Tough Times

Strategies for Stressed Budgets

It's hardly news to township officials anywhere in Michigan that this is a financially challenging period. The dramatic decrease in revenue sharing over the past few years has created a revenue vacuum for many townships, and the ongoing pressures of Headlee and Proposal A have been further exacerbated by real estate devaluation. Michigan's townships are finding it difficult to balance rising expenses with increasingly limited dollars.

The status quo is simply not an option in this financial environment. To assure financial viability, townships must identify means for further increasing cost-effectiveness and productivity. Historically efficient in their operations, townships must continue to search for ways of "doing more with less" and maximize the use of scarce resources to meet service demands.

As a first step in this process, township officials should explore all viable options at their disposal. This may involve modifying traditional methods of doing business. In other cases, it may involve assuming a more entrepreneurial posture—possibly to include private sector approaches to business management. Simply put, *all* viable options should be on the table.

As a further challenge, townships must face the realization that the current economic crisis will likely not be short-lived. There is evidence that things may worsen further and push the recovery well into the next decade. As a result, elected officials may be required to go beyond the "easy answers" and work toward the development of real solutions that produce long-term, meaningful results.

As difficult as this can be, there are opportunities to increase productivity in any operation—public or private. The following article introduces township officials to a number of ideas for pre-emptively planning for the future and/or improving the cost-effectiveness of operating practices. Not all of these ideas will apply to all townships. Michigan's townships vary greatly in population, organizational structure and service scope. There

This continuing education article and accompanying self-assessment is worth 2.0 elective credits in MTA's Township Governance Academy. See page 23 for details.

OBJECTIVES

- Compel officials to consider long-term solutions to alleviate fiscal distress
- Offer tips on applying strategic planning in fiscal considerations

CORE COMPETENCIES

- To utilize strategic planning to attain objectives
- To be aware of financial matters affecting the township

is no "one-size-fits-all" formula for a governmental structure that is so diverse. The cost-saving or revenue-enhancing options available to a particular township may be broad or narrow depending on its composition. The following discussion recognizes this fact and attempts to present a wide assortment of actions that are, in some cases, applicable to all townships.

EVALUATE TRENDS WITH A MULTI-YEAR BUDGET MODEL

Municipal budgeting is typically an annual process, building on the budgets developed in prior years. From an overall perspective, a municipality will seek to accurately quantify expected revenue inflows and match spending levels accordingly. Depending on the level of service needed, a township may seek to increase or spend down fund balances.

The municipal budget process depends on identifiable revenue sources to determine the levels of expenditure. As such, it can be described as an input-driven process. In contrast, the private sector can be described as output-driven, depending on "back-end" revenues and measures such as net profit or the "bottom line" to measure success. To assure ongoing profitability, a private business will frequently use long-range forecasts and multi-year budget models to measure the likelihood of future returns. Input-driven governments have not traditionally used this forecasting approach.

However, as revenue inputs have become less certain in recent years, more municipal governments are embracing the notion of multi-year budgeting as a planning tool. The growing use of automated spreadsheet programs has facilitated and encouraged this practice by providing an inexpensive and readily accessible automated tool that can be used to create an interactive budget program.

A financial model, properly conceived, will allow a township to view finances from an overall, long-range perspective. This can allow for pre-emptive planning and the avoidance of reactive decision-making that can threaten core services. A model can provide the ability to chart, illustrate and present a longer-range view of the township's financial choices. In a challenging fiscal environment, this is a logical and necessary starting point. *(Turn to page 21 for more on "fiscal forecasting.")*

SCRUTINIZE ADMINISTRATIVE CHARGES

A township's general fund accounts for the operations of the general government, including basic administrative services such as finance, personnel management, and overall policy and general management. Michigan law allows a township to establish administrative fee levels and charges to other funds for a portion of general overhead for services such as accounting, payroll, budget and personnel management services, and liability insurance.

Many townships have enterprise funds—typically water and sewer. These funds are expected to operate as separate business concerns. To do so, they require an administrative component. To fill this void, a township will provide the services required for day-to-day operations. The township will then assign a charge to recoup the cost of these services.

The tax assessment system's market data is only beginning to catch up with the decline in property values. Further reductions in housing values will continue to negatively impact taxable value and revenue generation. With this backdrop, Michigan's townships must make difficult decisions regarding service funding.

Under Michigan law, the administrative charge must be "reasonable." Faced with this vagary and the desire to legally conform, many townships undercharge for these services, thus creating a situation in which the general fund is effectively subsidizing the operation of another fund(s).

While this might seem to be an area of modest revenue potential, the opposite can be true. A township may wish to complete a cost allocation study, focusing on administrative charges due from the various departments operating through funds other than the general fund. Such a study measures the amount of administrative services utilized by each operation. In the end result, the township may find the need for the adoption of a new formula for administrative charges—which can increase general fund revenue.

A large-scale study is not always necessary to realize some improvement in the allocation of administrative charges. Many common-sense items are simply overlooked. Insurance coverage is often heavily weighted to liability coverage for the utilities. The specifics of a policy should be closely examined with costs allocated fairly to the utility fund. Similarly, a township finance director or utility clerk could be spending an inordinate amount of time on utility matters, both directly and indirectly—as could the supervisor and/or township board. This input should be monitored and charged. Human resource activities such as hiring, contract negotiations or records management should also be considered, as should legal fees, information technology costs and other cost components that could be equitably spread.

Any township can benefit from an analytic approach to the allocation of administrative charges. This effort should proceed from a desire to determine a level that is fair, accurate and defensible. All applicable funds should be targeted with results revisited regularly and adjusted accordingly.

EVALUATE CASH MANAGEMENT AND INVESTMENT PRACTICES

Most township officials would agree that idle cash should be invested to realize the most efficient return on investment. However, few follow a system that will achieve this objective. It is necessary to establish ongoing cash requirements. In turn, investments on the remainder of the assets can then be structured to achieve the best rate of return.

The first step in this process—establishing a cash flow model—is relatively easy for a township government. Primary revenue inflows, such as property taxes and state-shared revenues, are received at predictable intervals and can be easily charted. Similarly, most major expenses, including payroll, occur at consistent points in time. Charting all of these inflows and outflows will provide a clear picture of how much money is available—and when it will be needed. Armed with this information, a township can make rational decisions regarding the term (length) of investments. Since longer-term investments typically provide a higher yield, investment return can be maximized—assuming the proper mix of investments.

All Michigan municipalities must have a formal investment policy. Most provide the option of a variety of investment vehicles including certificates of deposit (CDs), treasury bills, commercial paper and others. However, many townships limit their investment options to traditional bank accounts, sweep accounts and short-term CDs. In many cases, a more expansive investment approach, supported by a cash flow analysis, would increase yield—possibly with minimal or no additional risk.

Visit www.michigantownships.org/investments.asp for resources and information on township investment policies, or contact an investment advisor for additional guidance.

EXPLORE INTERGOVERNMENTAL COOPERATION

As autonomous governmental units, townships are under constant pressure to provide the widest possible scope of services with available resources. In some cases, townships provide these services singularly or in cooperation with others. For instance, a township may have a fire department or participate in a larger fire authority or district that may achieve some economy-of-scale. Sharing the cost burden can reduce the costs for each entity and allow, for example, for the creation of a broad, expansive parks and recreation system that could better meet the leisure desires of all residents.

As finances have worsened, service consolidation is getting more attention. Some townships may not even consider working with other local governments, simply because the barriers seem too daunting. Fear of losing control and wariness on the part of residents are factors that may need to be addressed prior to the execution of any agreement. Certainly, consolidating certain services with other municipalities is not always the answer. However, with proper planning, open minds and good lines of communications, township officials can explore intergovernmental cooperation as a means to continue offering valuable services in today's current financial climate.

EVALUATE STAFFING IN RELATION TO OPERATING METHODS AND AVAILABLE OPTIONS

Personnel costs can represent a large portion of a township's operating budget. In addition to the recurring nature of these costs, the benefit portion of compensation is becoming a greater burden with each passing fiscal year. Townships generally seek to be cost-efficient about staffing and employment. However, there can be opportunities for personnel reductions. In some cases, newer equipment, automation or changes in operating procedures can effectively eliminate the need for some personnel. In other cases, part-time or seasonal personnel, rather than full-time assignments, can fill service needs adequately in departments ranging from finance and treasury, to parks and police.

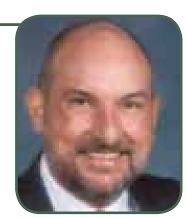
This can also be true in evaluating how some services can be performed more efficiently through outsourcing. As one example, building and trade inspectors are often employed in-house. But a township can also contract for these services by paying a third-party building inspector a percentage of permit fees. In a down economy, that can be more efficient than having an underutilized employee with a full salary and benefits package. In the area of finance, some townships outsource functions such as payroll, investment management, information technology or general ledger accounting to achieve cost savings. Other options, focusing on other departments, also exist and should be increasingly scrutinized as revenues continue to stagnate.

In many cases, resistance to change is the impediment that must be overcome. The reluctance to employ cut-back management practices on existing employees is one such impediment, as is the political fallout that some changes would engender. In a time of financial challenge, these impediments often dwindle in importance. Instead, many local governments are finding that staffing reductions or contracting with private vendors must be undertaken simply to maintain acceptable service levels.

To soften the blow, cutbacks can sometimes be achieved through attrition or one-time pension "sweeteners" to staff—but only if such options are included in the township personnel policy. Townships should consult with legal counsel for additional information on this option.

TIPS FOR TOUGH TIMES

All Michigan townships, regardless of size, face the common issues and challenges presented by the current economic environment. As service demands increase, all will face the continuing stress of "doing more with less." The response must be a continuing search for innovative solutions. These "tips for tough times" can be building blocks to aid in this process. ■



Mark Nottley, MPA, SPHR, Principal,
Governmental Consulting Division Director,
Rehmann Group, Farmington Hills
The author can be reached at (517) 841-4912 or mark.nottley@rehmann.com.

Financial forecasting

These are difficult times for many local governments in Michigan. The challenges faced by local leaders include a wide range of daunting realities, such as:

- the loss of major taxpayers
- declining property values
- increasing numbers of foreclosed properties
- reductions to public services
- burdensome unfunded liabilities
- uncertainty regarding the future of state revenue sharing
- a lingering recession that threatens jobs and community stability

The trouble that started on Wall Street is felt on Main Street, and the impact at the local level is unprecedented. According to a recently issued white paper from the International City/County Management Association, "the economic crisis is deeper and more severe than what we have experienced in the past 50 years." Some analysts believe we are now at the "end of the beginning" of this downturn. It could still be five to 10 years before some communities recover their financial footing.

Dire predictions abound and things seem so unpredictable. How can townships manage through these troubled times?

One solution many communities are turning to is long-term financial forecasting. No one can look into a crystal ball to see the future in terms of the financial crisis, revenue sharing, home values and community needs—but it's clear that small changes now can have a significant impact on finances years down the road. A well-developed financial forecast incorporates many variables and can be used to test the impacts of different assumptions in future years—in good times and bad.

SHORT-TERM CHANGES, LONG-TERM CONSEQUENCES

When the yearly budget cycle approaches, many township officials likely consider the revenues and expenditures of the prior year or two. Then they build a budget for the next fiscal year based on those historical values, with slight modifications to meet the anticipated priorities of the coming year.

A single year is a fairly narrow horizon in the life of a township. The decisions you make today have an impact far beyond just the approaching budget year. To be truly fiscally responsible, townships must expand their horizons and use longer-term financial forecasting.

When implemented correctly, a financial forecast can:

- anticipate periods of revenue shortfalls
- enable "what-if" analysis related to compensation, service levels, revenue sharing and a host of other financial variables
- provide a single source of information for dialogue and decision-making
- facilitate the process of budget prioritization
- help evaluate the potential long-term impacts of proposed new or expanded service offerings before implementation
- minimize short-term borrowing and maximize interest earnings
- serve as a framework for developing a working plan to meet anticipated budgetary needs in the future

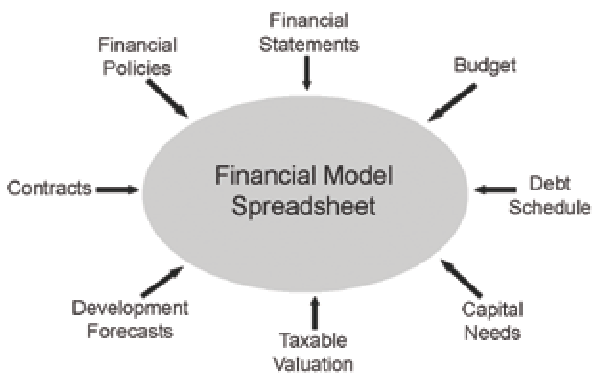
A financial forecast is basically an integrated spreadsheet file that incorporates many existing financial documents into a single source. This financial management tool enables decision-makers to look beyond the current and upcoming fiscal years, and can help your township predict its future financial position, based on all the financial information in the township. Financial forecasting often works best when used to look five years into the future—it's just far enough out to see the cumulative impact of decisions made today, but not so far away that the impact becomes merely theoretical.

GETTING STARTED: THE SAME INFORMATION FOR EVERYONE

While financial forecasting is a huge help to township governments, the biggest hurdle they face is at the beginning of the process—gathering all the financial information needed in a single place. It can seem a Herculean task since the needed data usually hasn't been centralized: taxable valuations are managed in one place, contracts in another, and so on.

Once you've gathered all the necessary information into a solid financial model spreadsheet, then you've got a powerful tool that presents a single, big picture of revenues, expenditures and fund balances. This allows for an overview so that everyone—elected officials, administrators and the public—can see the impact of current decisions on the future. While everyone certainly won't agree on the best course, all will be working off the same basic information and can see the long-term financial impact of decisions made regarding services.

To create a five-year plan, it's imperative to gather the following information:



'WHAT-IF' SCENARIOS

Once you've collected all the necessary information for your financial forecasting model, developed assumptions for future years and linked all of the information together, the benefits become immediately obvious. You'll gain the ability to efficiently evaluate a wide range of financial data by changing a few cells in the spreadsheet.

What if, for example, a township board wanted to better understand the impact of a recently adopted wage and salary increase for employees? After implementing a fiscal forecasting spreadsheet, it becomes much easier to investigate various scenarios, such as one with a modest increase for two years with a boost in years three, four and five, versus a more generous increase of 3 percent for each of the five years.

As shown in the example below, when looking only at a single year, the generous proposal seemed affordable. But when projecting the increases over five years, the outlook was more disconcerting. The cost of the year-after-year generous increase would place a much larger strain on the general fund than officials had anticipated—decreasing the township's ending balance by about $3.2 million over the more modest proposal.

	Modest Assumptions	**Generous Assumptions**
Year 1	1%	3%
Year 2	1%	3%
Year 3	2.75%	3%
Year 4	2.75%	3%
Year 5	2.75%	3%
Ending balance after 5 years:	$7,921,168	$4,690,008
Difference: $3,231,160		

Fiscal forecasting allows the township to make an informed decision, and see the impact of each "what-if" scenario on the bottom line.

That is the beauty of a properly constructed financial forecasting model: the ability to see the future financial impact of today's decisions for each piece of information collected. Can the township afford to build a new fire station? What is the budgetary impact of declining property tax revenue? How do rising gasoline prices affect the budget? Nearly all scenarios can be tested: changes in taxation, union proposals, health plan increases, etc.

Armed with this data, the township is able to provide better projections for investors, elected officials, labor negotiations and the public. You have consistent information that can help:

- evaluate the impact of proposed budgets, policies, legislation or changes to operations
- test scenarios involving compensation, capital projects, debt or revenue options
- support grant and millage requests
- provide useful information in negotiations and arbitration
- establish appropriate financial management policies

Consider, for example, a township interested in building a new municipal building. A brief look at each fund's projected year-end balance shows that some departments that would benefit

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from the building were able to afford it. But when financial information for the general fund is included into an integrated forecasting model, the township board sees that the general fund was in real trouble, and makes the prudent decision to put the new building on hold and address the shortages in the general fund.

DYNAMIC AND LONG-SERVING

A financial forecasting model doesn't create a budget written in stone; it creates a dynamic, working document that can help your township plan for the future—whether it's years of continued recession or a return to semi-normalcy. With the ability to test scenarios (i.e., "What if the millage doesn't pass?"), evaluate the longer-term impact of a budget and help prepare for periods of fiscal restraint, a financial forecasting model is an invaluable tool that promotes dialogue and can help create a working plan for a financially fit township in the years to come. ■

John Kaczor, MPP, Senior Government Financial Consultant, Rehmann Group, Ann Arbor
Kaczor can be reached at (734) 277-4454 or john.kaczor@rehmann.com.

A basic template of a municipal financial model can be found at www.michigan.gov/treasury (click on "Local Unit Fiscal Forecasting Estimator"). This free tool is available for local governments that wish to develop a very broad overview of their financial position. A more comprehensive, dynamic model could provide even more usability and accurate forecasts.

Turn to page 24 for a continuing education self-assessment, worth 2.0 elective credits in MTA's Township Governance Academy.

Continuing Education Self-Assessment

Participants enrolled in the Township Governance Academy (TGA), a credentialing program offered through MTA, may obtain 2.0 elective credits for successful completion of this quiz. To obtain credit, participants must answer the following 10 multiple-choice questions by circling the correct answer and receive a minimum passing score of 70 percent. The questions are based on content from the article, “Tough Times—Tips for Stressed Township Budgets” beginning on page 18.

There is no charge to take the quiz or to obtain TGA credit. Completed quizzes should be sent to: MTA Education Center, 512 Westshire Drive, Lansing, MI 48917, or faxed to (517) 321-8908. MTA will notify you of your results within two weeks after receiving your quiz. IMPORTANT: Please keep a copy of your completed quiz in your TGA binder.

Township officials interested in enrolling in TGA may call Shelley Tucker, MTA education specialist, at (517) 321-6467, ext. 251, or for more information, visit www.michigantownships.org/tga.asp.

TGA Continuing Education—November 2009
“Tough Times—Tips for Stressed Township Budgets”
2.0 Elective Credits

(To receive credit, this quiz must be completed by Nov. 1, 2013.)

NAME: ______________________________ **TOWNSHIP & COUNTY:** ______________________________

ADDRESS: ____________________________________ **CITY/ZIP:** ______________________________

E-MAIL ADDRESS: ____

1. The revenue vacuum townships are facing has been created by:
- a. Ongoing pressures of Headlee and Proposal A
- b. Real estate devaluation
- c. The dramatic decrease in revenue sharing
- d. A global economic downturn

2. The municipal budget process depends on:
- a. “Back-end” revenues and measures
- b. Identifiable revenue sources to determine the levels of expenditure
- c. A “one-size-fits-all” governmental formula
- d. Improving the cost-effectiveness of operating practices

3. Which of the following costs can represent the largest portion of most municipal operating budgets?
- a. Personnel costs
- b. Office supplies
- c. New equipment
- d. Automation

4. Under Michigan law, the administrative charge to provide services required for day-to-day operations must be:
- a. Subsidized by the general fund
- b. Revenue enhancing
- c. Rounded up to the nearest dollar
- d. Reasonable

5. All Michigan municipalities MUST:
- a. Limit their investment options to traditional bank accounts and short-term CDs
- b. Limit investment options to those yielding no additional risk
- c. Have a formal investment policy
- d. Use long-term investments, which provide a higher yield

6. Considered the most severe economic crisis the U.S. has experienced in 50 years, analysts believe:
- a. We are at the end of the downturn
- b. We are at the beginning of the downturn
- c. Communities could recover financial footing in three years
- d. It could still be five to 10 years before communities recover financial footing

7. A financial forecast is:
- a. Best when used to look 10 years into the future
- b. An integrated spreadsheet file that incorporates many existing financial documents into a single source
- c. A tool that looks at current and upcoming fiscal years
- d. All of the above

8. To create a five-year plan, it’s imperative to gather:
- a. Financial policies, statements and budgets
- b. Contracts and development forecasts
- c. Debt schedules, capital needs and taxable valuations
- d. All of the above

9. Financial forecasting best benefits:
- a. Elected officials, administrators and the public
- b. Elected officials and county administrators
- c. The public and state Legislature
- D. State treasury officials

10. A financial forecasting model creates:
- a. A reliable budget
- b. A tool to evaluate the short-term impact of a budget
- c. A working document that can help a township plan for the future
- d. A return to semi-normalcy