Village of Newberry
Luce County, Michigan

Ten Year Financial Health Assessment

For the Years Ending December 31, 2008 – 2017

Prepared by Plante & Moran, PLLC

Scope of Services Provided

As detailed in our engagement letter dated July 22, 2018, we have performed a 10 year analysis of the Village's historical financial statements (years ended June 30, 2008 – 2017) for the General Fund, Major Streets Fund, Local Streets Fund, Electric Fund, Water Fund, and Sewer Fund. The purpose of this analysis is to take a more in depth look at the financial history of the Village. To do this, we have analyzed long-term trends affecting a variety of financial elements including cash, fund balance, interfund borrowings, and original vs. actual budget results in these funds. This analysis provides the necessary data to draw conclusions on whether the Village as a whole and individual fund's financial position has been improving, eroding, or staying consistent over time and how successful the Village has been with projecting its annual budget. In addition to the health of the funds, another key component of this analysis is the Village's liability for legacy costs such as pension and retiree healthcare.

The data used in our analysis is all drawn from the audited financial statements of the Village for the years ending December 31, 2008 to 2016 and a draft report of the 2017 audit. Unfortunately, the 2017 audit was not yet finalized as of the writing of this report; however, the Village's external auditor, the Michigan Department of Treasury, prepared the draft financial statement utilized herein after completing their audit procedures.

Disclaimer: Plante Moran has not performed an audit, examination, or review of the Village's financial statements for any of the years included in this analysis. Accordingly, we do not express an audit opinion, nor provide any form of assurance on the information presented below. We have relied on the work of other independent auditors and extracted the information from the previously audited financial statements.

Financial Health Assessment

General Fund

The General Fund is the main operating fund of the Village. The General Fund is accounted for on a modified accrual basis which means that it accounts for debt and capital outlay expenditures rather than recording the resulting liabilities, change in the liabilities, capitalization of long-term assets, and the subsequent depreciation of those assets.

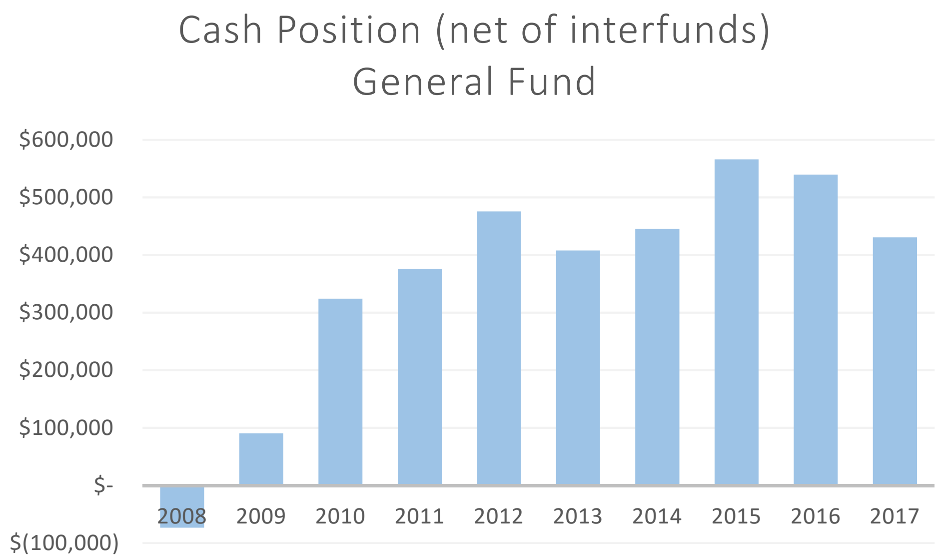
Cash Position

The first long-term trend we analyzed was the cash position of the general fund.

This chart depicts the 10 year trend for General Fund cash:

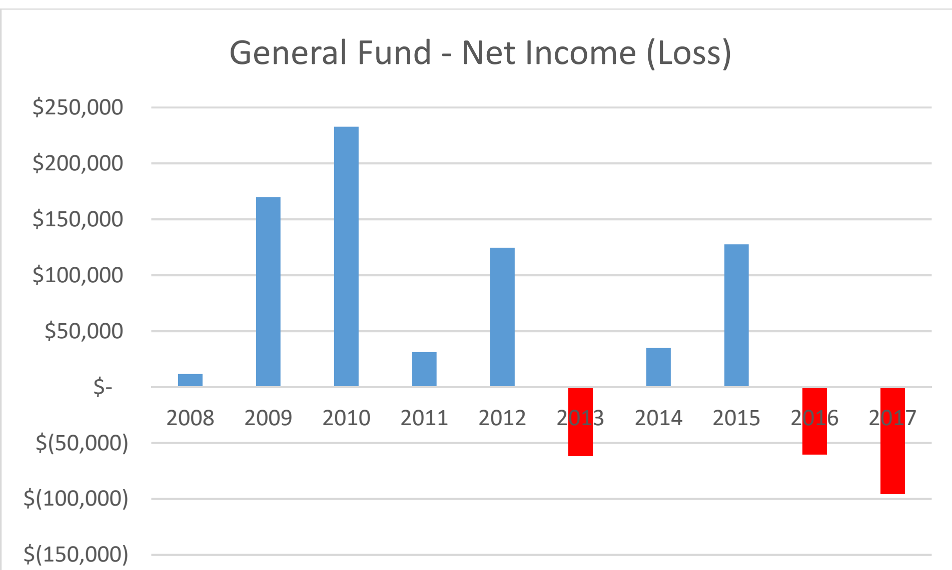
Based on this chart the General Fund has maintained on average between $209,000 to $500,000 in cash over the past 9 years through 2016. In 2017, the cash position dropped to $100,000, although as we will explain on the following pages, that is due to a combination of interfund borrowings, transfers to the Street funds, and timing differences related to bill paying.

Looking solely at cash does not tell the full story. Because the Village does not operate using a “pooled cash” system, the General Fund checking account will pay the bills for the other funds, thereby creating an interfund receivable (a “due from” other funds). Those receivables should be relieved when the other funds repay General Fund. If the net interfund is a receivable from other funds, the net cash is higher. Conversely, if the General Fund owes the other funds more than the other funds owe back to General Fund, the net cash is lower. Also, some of the cash as of the balance sheet date is about to be spent when the Village pays its vendors for work performed to date. This liability to third parties is referred to as “Accounts Payable.” To evaluate the cash position of the general fund further, we reviewed the cash balance as of the balance sheet date net of accounts payable and interfund balances (both due to and due from other funds). By looking at cash in this way, we can see a clearer picture of how the General Fund’s position is improving or eroding. The following graph shows the net cash position of the General Fund for the last 10 years:



In recent years, the net cash of the General Fund is higher than the actual cash because the net interfund balances are positive, meaning the other funds of the Village owe money back to the General Fund. Later in this report, we will demonstrate how the utility funds are utilizing General Fund's cash.

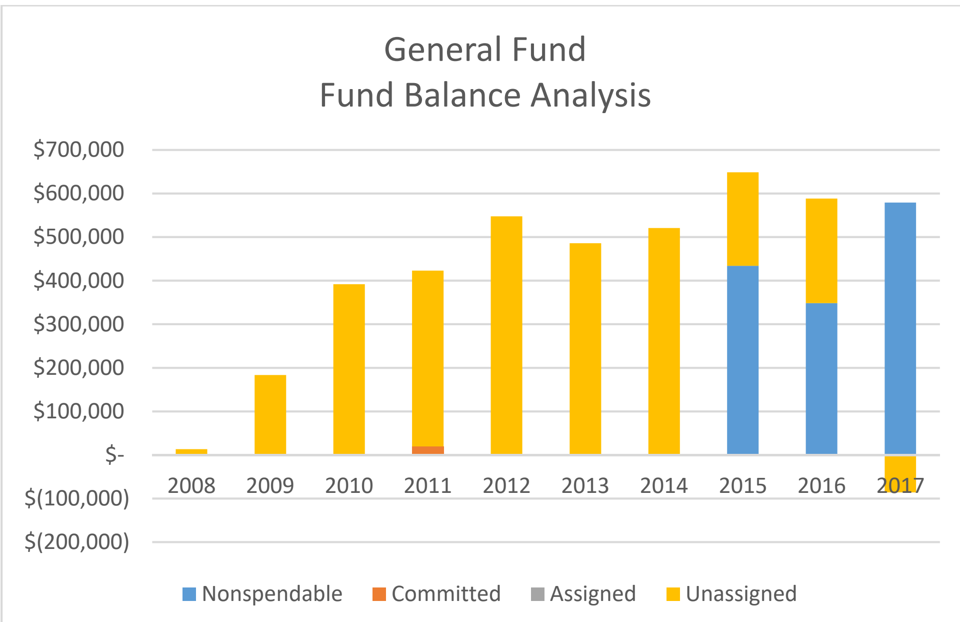
From 2008 to 2015, the trend is positive as net cash position steadily increased. Net cash position was approximately ($73,000) in 2008 and increased to approximately $566,000 in 2015. The most recent 2 years (2016, 2017) has shown this trend begin to reverse. Over the past 2 years, the net cash position has declined by approximately $135,000. This is supported by looking at the net income of the General Fund over the past 10 years:



The net loss for 2016 and 2017 (approximately $156,000) is consistent with the decrease in net cash over the same period of time.

Has the General Fund's financial position been improving, eroding or staying consistent over time?

The change in cash is one way to evaluate the overall health of the General Fund. Another is the change in Fund Balance. Fund Balance or "equity" is the difference between assets and liabilities. This can be considered the General Fund's savings account or "rainy day fund." To evaluate the General Fund's financial position, we reviewed the fund balance of the General Fund for the last 10 years to determine whether it has been improving, eroding or staying consistent over time. The following graph shows a breakdown of the General Fund's fund balance by classification for the 10 years ended December 31:



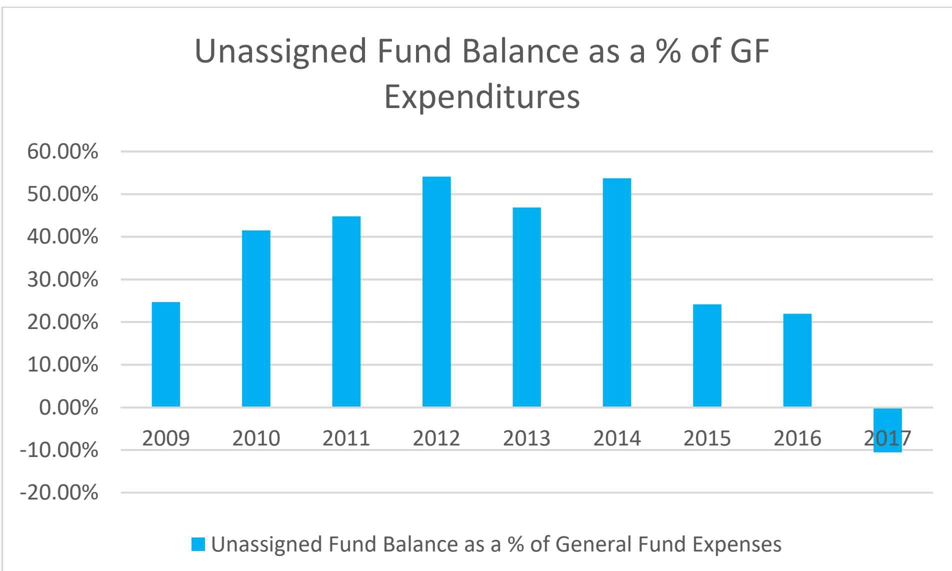
Like cash in the analysis above, the General Fund's total fund balance increased from 2008 to 2015, and then began to decline in 2016 and 2017. The changes in Fund Balance are directly tied to the net income or loss noted above. Looking deeper than just the change in the total fund balance, review of the classifications of fund balance also tell a story.

In governmental accounting, there are 5 classifications of fund balance, but for the purposes of our analysis, we are only concerned with two of them: Nonspendable and Unassigned. Unassigned fund balance is the most liquid and most available to be spent if necessary. Nonspendable fund balance is not available to be appropriated or spent because cash is not present because it was already spent (such as in the case of a prepaid asset or inventory) or receivables are not going to be collected in the near future.

For the Village, the nonspendable classification of the fund balance is directly caused by the interfund receivables due from the utility funds. As we will describe later in this report, the utility funds, Sewer in particular, owe a significant amount of money back to the General Fund and, to date, have not had the ability to repay General Fund. When the receivable is not expected to be collected and converted to cash in the near future, fund balance is classified as Nonspendable. This means that the General Fund, already in a state of decline as demonstrated by back to back years of a net loss, is less financially stable than just its total fund balance would indicate.

In 2017, the long-term receivable from the other funds has grown to the point that it is larger than General Fund's overall fund balance. If the utility funds do not begin paying back General Fund, the General Fund will technically be in a deficit position because, while total fund balance is positive, the Unassigned portion of fund balance is negative.

Another way to evaluate the health of the General Fund is to look at the unassigned fund balance as a percent of total expenditures:



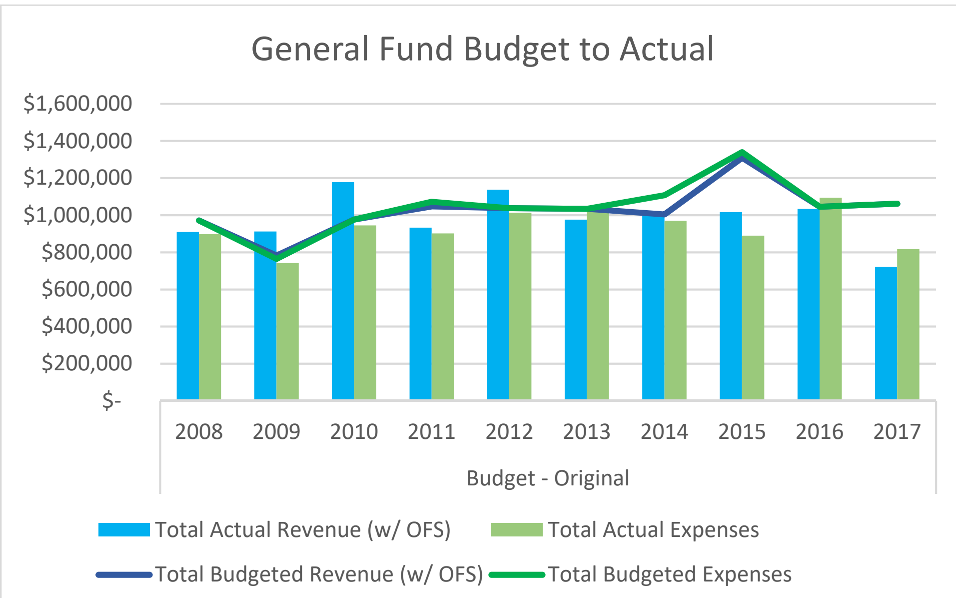
As a general rule of thumb, the Government Finance Officer's Association (GFOA) recommends a municipality have a **minimum** of two months (2 months is 16.67% of a year) of operational expenditures in fund balance. For smaller communities like the Village, a higher percentage like 30-60% percent may be more appropriate. Because the General Fund has been allowing the utility funds to borrow cash and because of the net losses incurred during 2016 and 2017, the unassigned fund balance decreased rapidly, jeopardizing the General Fund's ability to pay its bills as they come due. The General Fund deficit of unassigned fund balance in 2017 makes this percentage negative, meaning no more fund balance is available in the event of another net loss.

It is imperative for a General Fund to protect and maintain its fund balance. In the event of another economic downturn similar to the recession a decade ago, a municipality will need to have adequate fund balance and cash reserves in order to continue functioning and providing service to its residents.

The Village has not established a minimum fund balance policy, a best practice for maintaining financial health.

How successful or accurate has the municipality been with projecting its annual budget?

To evaluate how accurate the Village has been with projecting its annual budget for the General Fund, we compared the original budgeted revenue and expenses to the actual revenue and expenses. The following graph shows the actual total revenue (excluding other financing sources) and total expenses for the General Fund compared to the originally budgeted total revenue (excluding other financing sources) and total expenses for the 10 years ended December 31:



Takeaways from this graph:

1. In 2017, the Village made significant changes to the way activity between funds was recorded. Previously, the Village recorded expenditures paid by the General Fund on behalf of other funds as expenditures of the General Fund and the subsequent reimbursement from the other funds as revenue of the General Fund, basically grossing up revenues and expenditures. This is inconsistent with Generally Accepted Accounting Principles. The change in 2017 now nets this activity together, so that revenues and expenditures of the General Fund are no longer inflated. This is an improvement to the Village's accounting.
2. With one exception (2016), the Village's actual expenditures for the year have been less than the original budget. This means that the Village is not being surprised by unforeseen projects or

activities. Also, the department heads are able to provide services as expected and live within the budget.

3. In 3 of the first 5 years, actual revenues exceeded the budget. Actual revenue fell short of the budget in 4 of the last 5 years. So, even if the Village is spending less than planned, the Village is overestimating how much money is going to come in and therefore spending more than it can afford.

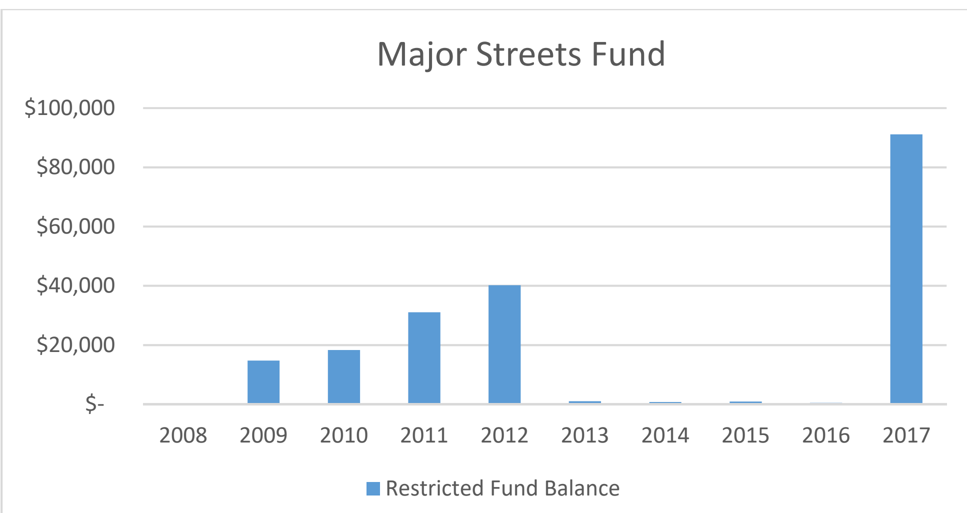
Major and Local Street Funds

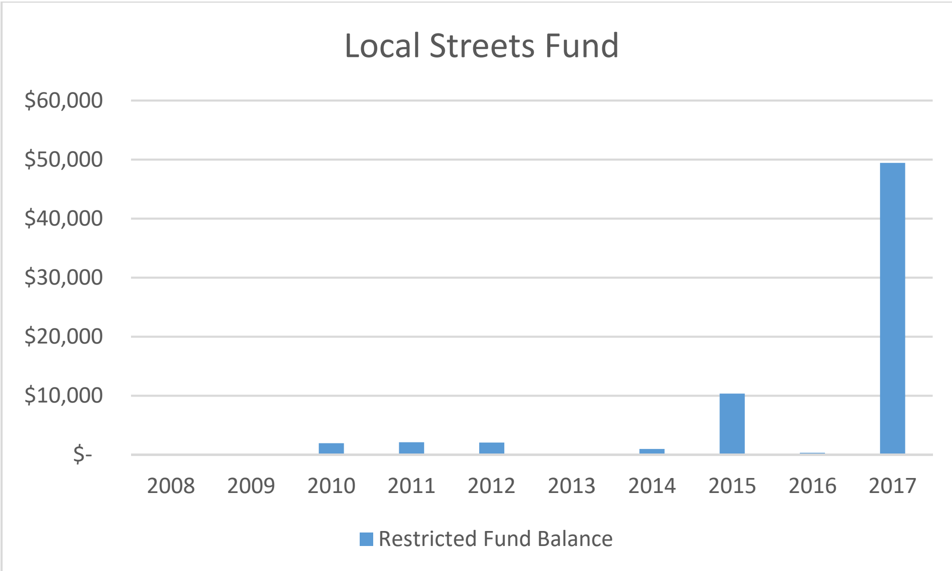
The majority of the revenue for the Major and Local Street Funds is received from the State of Michigan. This revenue is referred to as "Act 51" revenue because the law which created the system for road funding in Michigan was Public Act 51 of 1951 ("State Trunk Line Highway System").

Road Funding has been a very contentious topic in Michigan recently. The current level of funding has not been adequate to properly maintain roads throughout the state. Local municipalities state-wide are having to find alternative funding sources such as new road millages or subsidies from the General Fund in order to repair or replace badly damaged or aged roads. The Village of Newberry has been allocating a portion of its property tax revenue to the Local Street Fund to help subsidize this activity.

Fund Balance

A key component of the Major and Local Street funds is their fund balance as this shows how much is available for projects. The following graphs show the fund balance of the Major Street and Local Street funds for the last 10 years:





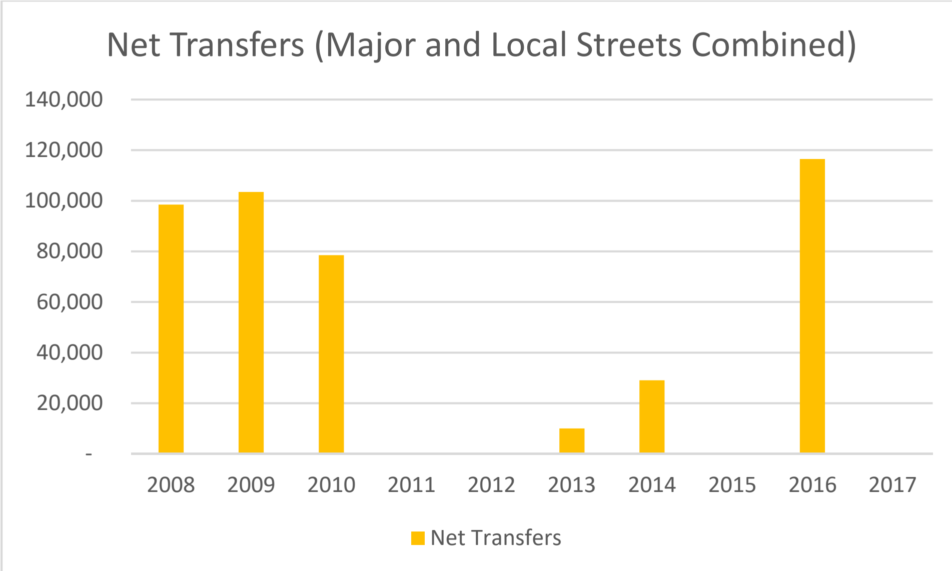
From 2008 to 2016, the Local Street Fund has basically spent all available revenue as evidenced by the lack of fund balance at the end of the year. Fiscal year 2017 is the first year in our analysis where Local Streets ended the year with a substantial amount of fund balance, or an amount to carryforward to future years for projects.

From 2009 to 2012, Major Streets did not fully spend its available revenue, saving it for a future project. In 2013, that accumulated surplus was used in addition to the new revenue received that year. From 2014 to 2016, Major Street spent all if its available revenue. Like Local Streets, 2017 is the first year in our analysis where Major Streets has saved a substantial amount of revenue to be used for a future project.

This analysis demonstrates how much money was left at the end of the year in the road funds, but it does not look at how much subsidy has been provided by the General Fund.

Transfers

As described above, the Major and Local Street Funds are primarily funded by State sources allocated to local governmental units by Public Act 51 of 1951. The Act allows the Village to transfer up to 50 percent of the Major Street revenue to the Local Street fund. So, it is very common to see transfers out of Major Street Fund and transfers into Local Street Fund, netting to zero in total. By combining all transfers into and out of both the Major and Local Street funds, we can see how much of a net surplus has been transferred into the street funds from outside sources. Net Transfers into the street funds over last 10 years:



The graph shows that prior to 2011, there were net transfers in ranging from approximately $80,000 to $100,000 per year. This would have come from the General Fund. During the period from 2011 to 2015, this funding was mostly eliminated, with only approximately $40,000 of net transfers coming into the street funds. This period of time correlates with the increase in General Fund fund balance noted above. In 2016, significant additional transfers in of approximately $120,000 came from the General Fund, a year that saw General Fund incur a net loss.

So what does this mean?

For the Village of Newberry, like many other municipalities in Michigan, road maintenance is tied to the ability of the General Fund to provide additional funding. If the General Fund is healthy, more road improvement projects are possible. If General Fund is struggling, the Major and Local Street Funds must get by with the funding provided by the State of Michigan. Or, if the Street fund projects are imperative, the State funding is not adequate, and General Fund does not have a surplus in that year, the General Fund's fund balance will be negatively impacted. This was the situation in 2016 as the General Fund incurred a net loss, thereby using up a significant portion of its fund balance, in order to subsidize road projects.

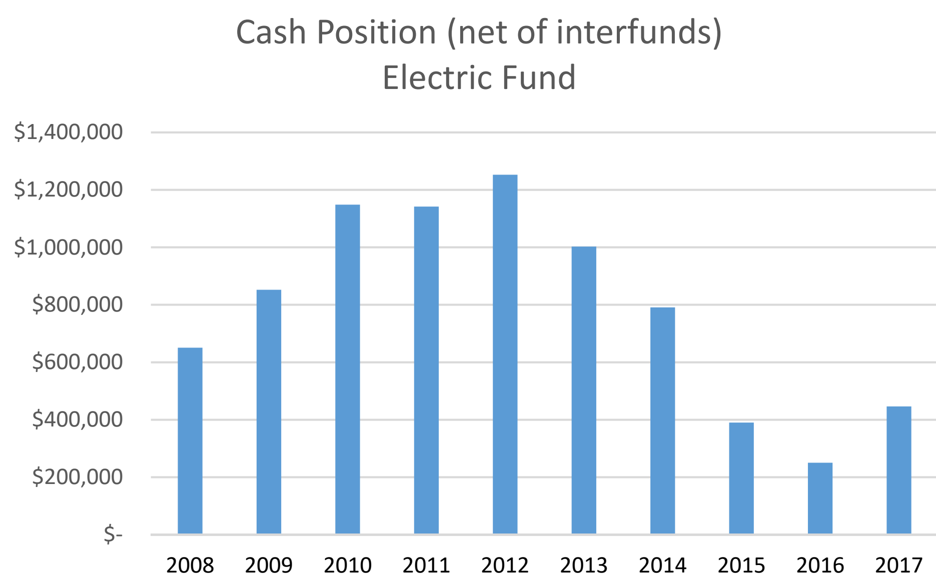
Electric Fund

So far, our analysis has focused on governmental funds, i.e. funds whose revenue is generated primarily through local property taxes and state government sources. The Electric, Water, and Sewer Funds are "Enterprise Funds".

An Enterprise Fund operates more like a business and is primarily funded through a user charge to its customers. Unlike governmental funds utilizing the modified-accrual basis of accounting where the focus is more on the immediate outflow of financial resources (cash) like making a debt payment or purchasing a new capital asset, an enterprise fund is accounted for on the full-accrual basis of accounting. This means that the fund records depreciation expense instead of capital outlay expense and a reduction to the debt liabilities on the balance sheet instead of debt service expense for principal payments.

Is the Electric Fund providing sufficient cash flow to support operations? If not, when did they stop? If not, who or what is providing the financial subsidy?

To evaluate whether the Electric Fund is providing sufficient cash flow to support operations, we looked at the net cash position of the Electric Fund. The net cash position is calculated as the cash balance as of the balance sheet date net of interfund balances. The graph below depicts the net cash balance for the last 10 years:



Although Electric Fund still maintains a positive net cash position, the trend over the last five years shows a severe decline in net cash. This indicates that the Electric Fund is not raising its rates adequately to pay for its operations and invest in its infrastructure. Rather, it is using cash reserves to survive. Also, the interfund balances, a net receivable from other funds, indicates other funds are temporarily using Electric Fund's cash to subsidize their own operations. This is not a sustainable course of action in the long term. In October of 2017, the Village instituted a rate increase for Water and Sewer, but not for Electric. The apparent turnaround in 2017 for Electric is not driven by an increase in rates. Rather, it appears the improvement is due to the Village doing a better job of allocating administrative costs to the proper funds, thereby easing the burden on Electric.

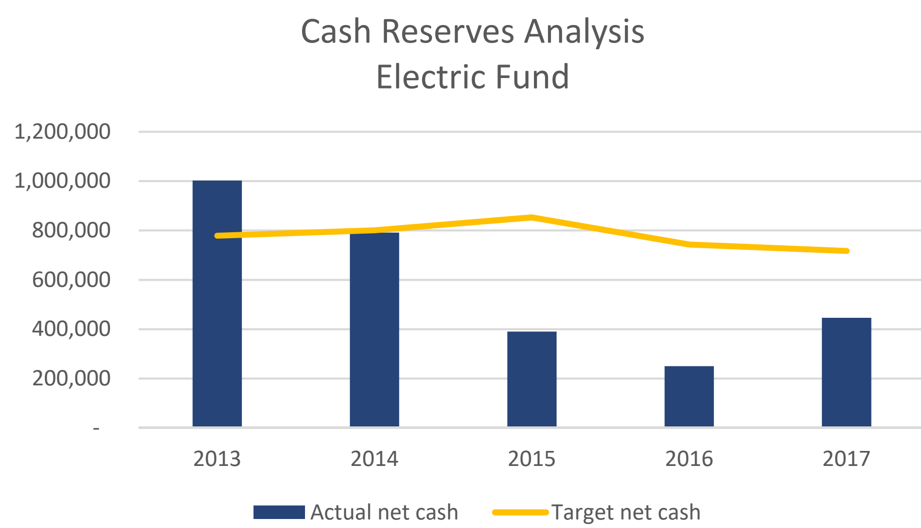
Has the Electric Fund been setting cash reserve adequately?

We just determined that the Electric Fund has a declining cash balance over the past 5 years, but what is the right amount of cash to have on hand? To determine whether the Electric Fund has been setting cash reserve adequately we must first determine how much cash an enterprise fund should have. When assisting communities with utility rate setting, we generally follow the guidelines set forth by the American Water Works Association (www.AWWA.org). While AWWA does not speak specifically to Electric, the theory holds true for any utility with a mix of operational, debt service, and significant infrastructure costs. Those guidelines are based on maintaining levels of working capital (current assets minus current liabilities). For the purposes of our analysis, there is not a significant difference between working capital and net cash.

A utility should have enough cash on hand to pay its operating bills and debt service payments, and have enough in reserve in the event equipment or infrastructure breaks and requires an immediate fix or replacement. Our calculation of the target cash reserve for the Village's utilities include three categories: operating reserve, emergency reserve, and debt service reserve. The operating reserve is calculated using 60 days of annual operating expenses, less depreciation expense since this is a non-cash expense. The emergency reserve is calculated at 5 percent of the net book value of capital assets. Finally, the debt service reserve is one year of principal and interest payments.

Please note: all three utilities have funded previous projects through the issuance of bonds. Bonds, especially revenue bonds, may have their own separately stated requirements for cash on hand. Many require the establishment of a "bond reserve" or a separate amount of money set aside for future repairs, replacement, and debt service. As each bond is different, our analysis has not taken into account the unique requirement of each bond. Rather, this is a high level analysis at the fund level to provide a general understanding of the adequacy of each fund's cash reserves.

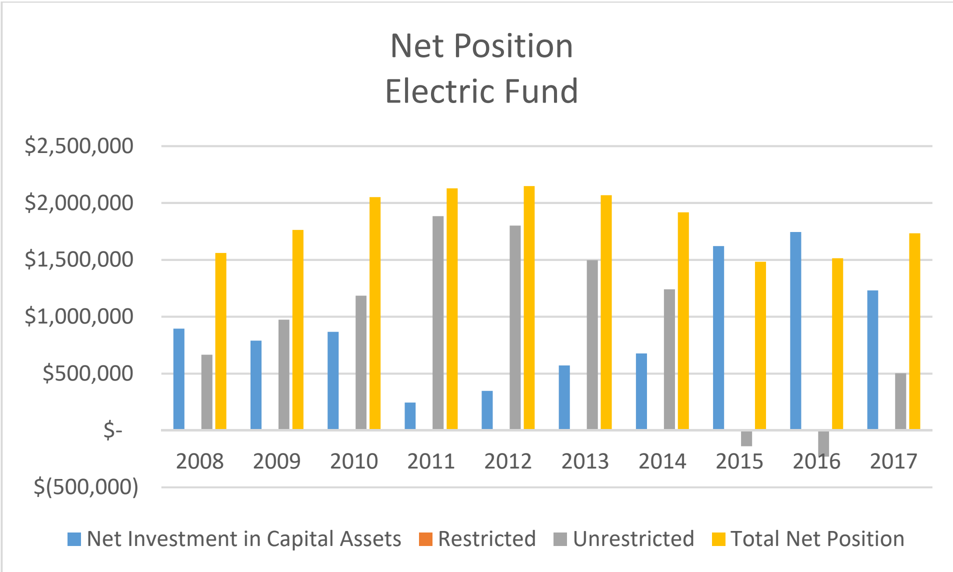
Below is a five-year analysis of the calculated target cash reserve for the Electric Fund compared to the net cash on hand, as noted above, for the years ended December 31, 2013-2017:



The Electric Fund's cash reserve has severely depleted over the last several years. In 2013, the Electric Fund had an adequate amount of net cash on hand, over the minimum target as described above. Over the next 3 years, the Fund used up 75% of its net cash on hand, falling well short of the minimum target, before finally raising rates in October 2017. As of December 2017, the Fund appears to be on the rebound, but still well short of the minimum target.

Net Position

In a governmental fund, equity (the difference between assets and liabilities) is called Fund Balance. In an Enterprise Fund, it is called "Net Position". The biggest difference between fund balance and net position is that net position includes capital assets like buildings, equipment, and infrastructure, as well as the long-term liabilities that are not recognized in governmental funds like bonds payable and long-term legacy liabilities related to unfunded pension and retiree healthcare obligations. Knowing whether or not an enterprise fund is doing well financially can be more complicated than for a governmental fund because of the differences between the short-term (cash, receivables, accounts payable) indicators and the long-term ones (capital assets, debt).



The unrestricted portion of net position is somewhat comparable to unassigned fund balance, except for the existence of long-term pension and retiree healthcare obligations. Unrestricted net position in the Electric Fund began declining around the same time as the net cash position did in a previous graph. There is a correlation between those two trends.

The Net Investment in Capital Assets portion of net position increases when an investment is made in new capital assets without incurring new debt (i.e., paying out of pocket instead of bonding) or when a bond payment is made to lower debt against the existing capital asset. Net Investment in Capital Assets decreases with the recording of depreciation expense because the recorded value of the capital asset decreases. A new investment in capital assets funded by incurring offsetting debt (i.e., Issuing $1M of bonds and performing $1M of improvements) does not increase or decrease net position as both asset and liability increase equally. The big jump in net investment in capital assets (with a corresponding decrease in unrestricted net position) from 2014 to 2015 is due to a change in the way the Village reported an asset called “Capital Credits in Co-op”. In 2014, this asset was treated as an unrestricted item. In 2015, it was removed from unrestricted and was included in the Net Investment in Capital Assets calculation, thereby driving up Net Investment and decreasing Unrestricted by the same amount (approximately $700,000). In addition, because the bond payments in the Electric Fund are greater than the annual depreciation expense, the Net Investment increases approximately $100,000 per year at the expense of the unrestricted portion

Note: In 2017, the new auditor for the Village reversed the position on the Capital Credits in Co-op asset, placing it back in unrestricted net position which explains the sudden increase in that component of net position without a rate increase.

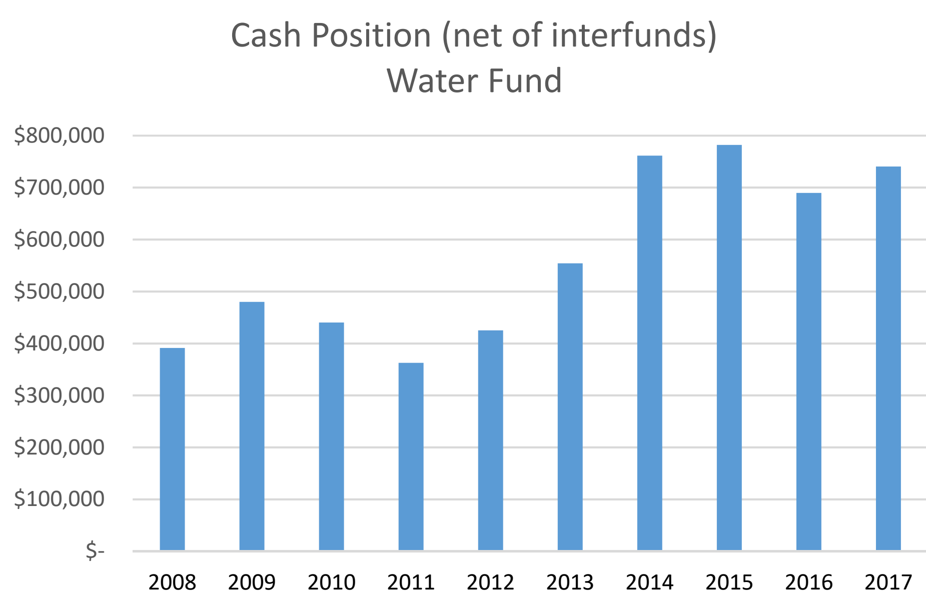
As mentioned previously, net position is more complicated than fund balance in trying to understand whether a fund is improving or regressing financially. The takeaway from this graph is that total net position continued to decline through 2016 and the October 2017 rate increase was necessary to begin reversing that trend.

Water Fund

Water is also an Enterprise Fund, meaning it is primarily funded by a user charge to its customers.

Is the Water Fund providing sufficient cash flow to support operations? If not, when did they stop?

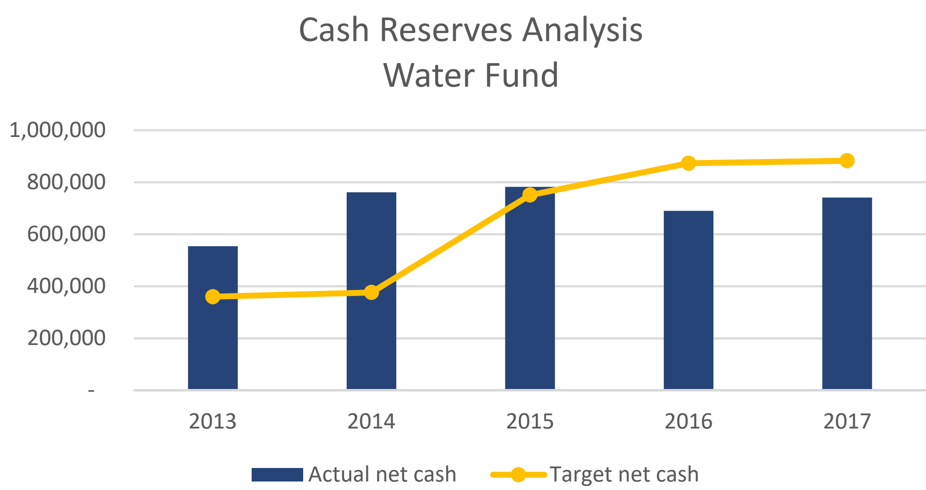
Using the method described earlier, we reviewed the net cash position of the Water Fund to determine whether the fund is providing sufficient cash flow to support operations. Below is the cash balance, net of interfunds, of the Water Fund for the 10 years ended December 31:



Although the 10 year trend of the Water Fund's net cash position has been somewhat volatile, the net balance is positive and has remained above $400,000. The volatility to cash can be the result of larger scale capital improvements in particular years, but the overall 10 year trend is positive. The Village passed a substantial rate increase for both the Water and Sewer Funds in 2017. For the Water Fund, this rate increase appears to have either reversed or prevented a trend of declining net cash position. It appears that the Water Fund is providing sufficient cash flow to pay operational costs as they come due, but this does not address whether the net cash on hand is the "right" amount.

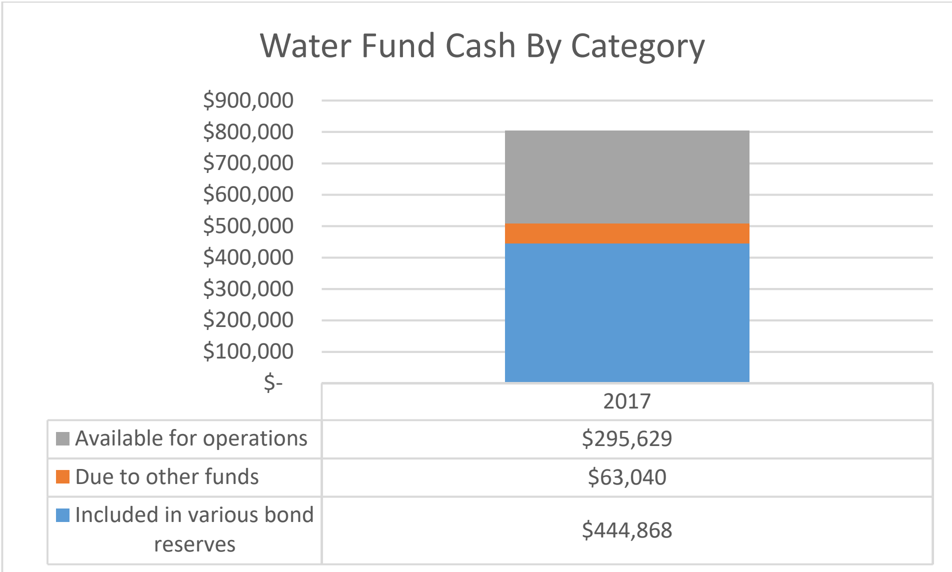
Has the Water Fund been setting cash reserve adequately?

Like with Electric above and using the same method described earlier, we calculated the target cash reserves for the Water Fund for the last five years and compared the target to the actual net cash position of the fund to determine whether the fund is setting cash reserve adequately and raising rates appropriately to maintain that reserve. The following graph displays this comparison for the years ended December 31, 2013-2017:



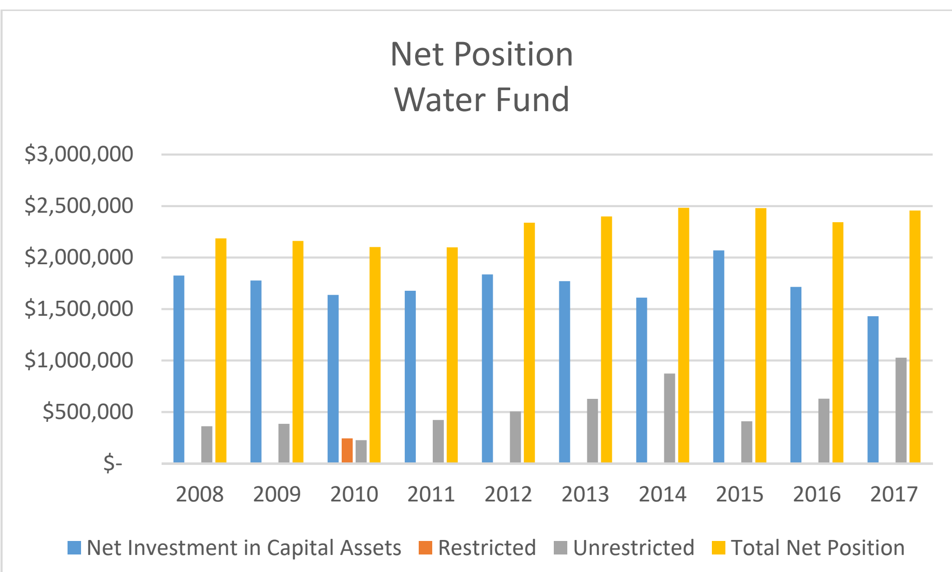
While our earlier analysis discussed that the Water Fund is providing sufficient cash flow to support operations and is financially self-sufficient, this five year trend shows that the cushion between the Water Fund's actual net cash position and the target cash reserve was depleted in 2016 and remains so in 2017 despite the recent rate increase.

Earlier, we mentioned that the utility funds have issued bonds to pay for substantial capital improvements and that those bonds have certain requirements about maintaining various reserves of cash for each bond. These reserves as dictated by the bond issuance documents have names like "Bond and Interest Redemption", "Operations and Maintenance", and "Repair, Replacement, and Improvement". Even though the Water Fund has cash, much of it is restricted and allocated to these reserves. For the year ended December 31, 2017, Water Fund's cash is categorized as follows:



	2017
Available for operations	$295,629
Due to other funds	$63,040
Included in various bond reserves	$444,868

While this fund's cash position is a little leaner than what we might expect or prefer, the Water Fund is unquestionably the strongest of the Village's three utility funds in terms of short-term financial indicators; however, we were not engaged to assess the physical structure of the Water system. If there are significant capital improvements required, the Water Fund does not have the necessary cash in reserve to pay for those improvements out of pocket. A new financing mechanism, likely the issuance of bonds or other long-term liability, would be necessary.



Unlike the Electric Fund, Water Fund's total net position has stayed fairly consistent over the past several years, although the Net Investment in Capital Assets has decreased over time (because of paying down the bonds which lowers the outstanding liability), which drives up the unrestricted net position automatically. An example of this can be seen when comparing 2014 to 2015. In fiscal year 2015, the

Water Fund ended the year with a loss of only $3,738, basically breaking even. When you look at the components of the net position, the net investment jumped approximately $460,000 and the unrestricted portion decreased by approximately the same.

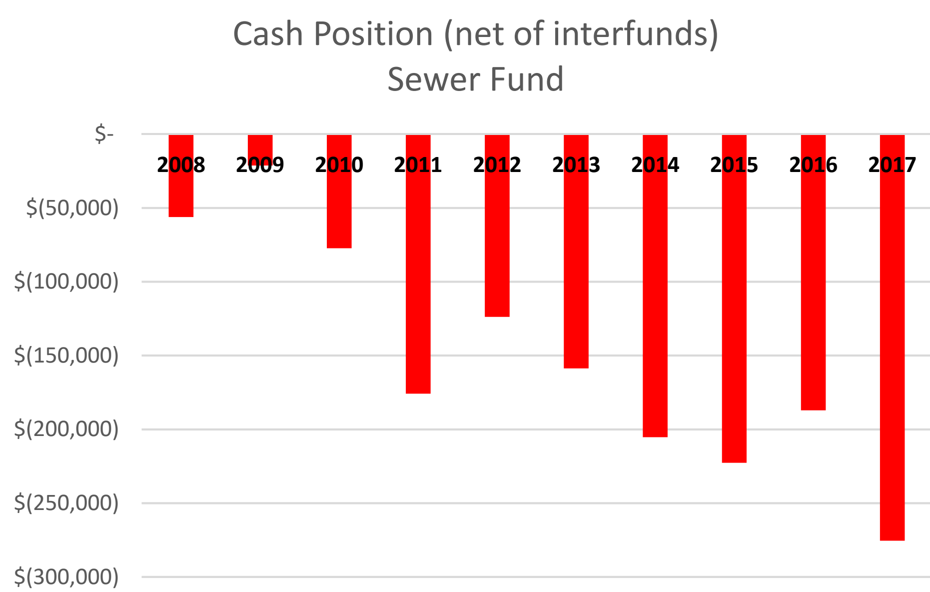
This graph reinforces the earlier point that the Water Fund is the healthiest financially of the Village's three utility funds, by both short-term and long-term metrics.

Sewer Fund

Sewer is also an Enterprise Fund, meaning it is primarily funded by a user charge to its customers.

Is the Sewer Fund providing sufficient cash flow to support operations? If not, when did they stop?

Using the method described earlier, we reviewed the net cash position of the Sewer Fund to determine whether the fund is providing sufficient cash flow to support operations. Below is the cash balance, net of interfunds, of the Sewer Fund for the 10 years ended December 31:

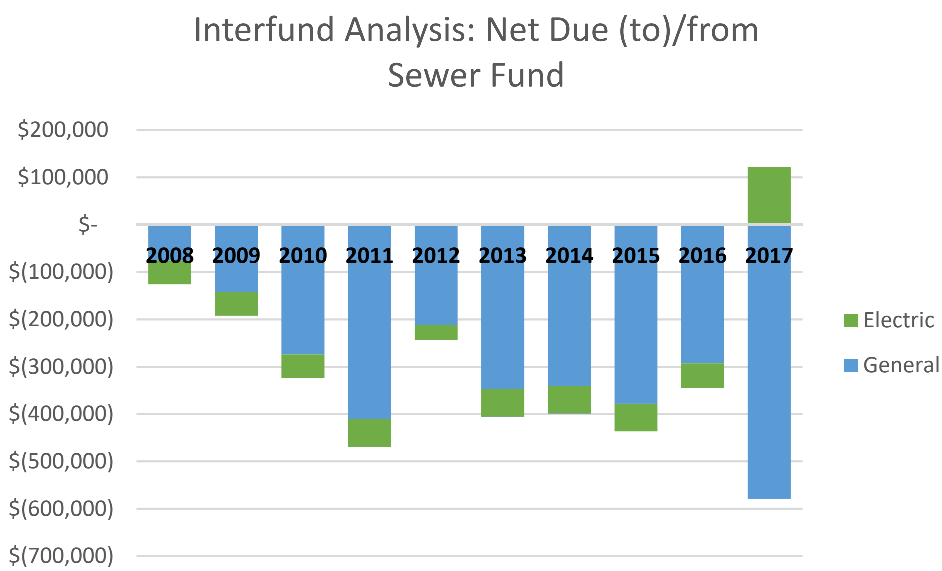


Not only has the net cash position of the Sewer Fund been in a deficit for each of the last 10 years, that deficit continues to grow. This fund has not had its own cash in any of the past 10 years and has been borrowing from other funds to survive. There is no question that this fund is not generating enough cash to support its own operations and has not for at least a decade.

Interesting to note, unlike what we saw in Electric and Water, the rate increase in October 2017 did not provide a visible "bump" to the net pooled cash. Given the Sewer rate increase was also substantial, we can conclude the 2017 results would have been significantly worse than they were without that rate increase and additional rate increases are likely necessary.

If not, who or what is providing the financial subsidy?

The graph below represents the net interfund balances of the Sewer Fund for the 10 years ended December 31:

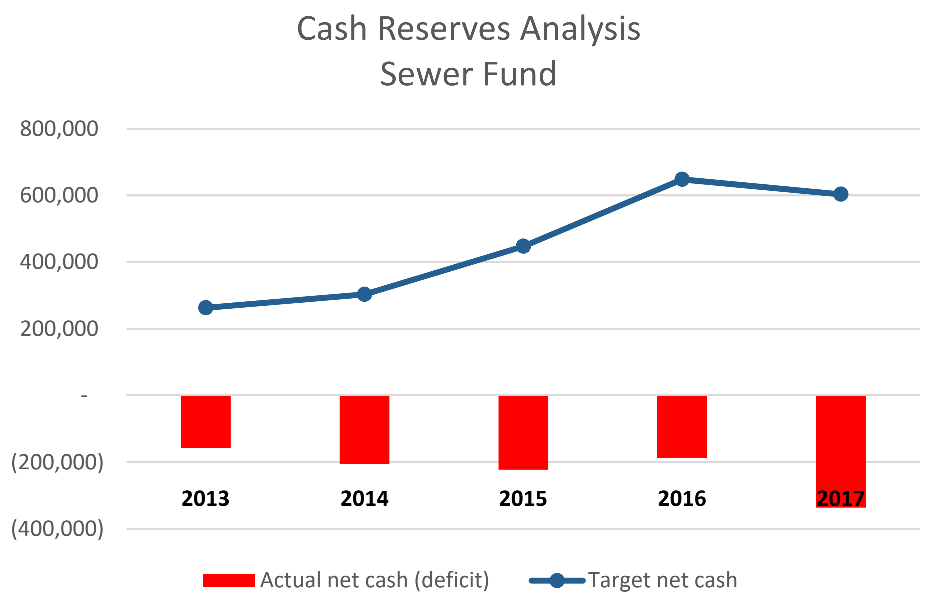


From at least 2008 through 2016, the Sewer Fund borrowed money from both the General and Electric Funds. The amount owed to Electric remained consistent year to year, but the amount borrowed from General Fund consistently grew over time. In 2017, the advance from the General Fund increased 66% from $348,490 to $579,058. Oddly, the payable to the Electric Fund “flipped” in 2017 and Electric now owes Sewer. This seems to be related just to the fact that the Village operates without a pooled cash system and money is moved between bank accounts periodically versus being indicative of any performance, good or bad, of the two funds.

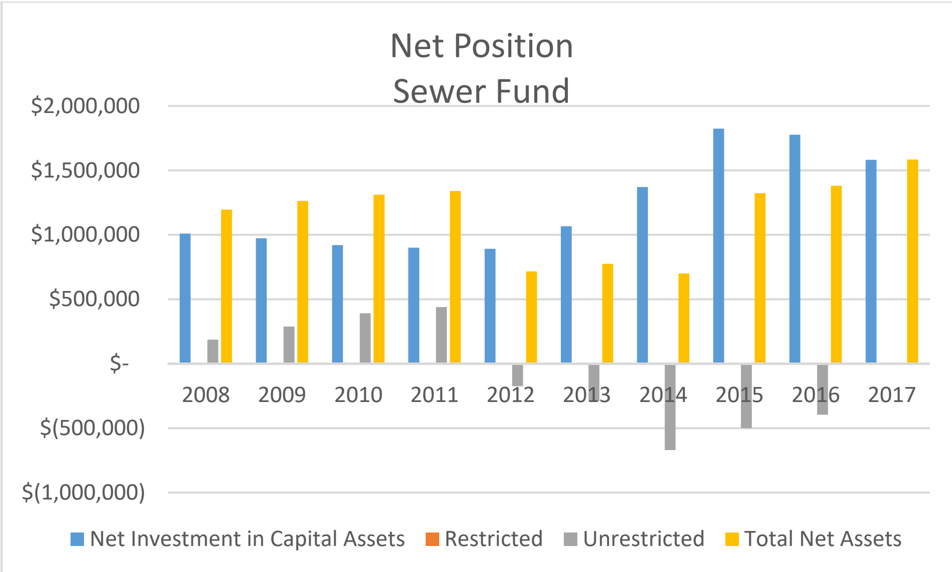
When discussing the Sewer Fund and subsidies, it is worth noting the Village’s ongoing billing and collection problem with one of its municipal customers, Pentland Township. For years, the Village’s sewer budget has assumed a certain amount of revenue coming in from Pentland Township, but the Township has paid to the Village only a fraction of that amount billed. As of December 31, 2017, Pentland Township owed the Village approximately $84,000 for prior service. Collecting on that receivable is a significant component of the plan to restore financial stability to the Sewer Fund. If the Township continues to not pay as billed based on their usage of the system, the necessary rate increases will affect the other customers of the system disproportionately. In other words, the Village residents and other customers have been and will continue to subsidize the customers from Pentland Township.

Has the Sewer Fund been setting cash reserve adequately?

Given that the Sewer Fund does not have any cash of its own and has been continuously borrowing from other funds for over a decade, the answer is obviously no. Using the method described earlier, we calculated the target cash reserves for the Sewer Fund for the last five years ended December 31 and compared the target amount to the actual net cash position of the fund:



The target for net cash increases as the operational costs of the system increase, when additional capital assets are constructed, and when additional debt is incurred. The gap between Sewer's target cash reserve and the growing deficit of cash owed to other funds is rapidly growing. The gap between the target cash reserve and the actual net cash on hand has doubled in a five year period.



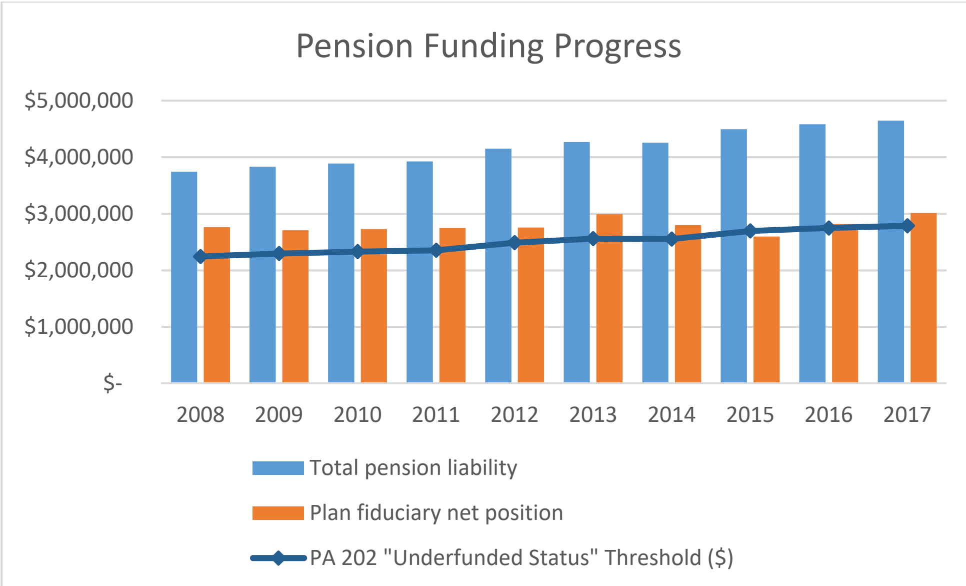
2017 is the first year the Sewer Fund has not had a deficit of unrestricted net position since 2011, although it has been climbing out of that deficit for several years. As explained above, unrestricted net position is positively impacted just by making debt service payments and lowering the outstanding bond liability. Although it has begun to improve, this graph demonstrates that the Sewer Fund, in addition to being in the worst shape financially per short-term financial indicators, is also in the worst shape by the long-term indicators as well.

Retirement Plans

Pension Funding

The Village participates in the Municipal Employees' Retirement System (MERS) of Michigan to provide retirement benefits to employees. To analyze the pension funding progress of the Village, we compared the actuarially calculated total pension liability of the plan to the plan fiduciary net position. Additionally, Michigan Public Act 202 of 2017 established reporting requirements for local units of government that sponsor pension plans, as well as an "Underfund Status" threshold of 60 percent.

The Village has made payments in accordance with the actuarially determined contribution (ADC) as required by law. However, just looking at their contributions to the pension plan does not give a true outlook for the plan. The following graph depicts the total pension liability and fiduciary net position of the Village's pension plan, compared to the State's "Underfunded Status" threshold as a dollar amount for the years ended December 31, 2008 – 2017:



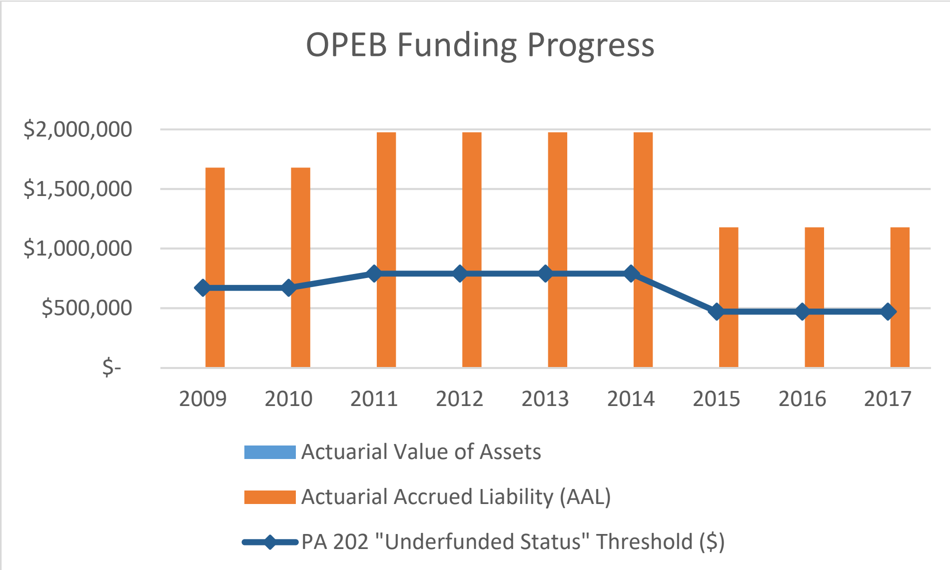
With the exception of 2015, the year the Village was required to implement GASB Statement No. 68, *Accounting and Financial Reporting for Pensions* and the calculation of the liability and plan net position was changed, the funding percentage of the pension system has exceeded PA 202's required 60%. In 2008, the plan was nearly 74% funded. In 2017, it is nearly 65% funded. The Village needs to remain diligent and continue making the required contributions in order to maintain a funding status above 60 percent. If the Village's financial situation will allow it, the Village is allowed to make additional contributions to the plan in order to improve the funded percentage.

Retiree Healthcare (OPEB) Funding

The Village provides retirement health care (Other Post-Employment Benefits, or "OPEB") benefits to employees who retire from the Village. Unlike pension contributions that are required by Michigan law to be made to the pension trust in order to fund the plan, there is no such legal requirement for retiree healthcare. Instead of pre-funding this benefit, the Village has opted to "pay as you go", i.e. pay the monthly healthcare premiums. While this practice is legal and very consistently practiced across the State of Michigan and the country, the result is an unfunded liability that continues to grow with the cost of healthcare benefits and a population that continues to live longer.

Similar to pension liability as noted above, Michigan Public Act 202 of 2017 established reporting requirements for those municipalities that sponsor OPEB plans that are 40 percent or less funded. The Village's plan is zero percent funded.

The following graph illustrates the actuarial accrued liability (AAL) and the actuarial value of assets of the Village's OPEB plan, compared to the "Underfunded Status" threshold as a dollar amount for the years ended December 31, 2009 – 2017 (Note: 2008 information was unavailable as this liability was not disclosed in government financial statements at that time.):



As noted previously, the Village has not funded any of the future retiree healthcare obligation. The Village has only made retiree healthcare payments as they are incurred ("pay as you go").

The liability is actuarially calculated as prescribed by GASB Statement 45, *Accounting and Financial Reporting By Employers For Postemployment Benefits Other than Pensions.* For OPEB plans as small as the Village's, GASB 45 requires a tri-annual valuation. In order for the AAL to have decreased so much in 2015, there must have been significant changes to the plan or to the assumptions used by the actuary in calculating the liability, but we have not reviewed the actuarial valuations to know what those changes may have been. Using the 2015 valuation, the Village would need to irrevocably contribute $471,000 to a trust in order to comply with the requirements of PA 202 to achieve 40% funding

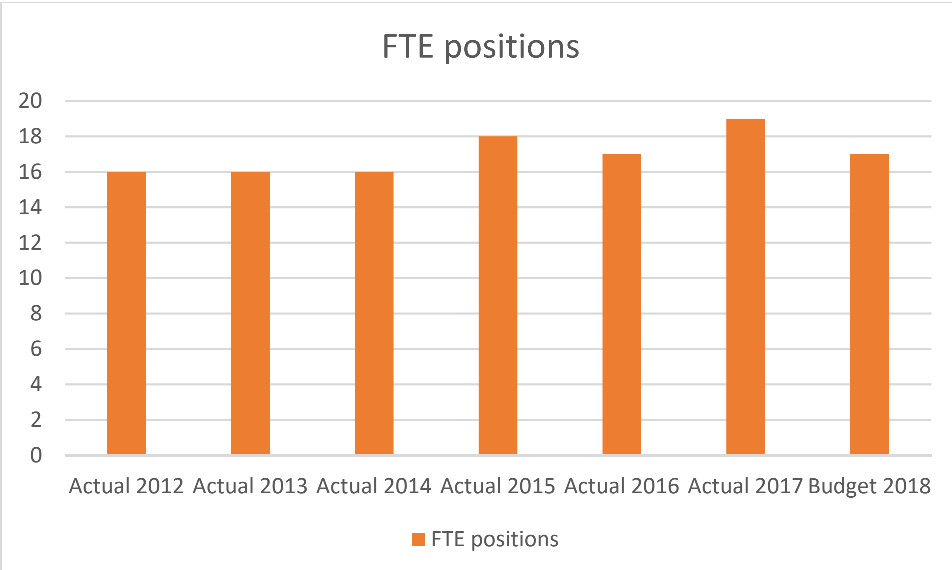
For the 2018 fiscal year, the Village will be required to implement GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other than Pensions,* the replacement to GASB 45. The liability will be calculated differently, but we do not have the information to be able to predict if it will increase or decrease, significantly or insignificantly. Whatever the liability, that does not change the fact that the Village's plan will still be zero percent funded.

The total unfunded legacy costs for year ended 2017, for both pension and retiree healthcare, totaled $2.8 million.

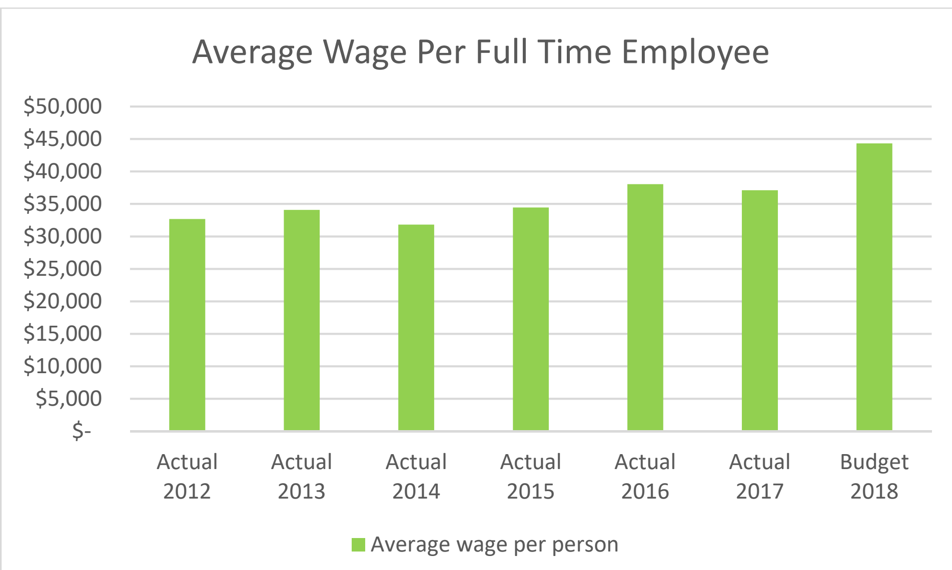
Personnel

While personnel information is not included in the financial statements of the Village, we thought it would be appropriate to include a brief analysis of the Village's staffing levels. The following information was obtained from the Village.

Without having its own police department and having a volunteer fire department, as well as operating water, sewer, and an electric utility, the overall full-time workforce employed by the Village is relatively small. Full time employee headcount for the years ending December 31 are as follows:



Average wage per full-time employee during the same time frame was as follows:



On average, the 19 positions during 2017 earned $37,114 per person. Due to some turnover from 2016 to 2017, the average wage per person decreased with the slight increase in filled positions. In 2017, only one employee made more than $60,000.

The budgeted figures for 2018 are likely higher than what the actual paid wages will be as the budget would include some amount of cushion for potential overtime. Also, any further turnover will also result in lower wage expense.

As the operation of the Village is quite lean and the wages paid are not excessive compared to other similarly sized local municipalities we have worked with, the financial troubles experienced by some of the funds as noted above are not the result of a bloated or overpaid workforce.

Overall Conclusions

Based on the analysis above, these are our key conclusions and suggestions to the Village:

Overall

1. While the Village is made up of several funds that may appear to operate independently of each other, they are inherently interrelated and dependent upon each other. If one fund falters financially, other funds and the services those funds provide, can be adversely affected. For example, because the Sewer Fund has borrowed cash from General Fund, General Fund may not have the ability to supplement road improvement projects in the Street funds. It is important to "right the ship" in every fund to prevent impairing another fund or service.
2. The Village's current banking system of having separate bank accounts for every fund, only paying bills out of a select few, and transferring money from one account to another to periodically reimburse the interfund activity has contributed much confusion when trying to assess the financial health of each fund. In addition, it creates a significant amount of extra work for the Village treasury and accounting staff to make the transfers, write additional checks, and perform up to 30 bank reconciliations per month. Under the current system, the analysis we performed of looking at "net cash" and the changes to net cash was cumbersome and time consuming, but entirely necessary to see the big picture and assess the financial health of each fund.

   We understand that the Village is in the process of consolidating bank accounts and will utilize a pooled cash system once the new computer system, BS&A, is implemented. This should be much more efficient, saving time every month by eliminating a significant amount of banking activity and performing so many monthly reconciliations. Also, it will be easier to monitor the health of each fund.

General Fund

1. The General Fund was relatively stable for many years, but because it supports the activities of other funds, General Fund has incurred a loss the last two years of $156,000 or 24% of its fund balance.
2. Other funds, because they are not performing well financially, have been borrowing General Fund's cash for years. This has resulted in the General Fund recording a large interfund receivable from these other funds. Because the other funds do not have the ability to repay this receivable currently, General Fund's fund balance is considered "unspendable". The other funds must improve their financial position in order to pay back the amount owed to General Fund.
3. Historically, the Village has been fairly accurate with its original budget projections for General Fund operational activity. The loss in 2016 was primarily due to General Fund providing funding for road projects.
4. We recommend creating a long-term projection or forecast of General Fund activity, including the interaction with the other related funds, in order to help the Village make strategic plans for financing future projects and operations.

Major and Local Street Funds

1. Historically, the Major and Local street funds have spent their entire allocation of Act 51 revenue, leaving little to no fund balance for future years. In addition, General Fund has periodically subsidized projects that Act 51 revenue was not sufficient to pay for.
2. Since General Fund's financial position is eroding, Major and Local Streets do not have access to as much support from General Fund as has been the case historically.
3. If road projects go over budget and Act 51 revenue is not enough to cover the overages, General Fund will be stuck paying for it. Given General Fund's financial position, it is imperative that the Street funds are budgeted accurately.

Enterprise (Utility) Funds

1. Through 2016, all three utilities had declining cash position over several years. The rate increases in 2017 for Water and Sewer were absolutely mandatory to begin reversing this trend.
2. Even with the 2017 rate increases, all three utility funds' cash positions are lower than the minimum we would recommend.
3. The poor financial performance of the utilities, specifically Sewer, is having a significant negative effect on the General Fund and its ability to pay for governmental services, including road projects. As the utilities are "Enterprise Funds", customer rates should be set at such levels so that enough revenue is generated for each utility to stand on its own and plan for future capital needs. Through 2017, none of the three utilities are doing this.

4. The Sewer Fund's ongoing disagreement with Pentland Township is a significant contributing factor to the Sewer Fund's poor financial performance. This disagreement must be resolved and either Pentland needs to pay what it is being billed or else the other customers of the system will need to incur even greater rate increases going forward.
5. We recommend conducting a multi-year cost projection for each utility fund, including repaying any amounts owed to each other and to the General Fund. This projection can be used for creating a long-term rate setting plan.
6. Rate setting should be incorporated into the Village's annual budget process. Most utility systems we have worked with require an annual increase to its customer rates.

Legacy Costs

Pension

1. The Village has been contributing the actuarially calculated annual required contribution (the "ARC") as required by Michigan law.
2. The Village's pension plan is approximately 65% funded, thereby exceeding the minimum funding status required by Public Act 202 of 2017.
3. Continued contributions must be made in order to keep the plan over the minimum 60% threshold.
4. The Village's unfunded pension liability is approximately $1,600,000.

Retiree Healthcare (OPEB)

1. The Village pays for retiree health care on the "pay as you go" basis, meaning the Village only pays for the monthly premiums for retiree healthcare. This means the Village has not prefunded the liability like it has for pension and the OPEB plan is zero percent funded.
2. The Public Act 202 of 2017 minimum funding requirement for OPEB plans is 40%. If the actuarially determined contribution for OPEB eventually exceeds 10% of the Village's General Fund budget, the Village will be in violation of PA 202 and will be required to submit a Corrective Action Plan to the Michigan Municipal Stability Board.
3. The Village's unfunded OPEB liability is approximately $1,200,000.

Thank you very much for the opportunity to serve you.

PLANTE & MORAN, PLLC

Brian J. Camiller