

September 12, 2007

To the Honorable Mayor and
Members of the City Council
City of Saline
100 North Harris Street
Saline, Michigan 48176

Dear Mayor and Council Members:

We have recently completed our audit of the City of Saline's (the "City") financial statements for the year ended June 30, 2007. For your information, we have provided information on several legislative issues that could impact the City. Before we discuss these items further, however, we would like to compliment the staff for their continued assistance during our engagement and for the overall positive condition of the financial records and related documentation.

Legislative Issues

Revenue Sharing

The future of the State's revenue sharing program continues to be directly tied to the condition of the State's budget. Reductions to statutory revenue sharing started in 2001 as shortfalls began occurring in the State's budget. The State's budget shortfalls continue to be significant. The magnitude of the State's deficit has become even more pronounced after the State's January and May 2007 revenue-estimating conferences. According to economists, Michigan is still approximately \$1.8 billion short of the revenue needed to cover basic services for the State's upcoming fiscal year 2007/2008 budget. It is not completely clear whether the State's fiscal year 2006/2007 budget has been completely balanced as well. The outcome of other matters will also impact revenue sharing and those matters include:

- **Future of County Participation in Statutory Revenue Sharing** - In 2004, the State terminated payment of statutory revenue sharing to counties (which was approximately \$182 million) but allowed counties to move their operating tax levy to July from December. Counties are required to deposit the additional monies from the earlier levy into a "reserve fund" which is to be used by the counties to replace lost statutory revenue sharing in future years. The question that remains is when the reserve funds established by counties are depleted, will counties come back into the "revenue-sharing formula" and to what extent? Will the size of the statutory pot grow to accommodate counties or will there be a shift of the same monies from cities, villages, and townships to the counties?
- **Statutory Revenue Sharing Formula Expires in 2007** - Legislative action is required on this Act for appropriations to continue into 2008 and beyond.

- Changes to Michigan's Tax Structure** - The Michigan single business tax has been eliminated effective on December 31, 2007, which will result in the loss of \$1.9 billion from the State's budget in 2008. In June 2007, a replacement for the single business tax - called the new Michigan business tax - was approved by the legislature. More details on this new tax structure are included below. In the overview, the plan creates a new tax structure for Michigan businesses, provides further personal property tax relief to business taxpayers, and is forecasted by the State to generate about the same revenue (\$1.9 billion) as the single business tax. Technical corrections on this recently passed law are still pending and the law is lengthy and complex. The true financial impact on the State's budget is hard to predict. Rumors on further changes to Michigan's tax structure continue to circulate around Lansing as the legislature continues their work on the State's fiscal year 2007/2008 budget and solving the estimated \$1.8 billion deficit that exists.

As introduced, the governor's budget for fiscal year 2007/2008 includes a revenue-sharing increase of \$27 million to be distributed using the three-part formula currently contained in the revenue-sharing act (taxable value per capita, population/unit type, and yield equalization) with an additional \$14.5 million for public safety funding. While specific details have not been announced yet, communities would only be eligible for the increase if they can demonstrate service sharing with other local governments.

While the debate is in process and all indications point to a very busy September for the legislature, there still remain considerably more questions than answers regarding long-term funding of statutory revenue sharing. Decisions still remain on the ultimate funding level for revenue sharing for the State's fiscal years 2006/2007 and 2007/2008. Local governments may need to react with budget amendments when these final decisions are made by the State.

Below is a summary of the City's revenue-sharing payment receipts during the State's fiscal years beginning in 2001:

State Fiscal Year	Statutory	Constitutional	Total	Decrease from 2001	Cumulative Decrease
2001	\$ 495,751	\$ 521,343	\$ 1,017,094	\$ -	\$ -
2002	441,094	526,655	967,749	49,345	49,345
2003	370,329	535,571	905,900	111,194	160,539
2004	284,426	529,754	814,180	202,914	363,453
2005	262,910	542,395	805,305	211,789	575,242
2006	244,716	551,629	796,345	220,749	795,991
2007	232,463	540,167	772,630	244,464	1,040,455
2008*	225,994	546,636	772,630	244,464	1,284,919

* Estimated

If the State were to eliminate the statutory portion of revenue sharing (as the constitutional portion cannot be modified without a change to the State's constitution), the City has \$225,994 at risk in its General Fund budget based on 2007 funding levels. In light of the current environment, we strongly encourage local governments to be conservative when budgeting or projecting the revenue sharing line item.

New Michigan Business Tax

As previously indicated, the new Michigan business tax (MBT) was approved by the legislature in June 2007 and replaces the single business tax (SBT) which expires on December 31, 2007. According to the State, the new MBT is intended to generate about the same \$1.9 billion generated by the expiring SBT

While the MBT intended to simplify the old SBT, the MBT is a very lengthy and complicated new law. The new MBT imposes two taxes - a modified gross receipts tax and a business income tax. The modified gross receipts tax is imposed at .8 percent on a tax base composed of gross receipts less certain purchases. The business income tax will be imposed at a rate of less than 5 percent on business income. The MBT provides for new investment, compensation, and research and development credits to businesses. The MBT also allows certain qualified small businesses to opt out of the MBT and pay a straight 1.8 percent tax on adjusted business income.

More personal property tax relief is also part of the new MBT. Business personal property classified as "industrial" or "commercial" will be exempt from certain personal property taxes – specifically from the State Education Tax (SET) and local school operating mills. "Industrial" personal property will receive exemptions from the 6 SET mills and the 18 schools operating mills (for a total 24 mill exemption). "Commercial" personal property will be exempt from 12 of the 18 school operating mills.

These newly enacted personal property tax exemptions will mean that local governments will collect less school taxes on these properties. For local governments that have enacted an administrative fee on tax collections, they will likely see a decrease in the administration fees that have traditionally been collected. Also, for those local governments with tax increment financing authorities that continue to have existing eligible obligations outstanding and are therefore allowed to capture school taxes (to the extent of these eligible obligations), the personal property tax exemptions on school millages will likely decrease the amount of school taxes available to capture.

Given the favorable tax treatment of industrial versus commercial personal property, it is expected that businesses will be re-reviewing the classification of their personal property. Your assessor will likely receive more frequent inquiries and requests to change classification of personal property to take the most advantage of the tax break afforded to industrial property and commercial property and the additional relief available for industrial property.

As we understand it now, these are the areas at the local governmental level (i.e., impact on administrative fees, impact on school dollars available for capture for certain tax increment financing authorities, property classifications) that are the most directly impacted by the new MBT.

We will keep you updated as we continue to explore these and other issues regarding the impact of the MBT on local units of government.

New Cable Franchise Legislation

The governor signed cable franchise legislation (House Bill 6456) into law effective January 1, 2007. The new law (Public Act 480 of 2006) creates the Uniform Video Services Local Franchise Act which provides a statewide framework for franchising agreements instead of individual community agreements. This Act requires video service providers to obtain a local franchise, good for 10 years, from the franchising entity (the local unit of government). As part of the local franchise, the provider is required to pay an annual video service provider fee, not to exceed 5 percent of gross revenue, as well as an annual fee for the costs of the PEG access facilities, not to exceed 2 percent of gross revenue. The Act allows providers to terminate the current franchise contracts before their expiration date in order to enter into this new local franchise agreement under the statewide framework.

Local units of government will be impacted in the following ways:

- Under the Act, no additional fees or charges other than those stipulated under the Act may be written into the local franchise agreements.
- To the extent existing cable franchise agreements provided more funding than provided for under the new Act, municipalities will see reduced fees from these new local franchise agreements.
- A credit, based on annual maintenance fees paid for use of public rights of way, to video service providers is allowed under the Act. This credit could eliminate or significantly reduce any revenue the local unit might receive under the bills' franchise fee.
- Audits of the video service providers' calculation of gross revenue are limited to once every two years.

Subsequent to the passage of the Act, amendments have been proposed in both the House and the Senate (House Bill 5047 and Senate Bill 636) to clarify language about the ability of local governments to receive PEG fees.

Municipal Finance Act Revisions - Reminder

The Municipal Finance Act was amended several years ago. Communities are now required to submit a municipal qualifying statement once a year with the Michigan Department of Treasury. The old 10-day "exemption from prior approval" process has been eliminated and is replaced with this qualification process. This filing will serve as a pre-approval for future debt issues. The current filing is due within six months of the City's year ended June 30, 2007 and is good for one year thereafter. The City should consider the need to file this qualifying statement for each of its component units.

Funding of Postemployment Benefit Obligations

As mentioned in the prior years, the Governmental Accounting Standards Board has recently released Statement Number 45, *Accounting and Reporting by Employers for Postemployment Benefits Other Than Pensions*. The new pronouncement provides guidance for local units of government in recognizing the cost of retiree healthcare benefits.

The intent of the new rules is to recognize the cost of providing retiree healthcare coverage over the working life of the employee, which also represents the period in which the benefits are being earned, rather than at the time the healthcare premiums are paid.


These new rules will apply to the government-wide financial statements, rather than the individual fund level. For many communities, the funding of postemployment benefits is the most significant financial challenge they will face in coming years. The statement will not be effective until the City's fiscal year ending June 30, 2009. The cost of health care currently paid each year as premiums become due has been increasing and the trend is expected to continue.

However, as previously mentioned, the City is part of an elite minority of communities that have already taken action in order to address this GASB pronouncement, including obtaining an actuarial valuation, and has begun to accumulate resources to fund the future liability. The vast majority of communities have not yet established any funding for this significant item.

We would like to thank the City and all those involved with the audit process for their assistance. If any questions arise upon reviewing the financial statements or on the above comments, we would be happy to discuss them with you or assist in the implementation of any of the recommendations. Thank you for the continued opportunity to be of service.

Very truly yours,

Plante & Moran, PLLC



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