Agencies agree that the Legislature is unlikely to cut Revenue Sharing to close the FY 2009 – 10 gap, since the State does have some reserve funds available, as well as a significant projected surplus in the School Aid Fund in FY 2010 – 11 to provide some temporary maneuvering space to deal with the General Fund issue.

State's FY 2010 – 11: The U.S. Senate recently delivered a major scare when they refused to appropriate Federal Medicaid reimbursement dollars (called "FMAP") to the States as promised. If this decision had stood, it would have had the effect of eliminating \$550 million of already planned revenue from the State's FY 2010 – 11 Budget. Just yesterday (Wednesday, August 4th), the U.S. Senate appropriated roughly one half of the FMAP dollars originally promised to the States. If re-affirmed by the U.S. House (as expected), these dollars will close most of the gap (according to recent reports, about \$300 million of the gap would be closed by this action) on the State's FY 2010 – 11 Budget. This would likely require a larger reduction in Revenue Sharing than the 4% reduction already passed by the Michigan Senate in May 2010.

SCENARIO #1: the Michigan Senate has already passed a 5% cut in Revenue Sharing for the State's FY 2010-11 Budget. This is less than the original estimated drop (10.0%) indicated in the City's FY 2010- 11 Adopted Budget. If this reduction were to hold, Revenue Sharing for the City for FY 2010 would likely be \$187 thousand more than currently projected, whereas Revenue Sharing for the City for FY 2011 would be \$874 thousand more than currently projected. In this case, total receipts for 2009 – 2011 would be approximately \$790 thousand more than current projections. The reduction in Revenue Sharing seems likely to be larger than the 5% at this time, due to the additional hole created by the FMAP shortfall described above.

SCENARIO #2: the \$200 – 250 million shortfall left over after the partial funding of FMAP translates to an additional 6-8% reduction in State Revenue Sharing, which when combined with the range of outcomes listed above, moves the range to a 5% to 12% cut, with a mid-point of 8.5%, a slightly smaller loss than anticipated in the 2010 budget). In this scenario, Revenue Sharing for the City for FY 2010 would likely be \$78 thousand more than currently projected, whereas Revenue Sharing for the City for FY 2011 would be \$574 thousand more than currently projected. In this case, total receipts for 2009 – 2011 would be approximately \$380 thousand more than current projections.

SCENARIO #3: If the State's final FY 2010-11 Budget includes cuts in Revenue Sharing that are equal to our original estimated drop (10.0%), Revenue Sharing for the City for FY 2010 would likely be \$129 thousand less than currently projected, whereas Revenue Sharing for the City for FY 2011 would be \$300

thousand more than currently projected. In this case, total receipts for 2009 – 2011 would be approximately \$100 thousand less than current projections. This appears unlikely at this time.

Summary: Given the recent legislative outcome in the U.S. Senate, the State's FY 2010 – 11 Budget appears to have a significant but surmountable shortfall. This would support the use of Scenario #2, resulting in a gain of \$78 thousand for the City's FY 2010, and a gain of \$574 thousand for FY 2011 over FY 2010 – 11 Adopted Budget projections.

Act 51 Revenue

According to the latest analysis conducted by the Michigan House Fiscal Agency on May 26, 2010 (see: <http://house.michigan.gov/hfa/transportation.asp>), the State is receiving gas tax revenues for FY 09-10 at a rate 1.3% lower than last year. Act 51 disbursements through Q2 of 2010 from the state to the City of Kalamazoo year to date are down less than 1% versus the first half of 2009. However, this is below adopted budget projections.

The State disbursed about \$344 million to cities in Act 51 money for the State's FY 2007-08.

The State distributed \$328 million to cities in Act 51 money for the State's FY 2008-09.

The House Fiscal Agency estimates that the State will distribute \$324 million for the State's FY 2009-10.

The Governor's Executive Budget for FY 2010 – 11 recommends distributions of \$321 million.

Act 51 revenues for the first half of 2010 are nearly the same as the first half of 2009, which would suggest a shortfall of roughly \$75 thousand in Act 51 revenue in the Major and Local Streets Funds in FY 2010 as compared to the FY 2010 Adopted Budget. Shortfalls in the road funds would have to be made up by reductions in road service levels and/or additional appropriations from the General Fund.

Interest earnings

The City's General Fund is projected to receive \$500 thousand in interest earnings in 2010. The historically low Federal Funds rate, which has suppressed short-term interest rates, is expected to continue at least until inflationary pressures emerge. Inflationary pressures usually cause changes in the Federal Funds rate within the first 6-12 months of an economic recovery. Positive GNP has been experienced since the third quarter of 2009. It would be reasonable to expect inflationary pressures to cause rate adjustments in the near future. However, to-date, inflation has remained largely in check.

While the City generally keeps about 40% of its cash in liquid investments (which are basically tied to the Federal Funds rate), the City has been successful in maintaining a little more than \$20 million dollars in intermediate investments. As these investments come due over the next year, the City will keep more dollars short in an attempt to avoid locking in low rates any longer than necessary to maintain reasonable maturity diversification.

The General Fund should be on target to receive the budgeted amount of interest earnings in 2010 versus the Adopted 2010 Budget consistent with prior year posted earnings.

American Recovery and Reinvestment Act

General Fund Savings Due to ARRA

	2009	2010
Staff	\$72,586	\$842,426 *
Programs	\$150,000	\$150,000
CIP	\$1,201,244	\$1,492,000
Bond Savings	\$90,000	\$160,000
TOTAL	\$1,513,830	\$2,644,426

* Includes \$633K of \$1.9M COPS Grant to be spent over three years

Additional ARRA Funding for Programs to be Spent over the next 3 Years

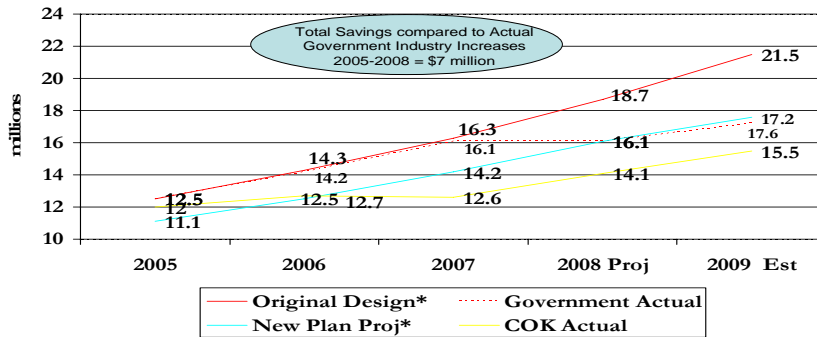
Neighborhood Stabilization Program 1 (NSP1)	\$1,700,000
Homeless Prevention & Rapid Rehousing Program (HPRP)	\$ 758,000
Community Development Block Grant (CDBG-R)	\$ 500,000
Neighborhood Stabilization Program 2 (NSP2)	<u>\$17,000,000*</u>
TOTAL	\$19,958,000

* - this is a county-wide allocation.

Expenditures

Health Care

Health Care Cost Comparison



*Source: Mercer Health Benefits Report 1/26/07

Table 25

Between 2005 and 2008, the City saved over \$7 million dollars by virtue of consolidating the employee health care plans from three a la carte offerings to one, as well as increasing cost-sharing measures such as monthly employee health care contributions, as well as co-pays and deductibles for care visits. The new contract with the Amalgamated Transit Union (ATU), effective January 1, 2010, means that every employee and retiree of the City will be on one plan, saving significant administrative and plan-design related costs.

Changes in behavior have helped constrain general health care inflation that continuously outstrips our growth in revenues. In the latest round of bargaining, the following changes were made:

- **Retiree Health Care:** new hires in KMEA (and the non-bargained for group) will receive a monthly stipend of \$75 to place into a health savings retirement account through MERS. This will result in approximately \$5 – 10 thousand of new annual expenditures over the next five years. This money is pre-tax for the employee and its use for health care costs is also tax-free.
- **Pharmacy Initiative:** A pharmacy initiative has been agreed to. This pledges the employees to taking steps to replace their use of name-brand drugs with generic drugs that come at much lower prices. The City spends over \$1 million in prescriptions every year, and a full 85% of drugs purchased by our employees are name-brand products.
- **Cost-Sharing:** existing cost-sharing amounts have been inflated nominally.

Savings realized since FY 2007 have created an unencumbered balance of \$4.5 million in the City's internal Insurance Fund. Other opportunities exist for the City to realize significant health care savings. Chief among them is mandating participation among KPSA and KPSOA retirees in the federal Medicare Part B program (which is currently optional in the respective collective bargaining agreements for these groups). **Savings of 5% of the City's accrued retiree health care liability could be realized by this one change alone.**

Energy

Energy and fuel costs through June 2010 are up 10% versus the same period last year, and are down 11% versus 2008 during the same period. The large drop when compared to 2008 versus is primarily due to the spike in prices for gasoline and diesel fuel in 2008.

According to the estimates of the Energy Information Administration (EIA) of the U.S. Department of Energy:

Gasoline: averaged \$3.26 per gallon in 2008, \$2.35 in 2009, are averaging \$2.84 for the first half of 2010, are projected to average **\$2.77** for the remainder of 2010, and are forecast to average \$2.90 in 2011.

<http://www.eia.doe.gov/steo>

Diesel: averaged \$3.80 per gallon in 2008, \$2.46 in 2009, are averaging \$2.95 for the first half of 2010, are projected to average **\$2.98** for the remainder of 2010, and are forecast to average **\$3.13** in 2011.

<http://www.eia.doe.gov/steo>

Natural Gas: averaged \$13.89/mcf in 2008, \$11.97 in 2009, are averaging **\$11.59** for the first half of 2010, are projected to average \$11.59 for the remainder of 2010, and are forecast to average \$12.56 in 2011.

<http://www.eia.doe.gov/steo>

Electricity: averaged 11.26 cents/kwh in 2008, 11.55 cents/kwh in 2009, are averaging **11.50** for the first half of 2010, are projected to average 11.64 cents/kwh for the remainder of 2010, and are forecast to average 11.96 in 2011. <http://www.eia.doe.gov/steo>

Energy expenditures total \$979 thousand for the General Fund for the first half of 2010. This represents a 10% increase versus the first half of 2009. If the second half of 2010 experiences the same rate of consumption as the first half, the General Fund would spend \$269 thousand less than the budgeted amount for 2010. If the same dollars for energy are spent as were spent for the last two quarters of 2009, the General Fund would spend \$139 thousand more than the budgeted amount for 2010.

Overtime

Public Safety OT: Public Safety overtime totals \$439 thousand for the first half of 2010, a 26% reduction versus the 1st Half of 2009. **If the last two quarters see the same percentage reduction as the first two, the projected overtime for 2010 would total \$529 thousand less than the budgeted amount for 2010. If Public Safety spends the same dollars in overtime as it did for the last two quarters of 2009, it will spend \$94 thousand less than budgeted in 2010.**

Non-Public Safety OT/non-Metro Transit (primarily Public Services OT): non-Public Safety overtime totals \$31 thousand for the first half of 2010, a 32% reduction versus the 1st half of 2009. **If the last second half see the same percentage reduction as the first half, then the projected overtime for 2010 would total roughly \$8 thousand less than the budgeted amount for 2010. If non-Public Safety departments spend the same dollars in overtime as they did for the last three quarters of 2009, the projected overtime for 2010 would total roughly \$14 thousand more than the budgeted amount. These savings or expenses accrue to the General Fund, however, the total amount of non-Public Safety overtime is minimal and the change is insignificant.**

Travel/conferences

Education and Training expenses in the General Fund (not including amounts to be reimbursed by the State of Michigan) totaled \$21 thousand in the 1st half of 2010, compared to \$68 thousand during the same period in 2009. **If the second half of 2010 experiences the same percentage reduction as the first half of 2010, expenses for 2010 would total \$170 thousand less than the budgeted amount for 2010. If the same dollars are expended in the second half of 2010 as was spent in the second half of 2009, expenses for 2010 would total \$134 thousand less than the budgeted amount for 2010.**

Telephone/Cell phones

Through the 2nd Quarter of 2010, telephone costs for the General Fund are recorded at \$92 thousand, inclusive of one-time charges that AT&T has agreed to credit back.

The expense of \$92 thousand represents a decrease of \$15 thousand or 14% over the same period in 2009. **If the second half of 2010 experiences the same percentage reduction as the first half of 2010, expenses for 2010 would total \$128 thousand less than the budgeted amount for 2010. If the same dollars are expended in the second half of 2010 as was spent in the second half of 2009, expenses for 2010 would total \$103 thousand less than the budgeted amount for 2010.**

Personnel Costs (non-overtime)

In the first half of 2010, the General Fund totaled \$17.2 million in personnel expenditures (excluding overtime), \$500 thousand less than in the first half of 2009, but very close to the same percentage of the annual budgeted expense (45.2% in the first half of 2010 vs. 45.0% in the first half of 2009). In the second half of 2009, personnel expenditures equaled 52.86% of the Budgeted amount, for a total positive variance of \$861 thousand in 2009.

If the percentage of the budgeted amount for personnel expended in the second half of 2010 is the same as it was in the second half of 2009, personnel expenditures would total \$733 thousand less than budgeted in FY 2010 for the General Fund.

Management Controls

Phase I (immediate)

Travel and Conferences: Limitations and Creative Solutions

Out-of-state travel has been limited to those events that are required to retain professional certification and other demonstrated needs. Employees are being encouraged to adopt creative ways to achieve professional development, including webinars and other on-line learning opportunities.

Telephone Cell Phone Usage Review

The Information Technology Department is working with staff from Budget and Accounting to develop a comprehensive review of telephony. Telephone units will be matched up to physical phone lines, and cell phones will be reviewed for business necessity.

Take-Home Vehicles and Car Allowance Review

The need for take-home vehicles is being reviewed at this time.

Selective Hiring Freeze

The Deputy City Manager, Human Resources Director and CFO have collaborated already on reviewing a number of requests to post job openings. Already several studies have been launched to see about re-designing tasks to achieve greater efficiency without simply replacing existing staff. In several cases, this review resulted in hiring a lower level staff person.

Overtime: Monitor and Control

The Public Safety Chief and Public Services Director have instituted a review of overtime, and are monitoring data and practices in order to limit the more than \$2 million of overtime spent in these departments. Other departments are being asked to do the same.

Phase II (if needed)

Furloughs: Voluntary and Involuntary

A Preliminary analysis indicates that if all employees who are paid directly by the General Fund were given an unpaid day off, the savings to the City would save roughly \$100,000. General Fund staff other than sworn Public Safety officers total about \$30,000 - \$35,000 a day. Minimum staffing levels in Public Safety would have to be examined carefully in order to determine furlough parameters within the sworn officer ranks and to avoid creating overtime replacements.

Early retirement

Given the renewed state of the Pension Trust Fund, enhanced retirement initiatives may be beneficial to the City. An analysis is being worked on during the 3rd Quarter of 2010.

Outsourcing and Operational Reductions, Program elimination

These opportunities are being looked at in many areas. The City Manager has asked for 10% "contingency" plans in order to prepare for anticipated cuts in FY2012 and FY2013, and also for any potential reductions that may be needed in FY2011.

Future Wage/Benefit Constraints

In light of the current state of the pension system, as well as issues with revenue sharing and property taxes, a heightened sense of the City's ability to pay to maintain staffing and service levels has been shared between the City management and collective bargaining leadership. In 2009, the City successfully negotiated economically rational agreements with ATU, AFSCME and KMEA, as well as the KPSOA.

Short term: If the outlook for revenue sharing and/or property taxes worsens significantly in the near term, the City would likely approach the bargaining units in an effort to restructure existing agreements as a way to preserve jobs and service levels. The City already approached several bargaining units in 2009 to discuss alternatives to layoffs.

Existing collective bargaining agreements with the KMEA and AFSCME include wage openers for 2011, which provides an opportunity to scale wage changes in accordance with the prevailing economic trends and financial need.

Long-term: The pension trust fund has experienced a dramatic turnaround. It may be beneficial to seek to close the defined benefit system to new hires, while retaining the defined benefit Pension benefit to existing retirees and employees. At this time, it does not appear to represent a benefit to the City.

Although converting new hires to defined contribution pension (similar to the change that was negotiated with KMEA to convert new hires to defined contribution health care) would involve a guaranteed annual expense to fund their retirement investment account, nevertheless such a change would gradually lessen the risk of unpredictable payments into the Pension Trust Fund. On the other hand, adding a guaranteed annual expense at a time when projected contributions to the Pension Trust Fund is over 15 years away, during a period of fiscal stress, does not seem advisable.

Capital deferment

The City plans to bond for over \$2.8 million in capital projects in 2010. While deferring capital improvements is by no means a preferred option, cutting out about \$1 million of projects from that list would save about \$500 thousand in interest payments every 5-7 years.

Due to previously budgeted capital projects that have been released, staff has identified roughly \$2 million of available capital reserves that has been reallocated in the FY 2010 – 11 Adopted Budget to priority capital projects such as critical road improvements.

In anticipation of the FY 2011 Budget process, project managers have been asked to reexamine capital projects to ensure that only essential projects are being planned, requested for budget authority, and implemented. Furthermore, ultimate project prioritization will be sensitized to the most pressing needs of the community at this time.

Cost Containment

The goal as set forth in the FY 2010 – 11 Adopted Budget and Fiscal Plan is to avoid the need for cuts in FY 2011 in the General Fund. The slippage of \$752 thousand as of the end of FY 2009 versus the projected net revenue is of concern, as well as the losses in property taxes and revenue sharing projected in this report.

In addition to the 10% contingency plans mentioned above, the City Manager has asked departments to engage in cost containment efforts by first identifying alternative methods to reduce cost while preserving services such as collaboration with other departments or organizations, as well as any new concepts that would alter how we do business and substantially reduce cost within an individual department or the entire organization.

It must be stressed that any further cuts that are needed that are enacted will be sensitized to maintain service levels to the community, so that across-the-board cuts are out of the question. Management will strive to achieve greater efficiencies and change the way we do business in order to keep the focus on delivering high-quality services to the public.

I wish to thank the dedicated staff in Management Services for their assistance and support in this process, particularly Phil Miller, Connie Darling and Wayne Nelson.

Thomas C. Skrobola
Director of Management Services/CFO