Strategic Public Policy

In conjunction with
McKenna Associates, Inc.

City of Middletown
Financial Analysis and Cost of Service Study
Comprehensive Plan Update

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CITY OF MIDDLETOWN
FISCAL ANALYSIS

Table of Contents

Chapter 1: Introduction

The City of Middletown is currently engaged in developing a Comprehensive Plan that attempts to reposition the City for the future. There is no question that National and State economic trends demand a re-analysis of many past held beliefs on the best way to create a strong economic base that will afford the City future financial stability and create cash flows that will allow for targeted redevelopment efforts.

It is of prime importance that City planners understand the changing relationships between land uses and a viable economic plan. While residents expect more in terms of quality services such as well-maintained streets, upscale recreation facilities and swift emergency response, the traditional revenue streams for supporting those services (i.e. state and federal assistance; commercial tax revenues) have been flattening or being totally eliminated. Cities are then forced to replace those funds with voter approved tax issues which, in the current climate, are not favorably viewed.

Older industrial cities are particularly hard hit by these trends. As tax abatements are regularly used to retain existing businesses, State tax laws remove equipment value tax charges, retail formats are changed and older properties abandoned, housing stock reaches its natural life cycle in terms of design and construction, and few redevelopment funds are available from Federal and State programs, the challenges for older, built-out cities are formidable.

Strategic Public Policy was engaged as part of the Comprehensive Plan Team to provide financial and cost of service analysis that will assist the City in establishing realistic plans for economic sustainability. The Fiscal Analysis includes the following elements:

- Current assessment of Key Economic Indicators
- Analysis of Historic Revenue and Expenditure trends (1999-2003)
- Projected Revenues and Expenses for the future (2008)
- Current Land Use Cost of Service Analysis and comparison of costs to other cities
- Recommendations for Economic Sustainability.

Chapter 2: Current Assessment of Key Economic Sustainability Indicators

While the primary goal of this project is to provide information to the Steering Committee engaged in developing the Comprehensive Plan, it is also intended to provide useful information to City Administrators, legislators and, most importantly, residents that will allow them to understand more fully the costs of providing basic services and the effect that changes in State and Federal policies will have on future revenue streams at the local level. It is hoped that this understanding will assist in encouraging proactive planning and management to achieve results that are value added and contribute to the quality of life for local residents and business concerns.

Intergovernmental Revenue Stream Changes

It is important to note at the outset that significant alterations have occurred over the past ten years that have affected intergovernmental revenue streams available to support City services. The effect of these changes has generally been to constrain the ability of local governments to provide the high level of services expected by residents and required to attract new business investment. These changes include:

- Elimination of virtually all Federal capital improvements grant programs to smaller cities;
- Changes to State tax regulations;
- Declining availability of shared State taxes; and
- Increasing requirements for local “matching" funds in order to have access to State and Federal grants.

(a) Capital Improvements

The most challenging costs for older cities are those related to significant capital improvements. Until the late 1980’s generous Federal grants were available for construction of water, sewer, road and recreation facilities. As these funds were recast as State Block Grant programs, States often changed the grant structure to loan programs or grants requiring high percentages of local matching funds. Today, for example, virtually all water and sewer capital costs must be addressed solely through user charges. As residents and businesses pay higher rates for such basic services as water and sewer, there is less discretionary money available to meet quality of life services such as enhanced recreation facilities or elimination of deteriorated areas. In the past, Middletown has benefited from Urban Development Action Grants, Police Service support Grants (COPS), Transit support grants and Community Development Block Grants. The COPS and UDAG grants have been eliminated. The City currently is still receiving approximately $790,000 annually from the CDBG programs which can be used for a variety of infrastructure improvement and community redevelopment programs. With the exception of "First Responder Grants" it must be recognized that these grant funds are at risk in the current Washington fiscal deficits climate.

(b) Since 1998, the State of Ohio has enacted significant changes to its tax policies. These include phasing out of the inventory tax for commercial properties, recalculation of equipment tax values, substantial reductions in public utility taxes and the phasing out of estate taxes. The changes relating to inventory taxes, equipment values and public utility definitions result in the weakening of commercial properties as revenue components for localities. At the beginning of the 1990's, businesses contributed approximately 21% of the non-income tax revenues to Ohio cities. Commercial properties now contribute less than 10%. This amount will decline even more so in the future.

(c) The State shares a variety of taxes with localities. These include "Local Government Funds" and "Local Government Revenue Assistance Funds". Through the 1990's, these funds to localities increased an average of 6% a year. Beginning with 2001, the funds were capped at 2000 levels. There was consideration by last year's legislators to eliminate these funds entirely and due to continued shortfalls in State revenues it is again being considered for the next budget cycle. At best, for the foreseeable future, a revenue source that helped cities keep pace with increasing cost demands has been weakened. The State has also considered eliminating its contribution to local property taxes through the "Rollback" reimbursement program. Further, the State has dramatically increased the value of estates which are subject to inheritance taxes. Middletown has averaged about $900,000 a year from this tax over the study period. In the future this will be reduced to an insignificant number.

(d) Most State infrastructure development programs are based on scoring systems that require high levels of local matching funds in order to be competitive. In many instances to get access to funds such as the Clean Ohio Funds (open space and Brownfield Clean-up) a greater than 50% match is required. This forces cities who envision significant future capital infrastructure needs to set aside increasing amounts of locally generated tax dollars at the same time revenue streams for basic services are declining.

For the City of Middletown, at-risk State shared taxes represent approximately 10.4 percent of its revenue stream. The Local Government Fund currently contributes $2,118,754 annually to the City's General Fund. Estate taxes have generated an average of $963,180 per year. The State currently contributes $494,145 per year through the Rollback program and changes to the Tangible Tax Structure are estimated to cost the City about $450,000 per year. Thus, approximately $4,026,079 of annual city revenues must be considered in the "at-risk" category. To put this into context, the amount "at risk" represents 84% of the current property tax receipt values and 23% of all income tax receipt values.

Land Use Tax Base Balance

While we have previously noted the declining advantage of commercial properties within the context of property tax revenue streams, non-residential development is an important land use component in that non-retail commercial properties in particular tend to require fewer government service support costs while substantially adding income tax revenues. Thus a proper balance of land uses is important to economic sustainability. The following table represents the assessed values of land use components from 2001 to 2004.

Assessed Values

	2001	2004	Change	% Chg.
Residential/Ag	**447,904,000**	**535,909,510**	**88,005,610**	**+ 19.7**
Industrial	**46,247,030**	**54,165,160**	**7,918,130**	**+ 17.1**
Commercial	**141,990,750**	**163,836,460**	**21,845,710**	**+ 15.4**
Public Utility	**52,757,620**	**38,624,390**	**- 14,133,230**	**- 26.8**
Tangible Personal	**215,164,970**	**252,765,967**	**37,600,997**	**+17.5**

It is clear that the changes the State enacted relative to lowering public utility taxes has already begun to have a significant effect. The final Public Utility Values will probably be reduced to a $2,000,000 level by 2010. The State Tangible Tax changes do not begin to be fully felt until 2005. This valuation is estimated to drop by 41.4 percent over the next fifteen years.

As to the tax base balance, a general rule is that a community should have a minimum of 30% of its tax base value that is not related to residential properties. Middletown clearly currently meets this test with the following breakdowns.

TAX BASE BALANCE

	2001	**2004**
Residential/Ag	**49.5 %**	**51.3%**
Industrial/Comm. Real	**20.8 %**	**20.8 %**
PU/ Tangible	**29.7 %**	**27.9 %**

Middletown currently has a total of 50.5% of its total valuation related to non- residential property. However, as the State changes noted above are phased in over the next fifteen years Middletown will begin to approach the 70% residential proportion.

Income Tax Structure

Middletown currently offers a full 100% credit for income taxes that are owed in the community where residents work. Many cities are eliminating part of this credit as it makes the community less vulnerable to downturns within specific community based businesses. With a moderate 1.5% income tax rate, the City is foregoing significant revenues by continuing the 100% credit. The City could increase revenue by as much as $500,000 for every .5% reduction in credit. However, when compared to other Ohio cities with an older industrial base which have seen drops in income tax revenues of 12-15%, the income tax revenues for Middletown have remained unusually steady.

Internal Revenue Source Balance

The City currently receives 54.3% of its overall operational revenues from income tax (excluding charges for service such as water and sewer charges). Many cities find themselves dependent upon income tax revenues to a larger degree. ***SPP*** has reviewed many cities with an income tax dependence of over 80%. This indicates that the City will be able to have more economic stability options, particularly if blended with a reduction in the tax credit discussed above.

Debt Structure

The City's long term debt is minimal. This lack of debt offers many options for funding future needed redevelopment concepts that may be considered in the Comprehensive Plan process.

Cash On-Hand/Fund Balances

It is advisable that the City maintains a six-month cash on hand balance to meet ongoing expenditure demands. (The City has a policy that requires it to have between 15 and 25% of General Government annual expense revenues on hand.) At the end of 2003, the City had a General Fund Balance which would meet or exceed this criterion, assisting in credit rating support.

Control of Personnel Costs

Over the past four years, the City has controlled total personnel cost increases to under 7% per year average while many cities have experienced personnel cost increases of over 15% a year. As personnel costs represent about 66% of the total general operating costs, this cost control factor has been an important component of financial sustainability in years where some revenue streams have been declining.

Over the four-year study period personnel numbers have only increased from 430 to 434 employees. A preliminary study of personnel operational task ratios indicates the City has personnel levels in the low to mid-range. (i.e. with the exception of the Service Department, departments appear to have staffing levels that are reasonably commensurate with demand). Our projections show personnel costs will increase about 4% a year based on current staffing levels.

Achievement of GASB 34 Requirement

The City has already instituted several new accounting procedures required by the Governmental Accounting Standards Board Directive 34. This directive requires governmental bodies to account for depreciation of capital assets owned by the City.

One area in which the City does not appear to have adequate funds to pay for future replacement is in roads. In order to meet replacement demands 11-14 miles of road should be fully improved each year. At present, funds have not been accrued to achieve this.

Recreation Facility Demands

In order to attract new development/redevelopment; quality parks, open space and recreation facilities are often identified as a key component. The City has been under-investing in this area during the Study Period, and will substantially have to improve that area of service.

Increasing Levels of Subsidized Housing

In the last four years the City has experienced a substantial increase in subsidized rental units (767 to 1,554). At present, approximately 30% of all rental units are in the subsidized category. As the City is heavily dependent upon income tax revenues to meet operational cost demands, the high concentration of units with incomes of under $10,000 has significant effect. It is understood that programs such as Section 8 are a necessity and that they also create opportunities for owners of rental properties that are exhibiting vacancy rates of over 8%. However, large increasing concentrations within Middletown are resulting in continued loss of local revenue. It is estimated that the increase in subsidized units in the last four years has resulted in a loss of $600,000 in income tax revenues. Many of the subsidized units represent housing stock that has reached the end of its useful life (see GEM Report). The City's home rehabilitation program is operating at a modest level in comparison to demand due to lack of funding. Substantial increases in acquisition and redevelopment of obsolete housing will be needed to return many residential areas to economic productive use.

In summary, an overview of economic sustainability factors shows that in terms of current tax base balance, income tax revenue generation, debt structure and personnel cost containment the City is in a reasonably sound position. The challenges will be in maintaining revenue streams that will offset anticipated intergovernmental reductions while also providing funds for redevelopment and capital investment needs and addressing the under funding of road maintenance operations.

Chapter 3: Analysis of Historic Revenue and Expenditure Trends

Operating Revenue Overview

This analysis looks at the various revenue sources for the city and shows historic trends since 1999. The income tax is the primary revenue source for the city.

Annual Revenue Collections by Category

	1999	2000	2001	2002	2003
Income Tax	$ 17,286,807	$ 18,065,818	$ 17,778,038	$ 17,904,916	$ 17,347,220
Intergovernmental Revenue	$ 5,508,604	$ 5,700,162	$ 5,852,325	$ 6,419,988	$ 5,101,608
Property Tax	$ 3,738,032	$ 3,940,097	$ 4,091,163	$ 4,202,780	$ 4,770,688
Charges for Services	$ 3,035,132	$ 2,522,789	$ 3,044,972	$ 3,202,807	$ 2,897,589
Miscellaneous	$ 616,175	$ 625,376	$ 589,392	$ 877,990	$ 695,508
Interest	$ 927,909	$ 1,203,808	$ 979,158	$ 499,668	$ 303,604
Licenses and Permits	$ 336,109	$ 308,101	$ 333,730	$ 276,076	$ 243,306
Reimbursements	$ 160,802	$ 136,773	$ 124,334	$ 169,405	$ 219,427
Hotel/Motel Tax	$ 144,511	$ 137,007	$ 148,337	$ 134,250	$ 158,912
Fines and Forfeitures	$ 103,608	$ 134,567	$ 110,192	$ 118,487	$ 107,012
Rentals and Leases	$ 96,394	$ 105,896	$ 95,667	$ 103,119	$ 66,262
Contributions and Donations	$ 49,235	$ 27,377	$ 37,241	$ 40,053	$ 37,495
Grand Total	$ 32,003,318	$ 32,907,771	$ 33,184,549	$ 33,949,539	$ 31,948,631

Intergovernmental revenue is the second largest revenue source for the city.

From 1999 to 2002, combined operating revenue increased from $32 million to almost $34 million. This represents an increase of approximately 6%. Operating revenue was increasing steadily until 2002. In 2003, total operating revenue dropped more than 6% reducing operating revenue to pre 1999 levels. Ohio has been dramatically affected by the economic downturn that began in 2001. The slowdown impacted all of 2002 and continues to affect communities into 2003. Middletown's operating revenue growth faired better than many Ohio communities that began experiencing the overall decline in revenue as early as late 2001. However, in 2003, the combined effects of lower interest rates, a weakened economy, and reduced state revenues finally took its toll on Middletown's operating revenue.

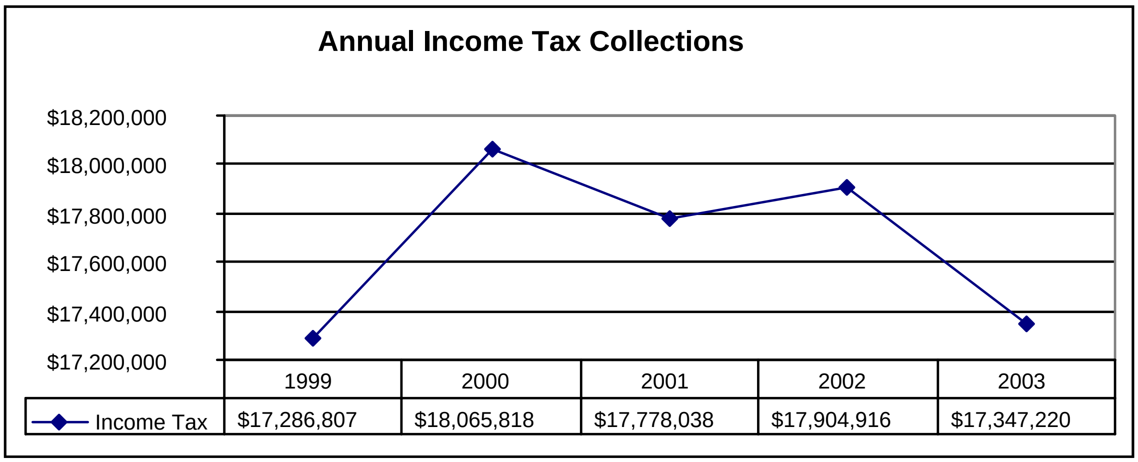
Local Taxes

Middletown's local tax revenue is predominantly comprised of its municipal income tax and property taxes. The city also collects a local hotel/motel tax. Total revenue from these local taxes has grown very slowly. Between 1999 and 2003, total local tax revenue increased from approximately $21.2 million to approximately $22.3 million. Income tax revenue actually declined slightly between 2000 and 2003 but this decline was offset by increases in property tax revenue for the period.

Income Tax

Income tax is the primary revenue source for Middletown. The tax is currently collected and administered by the city. The city has a 1.5% income tax on all wages paid in the city. The income tax provides approximately 54% of the city's operating revenue and about 80% of local tax revenues.

Income tax collections in many communities throughout Ohio have flattened dramatically since 1998. In Middletown, income tax collections continued to grow through 2000. In 2003, actual income tax revenue decreased by just over 3% returning to its lowest level



since 1999.

The decrease in 2003 collections is consistent with trends in other Ohio communities. Because of the city's reliance on the income tax, this trend needs to be monitored closely to ensure that the city makes necessary changes in its expenditure patterns to prevent a future fiscal crisis.

Property Tax

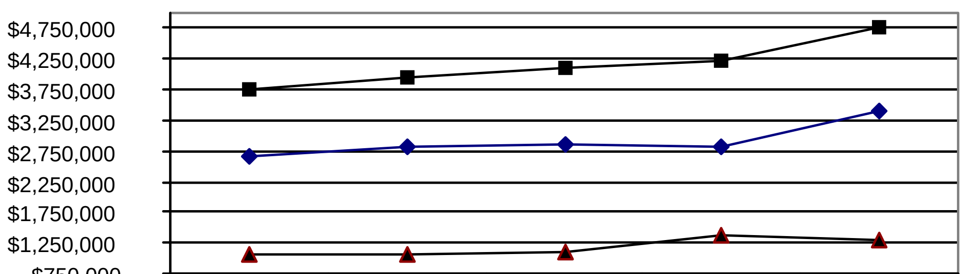
The property tax is collected and administered by the County on behalf of the city. State law provides for three property tax reductions that affect the local tax portion of the property tax. These state-mandated reductions are reimbursed by the state through shared tax programs.

Middletown collects 5.86 mills in property tax levies. All of this millage is either inside the state's 10-mill limitation (inside millage) or authorized by city charter (charter millage). Inside millage and charter millage are important for a community because they are not subject to any reduction factors mandated by the state. Therefore, these levies will continue to provide increased revenue as property values in the city increase.

The property tax is the third largest source of revenue for the city in 2003. Local property tax provides approximately 15% of the city's total operating revenue. When combined with related state shared taxes, over 16% of operating revenue can be attributed to the property tax.

Total property tax collections grew by over 27% between 1999 and 2003. The average annual growth rate was approximately 6.25%. Every three years, the county re-appraises property values. This creates a larger than average increase in property values and consequently a larger than average increase in property tax receipts when the new valuation takes effect. Property tax growth rate doubled (to approximately 13%) in 2003 due to the effect of the re-appraisal process.

Annual Property Tax Collections



	1999	2000	2001	2002	2003
Real	$2,657,972	$2,835,733	$2,869,012	$2,817,299	$3,394,151
Special Assessments	$11,176	$43,855	$92,644	$1,554	$80,383
Tangible	$1,056,434	$1,047,782	$1,118,886	$1,371,372	$1,296,074
Trailer	$12,450	$12,727	$10,621	$12,555	$80
Property Tax Total	$3,738,032	$3,940,097	$4,091,163	$4,202,780	$4,770,688

Recent changes in state law regarding tangible personal property began to effect the city's 2003 property tax collections. The city experienced its first year of significant decline in tangible personal property tax collections. However, an increase in real property tax collections fully compensated for the decline.

Intergovernmental Revenue

Intergovernmental revenues are a significant part of operating revenues for local governments in Ohio. Up until the 2001 biennial budget, the state continued to support

Annual Intergovernmental Revenue Collections

	1999	2000	2001	2002	2003
Beer and Liquor	$ 58,570	$ 62,756	$ 76,091	$ 56,930	$ 59,345
Cigarette	$ 1,980	$ 1,604	$ 2,019	$ 1,520	$ 2,235
County License Renewal	$ 33,011	$ 101,530	$ 33,272	$ 31,073	$ 6,887
County Vehicle License	$ 409,546	$ 273,500	$ 379,512	$ 367,891	$ 377,874
Federal Aid	$ 53,367	$ 40,000	$ 70,461	$ 69,827	$ 51,000
Gasoline Tax	$ 918,286	$ 894,611	$ 872,961	$ 906,413	$ 988,952
Homestead Rollback	$ 329,594	$ 355,824	$ 360,396	$ 366,192	$ 413,447
Inheritance Tax	$ 630,501	$ 780,986	$ 932,563	$ 1,508,670	$ 247,179
LGF (County)	$ 1,569,194	$ 1,566,912	$ 1,610,687	$ 1,521,563	$ 1,506,044
LGF (State)	$ 260,999	$ 308,149	$ 345,560	$ 333,835	$ 314,627
LGRA	$ 326,715	$ 334,108	$ 319,460	$ 301,842	$ 298,083
Municipal MV Tax	$ 278,734	$ 313,604	$ 298,956	$ 327,367	$ 318,875
MV Permissive Tax	$ 231,601	$ 222,475	$ 120,031	$ 294,188	$ 226,240
Pawn Brokers License	$ 500	$ 500	$ 300	$ 325	$ 200
Police Fed Grant	$ 284,182	$ 348,723	$ 315,026	$ 247,855	$ 152,177
Police State Grant	$ 24,863	$ 25,100	$ 12,587	$ 24,066	$ 52,289
Title XX	$ 26,906	$ 27,599	$ 25,630	$ 37,137	$ 56,795
Undesignated State Revenue	$ 70,055	$ 42,181	$ 76,813	$ 23,294	$ 29,359
Intergovernmental Revenue Total	$ 5,508,604	$ 5,700,162	$ 5,852,325	$ 6,419,988	$ 5,101,608

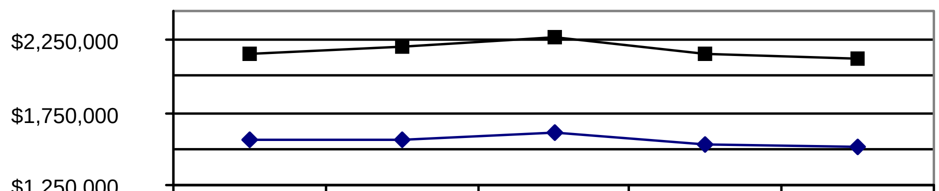
local governments through several revenue sharing programs. However, since 2001, the state's fiscal crisis has forced the state to re-evaluate its support of these programs. As a result, cities face cuts or outright elimination of revenue programs they thought were secure. Intergovernmental revenue accounted for approximately 16% to 17% of the city's annual operating revenue for 1999 through 2003. Between 1999 and 2002, intergovernmental revenue was growing in importance to the city's operating revenue. By 2002, intergovernmental revenue provided almost 19% of the city's operating revenue. Then, in 2003, its share of operating revenue declined to its lowest for the focus period at just under 16%.

Local Government Fund

Local Government Fund revenue includes money from two state sponsored tax sharing programs; the Local Government Fund began in 1935, and Local Government Revenue Assistance Fund started in 1989. Both of these programs are supported by six stateimposed taxes that include the sales tax, use tax, individual income tax, corporate franchise tax, public utility excise tax, and the kilowatt-hour tax. Total funding of the program is therefore affected by legislation that would reduce or eliminate the city's share of these funds or the amount of tax generated by the six taxes that fund the programs.

Due to recent changes in the State's funding of this program, local government fund distributions have decreased since 2001 and will likely decrease in the future. In 2003, the city received more than $2.1 million in local government fund revenue. This is approximately the same amount it received in 1999. Due to the State budgetary crisis,

Annual Local Government Fund Revenue



	1999	2000	2001	2002	2003
LGF (County)	$1,569,194	$1,566,912	$1,610,687	$1,521,563	$1,506,044
LGF (State)	$260,999	$308,149	$345,560	$333,835	$314,627
LGRA	$326,715	$334,108	$319,460	$301,842	$298,083
Local Government Total	$2,156,908	$2,209,169	$2,275,707	$2,157,240	$2,118,754

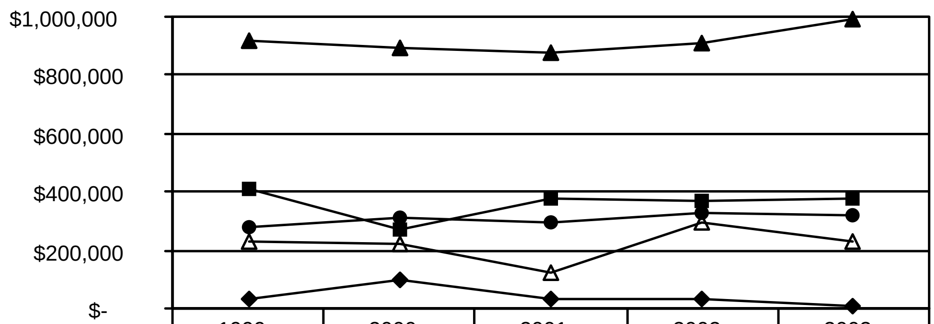
(State LGF and LGRA are not shown on graph)

elimination of the Local Government Fund is currently being discussed. Any change in state policy will likely have a major impact on future revenue.

Road Taxes

The gasoline and the motor vehicle license taxes are other revenue sources that are shared by the State. These road taxes account for more than 37% of the city's total intergovernmental revenue in 2003. Revenue from these taxes declined through 2001 but rebounded in 2002 and 2003. As a result of this rebound, total revenue from road taxes increased by approximately 2.5% for the period between 1999 and 2003. The most significant contributor to the fluctuations in the city's total road tax collections was the changes in gasoline tax collections. Gasoline taxes contribute approximately 50% of the city's total road tax collections.

Annual Road Tax Collections



	1999	2000	2001	2002	2003
County License Renewal	$33,011	$101,530	$33,272	$31,073	$6,887
County Vehicle License	$409,546	$273,500	$379,512	$367,891	$377,874
Gasoline Tax	$918,286	$894,611	$872,961	$906,413	$988,952
Municipal MV Tax	$278,734	$313,604	$298,956	$327,367	$318,875
MV Permissive Tax	$231,601	$222,475	$120,031	$294,188	$226,240
Road Tax Total	$1,871,178	$1,805,720	$1,704,732	$1,926,932	$1,918,828

(Total Road Tax collections are not shown on graph)

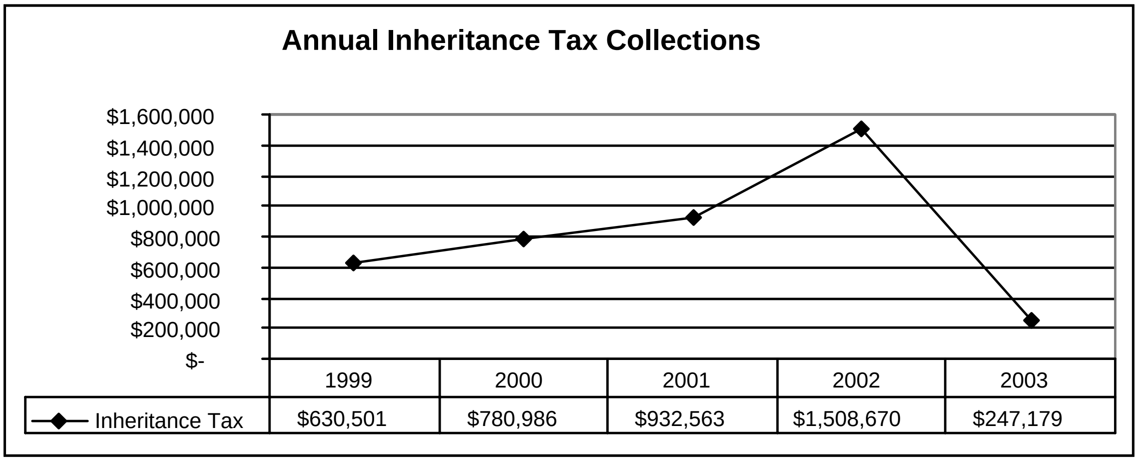
The city imposes a $5 motor vehicle license tax on all cars registered to residents of the city in addition to the county's vehicle license tax. Combined, the city and county vehicle registration taxes account for approximately 36% of the city's road tax collections.

Motor vehicle permissive license tax collections dropped significantly in 2000 but recovered through 2003. In addition, gasoline tax collections have increased since 2001. As a result, total road tax collections rebounded in 2002 and were still above 1999 levels in 2003.

Inheritance Taxes

The inheritance tax has been an erratic revenue source for local governments. Though the premise of the estate tax is questionable to some people, its contribution to city government revenue has been undeniable. However, this will likely change over the next five years. In September of 2000, the State Legislature enacted Senate Bill (SB) 108, which modifies the estate tax. SB108 increases the estate tax exemption over a two-year period. In 2003 the final exemption increase occurs. Between 2000 and 2003, the State's exemption increased from $25,000 to $338,000. It is estimated that this will exempt approximately 75% of all estates currently subject to the tax.

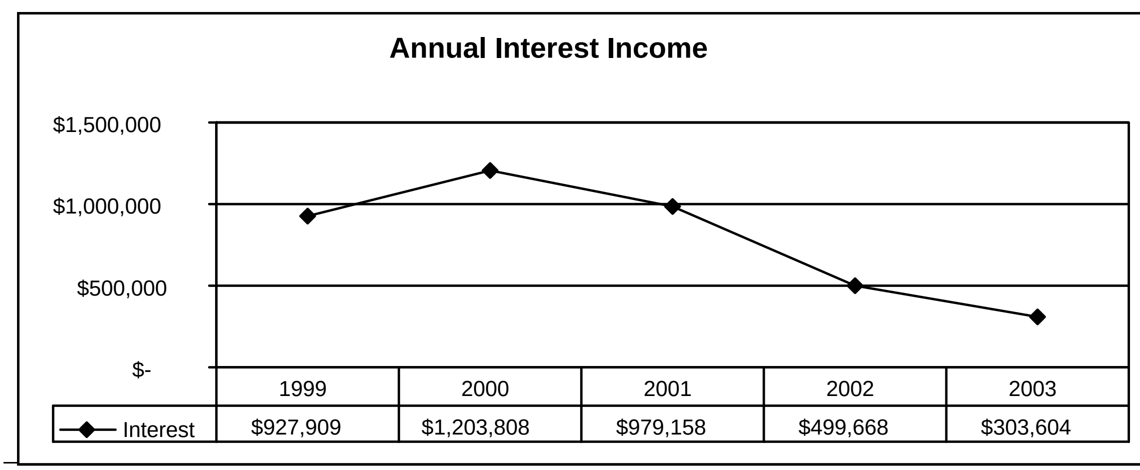
Through 2002, the estate tax was contributing between 11% and 22% of total intergovernmental revenue. In 2002, the estate tax's contribution actually hit its highpoint for the focus period at just over $1.5 million. The impact of the State's current



changes fully impacted the city in 2003 as estate tax revenue dropped by more than 83%. In 2003, the estate tax contributed approximately $250 thousand to the city's coffers or approximately 3.6% of the city's total intergovernmental revenue. This new level of estate tax revenue is likely to continue under current state policy. However, the future of the estate tax is questionable as Ohio legislators continue to look for ways to decrease or eliminate this revenue source.

Investment Income

Middletown's investment income has been hit substantially by the declining rate environment of the last several years. No city in Ohio has been immune to the precipitous drop in rates that occurred over the last several years. The city's average



investment yield has dropped from its highpoint of 6.17% in 2000 to its current low for the period of 3.9% in 2003. The impact has been dramatic on the city's operating revenue. In 2000, the city received over $1.2 million in investment income. By 2003, that amount had dropped to just over $300 thousand. Investment interest now accounts for less than 1% of operating revenue.

Operating Expenditure Overview

This analysis looks at the various types of expenditures for the city and shows historic trends since 1999. Most capital expenditures are not included in this section of the report due to their episodic nature. However, some minor capital expenditures for equipment and on-going maintenance programs are included as costs of operation.

In this report operating expenditures are subdivided by governmental function. Together, the following sections provide an historical perspective for Middletown's expenditures from both the total governmental perspective and the individual functions. Expenditures are also subdivided by purpose to aid in identifying where cost fluctuations occur. Differences in totals between the data categorized by function and purpose is due to miscellaneous expenses where the purpose could not be identified and differences in the data sources. Data categorized by function was taken from the city's Comprehensive Annual Financial Reports for all years up to 2002. Data for 2003 expenditures by function were taken from the city's Annual Budget.

Percent of Operating Expenditures by Purpose

Purpose	2000	2001	2002	2003
Personnel	64.53%	67.74%	69.68%	66.28%
Travel and Training	0.50%	0.37%	0.39%	0.44%
Contractual Services	22.54%	20.44%	19.34%	22.65%
Operating Supplies and Expenses	3.70%	3.66%	3.22%	3.39%
Operating Capital	8.73%	7.79%	7.36%	7.24%
Total	100.00%	100.00%	100.00%	100.00%

In the table above, operating expenditures are subdivided by purpose. All figures were compiled using the City's Annual Budgets. Figures for 2000 through 2002 combine prior year actual numbers for the given years. The 2003 figures are budgeted amounts.

Therefore, actual increases in 2003 expenditures are likely to be lower than those reported here.

Personnel costs traditionally consume the majority of a city's operating expenditures. Middletown finds itself in a position that is similar to the experiences of most communities. Personnel costs have consumed approximately 66% of the city's total operating expenditures. Contractual services have been consuming approximately 20% of operating expenses.

Personnel expenditures have been increasing at about 6% per year. This includes wage and salary adjustments as well as increases in health benefits and other employee benefits. From a citywide perspective, this level of increase is similar to or lower than increases being experienced in other Ohio communities.

Contractual service expenditures were decreasing over the period. However, the budgeted figures for 2003 increased substantially (almost 35%) over 2002 levels. This increase equates to more than $2 million and could be one of the reasons for the apparent change in the city's financial condition between 2002 and 2003. Five line items contributed account for almost 70% of the total increase in contractual services. The largest increase of nearly $900,000 is budgeted in the Development Services area. In addition, the Home Program and the City Centre Mall Program have significant increases in their contractual service line items. The Personnel Department increased its contractual services by over $100,000 and the budget for street lighting increased by over $95,000. Since these increases are budgetary increases, the final expenditure figures will likely reduce their impact as portions of anticipated contracts are not awarded.

Operating Expenditures by Government Function

Cities generally review their operating expenditures by government function to determine how much they are spending on the various services they provide to their constituents. The city's operating expenditures grouped into the six primary local government

Expenditures by Function

Function	1998	1999	2000	2001	2002	2003
General Administration	$ 4,207,208	$ 5,146,255	$ 4,961,376	$ 4,952,663	$ 5,550,782	$ 6,019,834
Roads	$ 3,038,025	$ 3,269,939	$ 3,582,124	$ 3,818,487	$ 3,492,861	$ 3,724,347
Parks and Recreation	$ 3,024,646	$ 2,923,147	$ 3,289,339	$ 3,211,096	$ 2,992,475	$ 2,977,737
Fire	$ 6,156,739	$ 6,431,036	$ 6,758,066	$ 7,139,988	$ 7,936,257	$ 8,501,721
Police	$ 7,924,726	$ 8,259,966	$ 8,869,364	$ 9,395,545	$ 9,407,674	$ 10,212,049
Development Services	$ 3,313,960	$ 3,842,505	$ 4,176,996	$ 4,028,142	$ 4,398,678	$ 5,302,514
Grand Total	$ 27,665,304	$ 29,872,848	$ 31,637,265	$ 32,545,921	$ 33,778,727	$ 36,738,202

functions. The city's total operating expenditures increased at an average rate of 5.86% per year between 1998 and 2003.

General Administration

General government operating includes basic administrative expenditures for financial, legal, administrative, legislative and similar types of functions. Total operating expenditures for general government purposes increased at an average annual rate of approximately 3.5% between 1998 and 2003. General administration expenses accounted for 16% of the city's total operating costs on average.

General government expenditures increased at an average rate of 7.8% for the period despite declining expenditures in 2 of the last 5 years. In 1999, general administration expenditures increased more than 22% over 1998 levels. In 2002, general administration expenditures increased almost 12% over 2001 levels.

More than 92% of the city's general administration expenditures are from personnel and contractual services. Nearly 60% is due to personnel expenditures. Because of this, the budget for general administration is very sensitive to changes in personnel costs including wage increases and increases in employee benefits. It also makes cutbacks in general administration expenses difficult because budgetary cuts in this area often require eliminating personnel. Contractual services consume around 32% to 35% of the city's expenditures for general administration.

Roads

Road operating costs have averaged approximately 11% of the city's annual operating expenditures for the focus period. While total road expenditures increased at an average rate of about 4.4% per year for the entire focus period, they actually declined between 2001 and 2003.

Personnel expenses consume about 38% of road expenditures. As one might expect, operating capital and operating expenses consume more of the road budget than many other functional areas. These two areas include equipment for road maintenance and the purchase of various types of asphalt and road maintenance supplies. These costs consume about 27% of road expenditures. The amount spent on these functions has remained fairly constant at about $1 million. Contractual services for road maintenance consume about 35% of expenditures.

Parks and Recreation

Departmental operating expenditures have been flat for the focus period. Expenditures for the period declined by .1% on average between 1998 and 2003. Park and recreation expenditures have been shrinking relative to other operating expenditures. In 1998, recreation expenditures accounted for nearly 11% of operating expenditures. In 2003, that percentage had dropped to just over 8% of operating expenditures. On average, park and recreation functions consume approximately 10% of the city's total operating costs.

Personnel and contractual service expenditures account for 75% of park and recreation expenditures. As a result, budgeting in this functional area faces many of the same challenges the city faces in cutting general administrative expenses. However, park and recreation functions rely on more temporary and part-time labor so the effects of increases in health care and other benefits do not have as significant an effect in this area. In addition, cutbacks in personnel do not necessarily require layoffs of permanent employees since the city can adjust its annual hiring of part-time support.

The city reduced its total funding of park and recreation activities by reducing operating capital and operating supply expenditures. Since 2000, the city has steadily reduced the amount it spends on these items from $1.1 million to just over $700 thousand.

Fire

Fire departments usually require significant resources for a community when they provide their own fire suppression and emergency medical services. These operations, like police departments, are required to operate on a 24/7 schedule. Between 1999 and 2003, departmental operating expenditures increased at an annual average rate of approximately 6.7%. Larger than average increases have been experienced by the department over the last two years. In 2002, departmental expenditures increased more than 11% and in 2003, expenditures increased more than 7%.

Personnel costs consume more than 83% of the city's fire expenditures. Fire and police are the two most personnel intensive departments in the city. This is not unusual due to the 24/7 nature of departmental operations and the requirement to have employees ready to respond quickly. It does, however, highlight the need for the city to carefully negotiate changes in wages and benefits offered to fire and police employees.

Police

Law enforcement functions tend to be the largest cost center for local governments due to the department's 24/7 schedule. In Middletown, police expenditures on average consumed more than 28% of the city's annual operating expenditures between 1998 and 2003. Total police expenditures increased at an average rate of about 5% per year between 1998 and 2003. Police cost increases were relatively modest between 1999 and 2002. Departmental operating expenditures increased at an annual average rate of 5.24%.

Personnel costs account for approximately 87% of the total operating expenditures for police operations. In 2002 and 2003, personnel costs began increasing significantly for the department. Personnel costs increased by more than 7% in 2002 and an increase of over 10% was budgeted for 2003. Over the two-year period annual personnel costs increased by approximately $1.4 million. In 2002, the city controlled the overall growth in the department's expenditures by reducing purchases of operating supplies, operating capital and contractual service expenditures. In the 2003 budget, these areas returned to traditional levels.

Development Services

Development services include those departments that provide the majority of their services to land and community development operations. They include engineering, planning and zoning operations, economic and community development functions. Spending in this area has been very cyclical for the city. In 1999, the city increased spending in this area by over 15%. In 2001, the city decreased expenditures by more than 3.5%. In 2003, the city budgeted an increase of over 20% in expenditures related to development services. Overall, the city increased expenditures for development services by 10% per year on average between 1998 and 2003.

Development services is an area that relies upon contractual service expenditures more than any other department in the city. In 2003, 59% of the budget for development services was consumed by contractual services. This is contributed in large part to the department's cyclical expenditures because it is relatively easy for the city to reduce these expenditures quickly in the face of projected budgetary shortfalls. Over the last four years contractual service expenditures fluctuated between a low of $1.7 million in 2002 and a high of $3.1 million in the 2003 budget.

Comparison of Revenues to Expenses by Government Function

Comparison of definable revenue streams to operational expenses by functional departments helps both to identify financial trends and to establish the parameters for the land-use type cost/benefit analysis.

General Governmental Administration

General Administrative costs have several dedicated revenue sources including property taxes, the 1.5% income tax, the inheritance tax, local government funds from the State and County cigarette taxes and liquor permits among others. In 2003, Middletown projected almost $25.9 million for general operations. The cost of general administrative operations was $6 million representing a positive cash flow of approximately $20 million, which was available to transfer to support other departmental functions.

Road maintenance, parks and recreation, fire, police operations and development services all have deficits placing demand on this revenue availability. In 2003, this demand was budgeted in excess of $24 million. Thus available funding from dedicated revenue sources was short of meeting expenditure requirements by approximately $4.7 million. In 1999 the operational surplus was approximately $2 million but it has been declining steadily throughout the focus period.

Roads

Road operations receive gasoline taxes and motor vehicle license taxes. Cities have access to three sources of revenue from motor vehicle license taxes. The state provides 34% of state license tax revenue to cities. The amount of this tax varies by vehicle. Currently, passenger cars are charged $20, motorcycles are charged $10, and non-commercial trucks are charged $35. Commercial trucks and vehicles are charged based upon size. The second source of motor vehicle license tax is from the taxes collected by the county. The city's portion of this tax is $2.50 on every vehicle in the district. The third source of motor vehicle license revenue is from a city-requested tax of $5.00.

Road operations received approximately $2.1 million in 2003. Most of this revenue was from gasoline and motor vehicle license taxes. Total road operation costs were approximately $3.7 million for 2003. This creates an additional demand of approximately $1.6 million on total operating revenue.

Parks and Recreation

Parks and Recreation has no dedicated revenue source other than fees. In 2003, department revenues were approximately $1.7 for operations. The cost of providing the services was approximately $3 million. Therefore, parks and recreation experienced a functional deficit of approximately $1.3 million.

Fire and Emergency Medical Services

Dedicated funding sources for fire and EMS operations include the property tax and charges for services. These sources generated approximately $1 million in 2003. Operational costs for fire and EMS were approximately $8.5 million for 2003. This creates an additional demand of approximately $7.5 million.

Police Operations

Property taxes, intergovernmental revenue, fines and forfeitures are the major revenue sources for the police department. Dedicated revenue for police operations were approximately $640 thousand in 2003. Police revenue has been steadily declining since 2000 and is currently below 1999 levels. Police operation costs, on the other hand, continue to increase. In 2003, police costs were approximately $10.2 million. This creates a net additional demand of approximately $9.6 million on the city's total operating revenue.

Development Services

Planning and Zoning is a fee generation center and thus it is appropriate to compare fees for service generated to the cost of operating the department. In cities experiencing strong development activity, the Planning and Building Departments often operate as revenue centers rather than cost centers. Mature communities with limited growth potential have a more difficult time recovering costs for the department. In Middletown, departmental expenses for 2003 were over $5.3 million while fees and other dedicated funding sources generated approximately $548 thousand representing a functional deficit of approximately $4.8 million.

Summary of Current Operating Revenues and Expenditures

The following table shows how the city's operating surplus has been eroding over the last several years.

Operating Cashflow (Revenue-Expenditures)

	1999	2000	2001	2002	2003
General Administration	$ 20,722,515	$ 22,079,915	$ 22,045,097	$ 22,065,519	$ 19,850,703
Roads	$ (1,198,122)	$ (1,554,367)	$ (1,864,002)	$ (1,424,662)	$ (1,587,313)
Parks and Recreation	$ (1,006,904)	$ (1,452,605)	$ (1,322,123)	$ (1,107,291)	$ (1,279,415)
Fire	$ (5,455,942)	$ (6,086,363)	$ (6,162,712)	$ (6,859,063)	$ (7,451,234)
Police	$ (7,566,137)	$ (8,021,546)	$ (8,598,310)	$ (8,650,534)	$ (9,567,575)
Development Services	$ (3,364,940)	$ (3,694,528)	$ (3,459,322)	$ (3,853,157)	$ (4,754,737)
Grand Total	$ 2,130,470	$ 1,270,506	$ 638,628	$ 170,812	$ (4,789,571)

From 1999 to 2003, combined operating revenue was constant at about $32 million. During the same period, basic governmental operational costs have increased from approximately $28 million to over $36.7 million. This represents an average annual increase of 5.86% for the period. The city was operating at a surplus or breaking even through 2002. However, the growth differential in operating expenses versus operating revenue created an operating deficit of nearly $4.8 million in the 2003 budget. With the substantial decreases expected as the result of new State law and policies, the City will likely face additional challenges to maintain its current financial position.

Debt Overview

The city has established a debt policy to govern the purpose, type and of debt it is willing to issue. Per that debt policy, the city will not issue debt to finance current operations. Debt will be used to fund capital improvements only. The city will also employ self supporting debt instruments as its first choice. Therefore, it will actively pursue revenue options including special assessments and charges for services. Debt will not be issued in excess of the city's statutory debt limitations.

The city currently has debt obligations in excess of $29 million. This includes tax supported debt of about $17.8 million, enterprise support debt of about $8.6 million and special assessment debt of about $2.6 million. Of this approximately $4.6 million is subject to the city's statutory debt limitations.

Statutory limitations are based upon total assessed valuation. As of December 31, 2003 the city's assessed valuation was approximately $1.04 billion. The city's total outstanding debt principal that is subject to statutory limitations cannot exceed 10.5% of the city's total assessed value. Approximately $104 million dollars in additional debt principal could be issued by the city before reaching this statutory limitation. This would include voted and unvoted debt principal, however, all of the city's current debt subject to statutory limitations is unvoted debt. An additional limitation applies to unvoted debt. Unvoted debt may not exceed 5.5% of the city's total assessed value. Therefore, the city could issue approximately $52 million in additional unvoted debt principal before reaching this lower statutory limitation.

The city has sufficient legal capacity to issue additional debt. As of December 31, 2003, the city had only used 8% of its unvoted debt limitation and only 4.2% of its combined voted and unvoted limitation. The city currently enjoys an A-1 rating by Moody's.

Chapter 4: Analysis of Projected Revenues and Expenses

The revenue and expenditure projections for this report are prepared using a linear extrapolation method that predicts future values based upon the historic data provided by the city. Since this projection method assumes that historic conditions will remain constant over the projection period, each line item is reviewed to ensure that the projections look appropriate. If there is historic data that seems to skew the projections significantly, those projections are recalculated using a different method.

One alternative method is the moving average method. Some items, like donations, may fluctuate significantly during the given historic period but remain fairly stable over longer periods of time. The moving average method is used in these instances to smooth out the projections.

In those instances where circumstances have clearly changed or we know that significant changes are being proposed within the projection period, we have adjusted projections to account for these changes. Programs that will be discontinued are eliminated and those that are to be reduced are adjusted to account for any legislated changes. If the city has informed us of anticipated workforce additions or reductions, these are calculated into the future projections.

Individual line item projections are then combined into the data presented here.

The projections cited in this report do not include certain factors that will potentially impact future revenue and expenditures but were still in early planning phases at the time this analysis was being conducted. One such project is the planned hospital expansion and interchange upgrade. The new interchange development was not factored into these projections. Costs for this development are assumed to be funded by the city's excess debt capacity and will include major capital costs that are not associated with on-going operations. This report also does not include the Gem market study recommendation that an in-house economic development department of 4 to 6 employees be created. This recommendation was not approved by the city or the Comprehensive Plan Steering Committee at the time this analysis was performed.

<u>Revenue Projections by Source</u>

The income tax will continue to be the primary revenue source for the city. Property tax collections will continue to be the second largest revenue source for the city. For these projections, property tax revenue includes real and tangible property tax collections from all city levies and the portion of property tax refunded by the state for the homestead exemption and state property tax rollback.

The city will reduce its overall reliance upon state shared taxes over the next five years. In 2003, these taxes, excluding property tax reimbursements, provided approximately 15% of the city's total operating revenue. By 2008, they will contribute less than 12%. However, the effect of these changes is even more significant when one accounts for what the shared revenue will fund. In 2003, the general fund portion of these taxes was nearly 60% with the balance being apportioned to various road taxes. By 2008, the general fund portion will drop to 49% and the road portion will account for the majority of all shared tax revenue excluding property tax reimbursements.

Annual Revenue Collections by Category

	2003	2008
Income Tax	$ 17,347,220	$ 19,555,022
Property Tax	$ 5,184,135	$ 5,847,710
Intergovernmental Revenue	$ 4,688,161	$ 4,147,942
Charges for Services	$ 2,897,589	$ 3,055,216
Miscellaneous	$ 695,508	$ 968,784
Interest	$ 303,604	$ 475,048
Licenses and Permits	$ 243,306	$ 147,123
Reimbursements	$ 219,427	$ 219,427
Hotel/Motel Tax	$ 158,912	$ 163,538
Fines and Forfeitures	$ 107,012	$ 131,910
Rentals and Leases	$ 66,262	$ 86,419
Contributions and Donations	$ 37,495	$ 38,255
Grand Total	$ 31,948,631	$ 34,836,394

State shared taxes will continue to be a significant revenue source for local governments in Ohio. However, since 2001, the state's fiscal crisis has forced the state to re-evaluate its support of revenue sharing programs. As a result, cities face cuts or outright elimination of some programs they thought were secure.

Due to State budgetary problems, the State has reduced its support of the local government fund. As a result, we project that local government revenue will decrease over the next five years. In addition, as cities become less reliant on the state for local government fund support, the state's resolve to eliminate this funding source will likely increase.

The state legislature has also taken steps to eliminate the estate tax. In September of 2000, the State Legislature enacted Senate Bill (SB) 108, which modifies the estate tax. It is estimated that these modifications exempt approximately 75% of all estates subject to the tax prior to SB108. The estate tax is viewed as an objectionable tax by the state legislature. There have been significant moves to eliminate this tax altogether. As with the local government fund, Middletown should not count on any estate tax revenue in the future. Our projections assume the estate tax will be eliminated prior to 2008.

Revenue Projections by Government Function

The following table shows how the operating revenue just considered applies to the major governmental functions. All revenue sources are kept with programs in the same fund group. Revenue sources within a fund group were matched to particular functions using the city's line item coding system.

Revenue by Function

	2003	2008
General Administration	$ 25,870,537	$ 27,631,065
Roads	$ 2,137,034	$ 2,355,251
Parks and Recreation	$ 1,698,322	$ 1,851,080
Fire	$ 1,050,487	$ 1,384,222
Police	$ 644,474	$ 878,518
Development Services	$ 547,777	$ 736,259
Grand Total	$ 31,948,631	$ 34,836,394

Operating revenue was increasing steadily through 2002. In 2003, it dropped by about 6%. This drop in revenue is consistent with the experience of other Ohio cities. However, it appears to have affected Middletown about a year later than other areas of Ohio. The economic downturn that began in 2001 impacted all of 2002 and continues to affect communities into 2003. Over the next five years, we expect that revenue growth will return to pre-2002 levels.

Projected Operating Expenditures by Purpose

Operating expenditures are grouped into five categories for comparison with other local governments; personnel costs, travel and training, contractual services, operating supplies, operating capital. Operating capital includes vehicle and equipment purchases that are used in regular operations but may not be purchased annually due to cost or useful life of the asset. Buildings are not included in operating capital.

The following chart breaks down Middletown's operating expenditures into the five basic categories.

Citywide Operating Expenditures by Purpose

	2003	2008
Personnel	$ 24,349,977	$ 29,737,705
Travel and Training	$ 160,510	$ 165,254
Contractual Services	$ 8,322,672	$ 7,178,058
Operating Supplies and Expenses	$ 1,244,302	$ 1,288,992
Vehicles and Equipment	$ 2,660,741	$ 2,661,143
Total	$ 36,738,202	$ 41,031,152

Percent of Operating Expenditures by Purpose

	2003	2008
Personnel	66.28%	72.48%
Travel and Training	0.44%	0.40%
Contractual Services	22.65%	17.49%
Operating Supplies and Expenses	3.39%	3.14%
Vehicles and Equipment	7.24%	6.49%
Total	100.00%	100.00%

Personnel Costs

Based on historic trends, personnel costs are expected to increase by approximately 4% per year through 2008. Given increases in health care costs, this figure assumes a continuing effort by the administration to control staff size and wage increases. Even with these controls, personnel costs as a percentage of total operating costs will increase to 72% of the city's operating budget by 2008. This shift of financial resources toward personnel is primarily due to slower growth projections in spending for other purposes.

Travel and Training

The city controls its travel and training expenditures to those programs that are required to maintain employee certifications. As a result, Middletown spends a very small portion of its budget in this area. Growth in this area is expected to be slower than in other areas due to the relative stability of course pricing.

Contractual Services

Contractual services will consume a significantly smaller portion of operating expenditures by 2008. This is partially due to the 35% increase in contractual services the city budgeted for 2003. Contractual service expenditures are expected to decline in 2004 and 2005 as expenditures return to levels that are more comparable to historic expenditure trends. After 2005 the growth through rate through 2008 is projected to return to pre-2003 levels.

Operating Supplies and Expenses

Middletown has been very consistent in its level of expenditures for operating supplies and expenses. Assuming the city continues to control these expenses as it has over the last four or five years, the city can expect that there will be very little growth in this area. Based upon historic data, the city can expect expenditures of between $1.2 million and $1.3 million per year over the next five years. Operating supplies and expenses will also continue to consume approximately 3% of the total operating budget.

Vehicles and Equipment

The projections for vehicle and equipment expenses are based upon the city's vehicle replacement and maintenance schedules. It is not unusual for cities to consider vehicles and equipment as capital expenses. They are included in this report as operating expenses because they are required to provide services to the residents, have a relatively short and predictable useful life, and it is consistent with how we combine expenses for other communities that we have studied. Regular equipment purchases that are not vehicle related are also considered operating expenses in this report even though the city may consider them as capital expenses for budgetary and reporting purposes.

Expenses for vehicles and equipment tend to be cyclical due to replacement schedules. Middletown's expenses are consistent with this trend. Expenditures were higher in 2003 than previous years and the next cycle for this higher than normal expense year falls in 2007. Consequently, the 2008 figures appear to show virtually no growth from the 2003 figures. In 2007, vehicle and equipment expenditures are projected at just over $3.3 million.

Projected Operating Expenditures by Government Function

City's generally review their operating expenditures by government function to determine how much they are spending on the various services they provide to their constituents. The following table shows the city's operating expenditures grouped into the six primary local government functions.

Operating Expenditures by Function

	2003	2008
General Administration	$ 6,019,834	$ 6,315,671
Roads	$ 3,724,347	$ 3,960,935
Parks and Recreation	$ 2,977,737	$ 3,128,563
Fire	$ 8,501,721	$ 11,321,244
Police	$ 10,212,049	$ 11,865,755
Development Services	$ 5,302,514	$ 4,438,985
Grand Total	$ 36,738,202	$ 41,031,152

Percent of Operating Expenditures by Function

	2003	2008
General Administration	16.39%	15.39%
Roads	10.14%	9.65%
Parks and Recreation	8.11%	7.62%
Fire	23.14%	27.59%
Police	27.80%	28.92%
Development Services	14.43%	10.82%
Grand Total	100%	100%

Overall, operating expenditures are expected to grow at about 2.25% per year over the next five years. This growth rate is consistent throughout most of the functional areas as is indicated by the consistency in the percent of operating expenditures that are devoted to each function. The notable exceptions are fire and police operations. Both of these functional areas experience higher growth rates than other functions due to increases in personnel costs.

Summary of Projected Operating Revenues and Expenditures

In 2003, the city's budget expenditures exceeded budgeted revenue by approximately $4.8 million. By 2008, the city's functional deficit is projected to increase to more than

Projected Operating Cashflow (Revenue-Expenditures)

	2003	2008
General Administration	$ 19,850,703	$ 21,696,143
Roads	$ (1,587,313)	$ (1,605,684)
Parks and Recreation	$ (1,279,415)	$ (1,277,483)
Fire	$ (7,451,234)	$ (9,937,022)
Police	$ (9,567,575)	$ (10,987,237)
Development Services	$ (4,754,737)	$ (3,702,726)
Grand Total	$ (4,789,571)	$ (5,814,010)

$5.8 million. The increase in the functional deficit in the fire and police departments is the primary cause of the change in the overall operating deficit. Dependent upon the recommendations of the Fire Department Operation Study, we see definitive need for a separate funding source for fire operations. The projections show that the city cannot continue to subsidize fire operations without some additional revenue.

Chapter 5: Land Use Cost of Service

In an effort to develop a sustainable economic base, cities have begun to carefully evaluate the cost/benefit of various land uses. This has become particularly important in light of recent tax code changes at the State level. For example, the inventory portion of the tangible personal tax used to make land uses such as car dealerships and warehousing very profitable for cities. With the elimination of the inventory tax, these uses are much less desirable from a local economic sustainability standpoint. Similarly, the lowering and eventual proposed elimination of equipment tangible value has caused cities to carefully evaluate when and where to use tax abatements, tax increment financing mechanisms and whether to contribute to initial public incentive investments such as road improvements and other service facility upgrades.

This Chapter focuses on the current cost of service for city land uses based on the data included in Chapter 3. It attempts to define what specifically it costs in terms of Police, Fire, General Government, Road and Recreation to provide services to various elements of the City. It should be noted here that the cost/benefit results vary widely between cities dependent upon their revenue source, development regulatory practices and general operating procedures. The cost/benefit detailed in this Chapter reflect personal interviews with department heads to establish basic operational parameters, annual city budget/expenditure reports, careful review of annual operational reports to determine levels of response to various land uses (particularly for the Police, Fire/EMS services), employment levels and task assignments. The specific methodology parameters are included in the appendix documents.

SPP breaks down cost and revenue sources by the following categories: General Government, Recreation, Police, Fire/EMS and Road Maintenance as these are the primary function areas.

<u>Cost Assignments</u>

General Administrative costs were assigned by reviewing permit data, land development activity, employee assignments and land use acreage distribution. Costs for Police, Fire/EMS services were established through review of actual response numbers, location and type of response. Where specific detailed information was not available (for instance, police accident responses attributable to pass-through traffic), ***SPP*** utilized information and ratios from representational equivalent cities within its database. Road costs were assigned by calculating road miles and basic frontage requirements serving existing land uses.

Revenue Assignments

Revenues were based upon County Auditor valuation data to establish average residential, new residential, office commercial, Big Box retail and industrial tax values. Income tax revenue assignments were based upon historical actual receipts, recent studies conducted by the City Finance Director, and regional studies of average number of workers per acre and salaries by business type. Revenues from State tax sharing such as the Local Government Fund, estate taxes and Motor Vehicle License taxes were based upon 2003 distributions, and assigned to residential uses based upon 2000 census data for household size.

The Revenue Inputs by category are as follows:

General Government:	Property tax 5.26 mils (4.15 dir)
	Local Government Fund
	Estate tax
	Residential Component of Income Tax
	Cigarette, Liquor Taxes
	Fees/Permits
	Hotel/Motel tax
Fire/Emergency Service:	Transport Fees
	Other Fees
	Property Tax 0.3 mils
Police:	Property tax 0.3 mils
	Fines/Fees
Recreation:	Fees for services
Road Maintenance:	Motor Vehicle License Tax
	Permissive tax
	Gasoline tax

All Revenue Sources and Costs were reviewed for a five-year period to assure that the figures used for cost/revenue comparisons were accurately representational. Anomalous expenditures were excluded. Please note that this analysis does not include water and sewer costs and revenues as these are rate based Enterprise Funds whose revenues and costs must not be co-mingled with other City accounts and whose rate, by law, must cover expenses. This cost of service analysis is focused upon dependable revenue sources and basic operational costs. It does not include funds attributable to grant specific activities such as the First Homebuyers Program, UDAG grants etc.

Current Land Use Cost/Benefit Analysis

	Existing Single Family Cost	Existing Single Family Revenue		New Single Family Cost	New Single Family Revenue
General Government **	$472	$639		$472	$1,371
Fire/EMS	$272	$44		$272	$61
Police	$335	$10		$335	$28
Road Maintenance	$154	$92		$308	$184
Recreation/Open Space *	$27	$2		$27	$4
	$1,260	$787		$1,414	$1,648
Net Deficit	**($473)**		**Net Revenue**	**$234**	

	MultiFamily Cost	MultiFamily Revenue		Newer Office/acre Cost	Newer Office/acre Revenue
General Government	$315	$248	General Government	$81	$7,758
Fire/EMS	$272	$37	Fire/EMS	$256	$140
Police	$402	$4	Police	$338	$96
Road Maintenance	$62	$53	Road Maintenance	$616	$0
Recreation/Open Space	$27	$2	Recreation/Open Space	$0	$0
	$1,078	$344		$1,291	$7,994
Net Deficit/unit	**($734)**		**Net Revenue/acre**	**$6,703**	

	Big Box Retail/acre Cost	Big Box Retail/acre Revenue		Industrial/acre Cost	Industrial/acre Revenue
General Government	$807	$7,712	General Government	$108	$3,606
Fire/EMS	$1,711	$513	Fire/EMS	$122	$120
Police	$2,257	$93	Police	$163	$15
Road Maintenance	$3,080	$0	Road Maintenance	$1,200	$0
Recreation/Open Space	$0	$0	Recreation/Open Space	$0	$0
	$7,855	$8,318		$1,593	$3,741
Net Revenue/acre	**$463**		**Net Revenue/acre**	**$2,148**	

** Includes Income tax
* Excludes Golf Course Revenue/Expense

The results of the Cost of Service analysis show that for the average existing single family home value ($91,600), the City is spending $473 more per year to provide services than it is receiving in local and state share revenue. This figure is not unusual and is, in fact, at the low end of the scale for older Ohio communities. New single family with an assumed value of $260,000 actually produces a positive cash flow of $234 per unit. The current break-even point for the City if a home value of $235,000. It is worth noting that if the income tax credit were completely eliminated, a large percentage of existing single-family households would represent a cost/revenue break even point. Multi-family housing represents a heavy cash flow loss for the City due to the low assessed value of units and the higher service demand requirements related to police response.

The Cost of Service results highlight the benefits of residential redevelopment. If one acre of obsolete multi-family housing (estimated at 10 units) was replaced by four units of new housing, the resulting cost of service would shift from a deficit of $7,340 to a positive cash flow of $936, a net improvement of $8,276 per acre. ***SPP*** notes that the GEM market study indicates a demand for approximately 160 new owner-occupied units per year through 2007. If this were achieved in currently undeveloped areas it would represent an increased revenue source of $149,760 per year in 2007. If half of that number were achieved through redevelopment of older, obsolete housing, the net increase in operating revenue would be $927,640 per year. Clearly this indicates the long-term benefits of a defined redevelopment program.

In terms of the non-residential sector, modern office complexes represent a positive cash flow of $6,703 per acre per year. Big Box Retail represents more of a break-even scenario due to increased usage of emergency services, lower salary scales and higher road maintenance costs. This analysis suggests that the use of tax abatements, tax increment financing approaches or public participation in infrastructure costs is inappropriate for large-scale retail development. This is particularly true due to the transient nature of retail in today's market.

The industrial development in Middletown is currently contributing to relatively modest revenue per acre cash flows on a per acre basis. However, this is due to the overwhelming spatial requirements of AK Steel. Using the parameters of a new "GreenPlan" Industrial Office Park as suggested in the GEM Market Study, an acre of new office/industrial could produce a positive cash flow of over $11,000/acre for the City even with full property tax abatement. However, GEM study assumes 24 employees per acre. Studies conducted by ***SPP*** for new GreenPlan office/industrial parks suggest that the employment rate would be closer to 10 employees per acre which would reduce the positive cash flow to $3,402 per acre with full tax abatements. If the City offered sites which included road improvements to be paid off over 10 years, a 50 acre new industrial office park would be reflecting a $30,000 deficit cash flow for the first 10 years. After the road costs were paid, a 50-acre site would represent a $170,000 positive cash flow per year.

In terms of future industrial/office development for the City, it would clearly be beneficial to be able to market the sites the City currently has developed.

In all, the Cost of Service study supports the conclusions of the GEM Market Study in that the benefits of “new economy” office development (including medical services) are clear.

Cost of Service Expenditure Comparisons

As part of the Fiscal Analysis, ***SPP*** has compared the expenditure and service levels of Middletown to other similar “peer group” cities in Ohio. In this era of resident demand for accountability and efficiency in government and low tax components, we feel this is a useful exercise. It is also important in establishing that the Cost of Service numbers represent reasonable cost.

In establishing relative peer group costs, ***SPP*** utilizes data provided through the State Auditor’s office, the International City Managers Association benchmark project in addition to data compiled by ***SPP*** for other Ohio projects. Review data is gathered from cities that have the same demographic parameters, and that provide the same services at equal levels of effort. For example, costs for a full-time Union Fire Department are not compared with volunteer department costs. In general , Ohio cities included in the "peer" comparison base are: Wooster, Springfield, Cuyahoga Falls, Parma, Maple Heights, Barberton, Lima, Painesville and N. Royalton.

Police

SPP evaluates Police services levels based upon several factors: fulltime sworn officers per thousand; cost per capita; incidents per mile of road patrolled and officers per total calls for service. For a diverse urban community such as Middletown, a police service level of 1 officer per 180-200 households is usual. The data provided to ***SPP*** indicates a current level of 93 sworn officers. This represents a ratio of 1 officer per 231 households. It appears to indicate a current deficit of approximately 10 officers. However, the rate of calls for service per officer in peer communities is 3.9 total responses per household. The average 3-year response per household in Middletown is 2.2. If the jail service response numbers are removed from the total calls for service, the response per household drops to 1.8.

In terms of cost per capita, Middletown is paying approximately $198 per capita for police services. This is slightly below the $200-225 per capita costs for peer cities in recent years. In terms of responses per miles of roads, and patrol officers per mile of roads, Middletown has been experiencing lower demand than comparable communities. Taking all factors into account, it appears that while there is currently a deficit of Police personnel, the demand levels are also slightly below comparable cities. In terms of pure cost, the police cost of service per capita is comparable to other cities.

Fire and EMS

SPP is aware that the City is currently engaged in a detailed study of Fire and Emergency Service operations. Therefore we have confined our review to a limited number of factors. The average peer community response per household for EMS services is .17, Middletown is experiencing a demand level of .29 response per household which is substantially higher. The overall operations cost/run for total incidents is $1,070 per response. The peer group data suggests costs per response to average between $750 and $850. However, when the income for transport fees is used to adjust the total cost figure, Middletown total cost per run drops to $938. In terms of actual fire response demands, the City for 2003 had a demand of .03 calls for fire response per household. The peer group average is .04. Although SPP has not done any in-depth review of incident demands and response times for various fire stations in the City, it appears that the higher cost factors are a reflection of the high number of stations. We are assuming that this factor will be looked at in detail in an overall Fire Department operational assessment.

Road Maintenance

The City is currently spending approximately $16,300 per mile of road for basic maintenance operations. The peer group average is between $18,500 and $22,000. This indicates that the City is under spending on ongoing road maintenance by between $504,000 and $1,305,000 per year. We further note that comparable communities have 1 employee assigned to street operations for every 4.3 miles of road. According to our interview data, Middletown currently has 15 employees assigned to ongoing road maintenance. This represents a ratio of one employee for every 15 miles. In order to be comparable in terms of service levels, the City would have to substantially increase its road maintenance staff. The lack of funds attributable to ongoing road maintenance and repair has been previously mentioned in this report. Substantial improvement will be needed in this area for the city to keep up with its road maintenance program.

Recreation

Comparable cities in terms of overall population and demographics spend between $85 and $165 per household for open park maintenance and recreation. Middletown is currently spending about $27 per household when golf course expenses are excluded. This low expenditure level seems fairly evident when viewing City facilities. All recent study data has shown the relationship between high value communities and quality open space opportunities. The City currently collects a recreation impact fee of $500 per unit for new residential units which will help address the deficit. Further, we note the City has been investing in the creation of a new bike path system. These are positive steps.

General Administrative Costs

The cost per resident for general administration expenses, excluding development services and planning, is approximately $117. The peer group average is $200. General government costs are substantially lower than other cities on a per capita basis.

Chapter 6: Recommendations

Recommendations are included in this draft in summary form, as the final recommendations need to be blended with other analysis being conducted as part of the Comprehensive Plan process. Several issues, however, need to be highlighted as the result of the SPP Fiscal Analysis.

1. The city revenues derived from real and personal property tax are unusually low. With the potential dampening of the productivity of the Income tax, property tax revenues will have to play a larger role in the funding of basic operational costs. For that reason, it appears that tax levies to support Emergency Services and recreation facilities should be seriously considered by the City. Police and Fire services will continue to place major stresses on local expenditures and indeed will increase their percentage of overall operational costs based on current practices. This trend will prevent the City from making needed expenditures in the areas of Road Improvements and quality recreational facilities. Other funding sources must be developed to address Emergency Services costs.

2. Over 30 % of current homeowners in Middletown are above 65 years of age. This indicates that an increasing number of owner occupied structures will be coming on the market in the next ten to fifteen years. These homes will tend to be older, and not as desirable from a market standpoint. Analysis of current data suggests that an increasing number of homes in Middletown are shifting from owner occupied to rental property. The City already has a relatively high concentration of rental properties (41%). High percentages of rental properties tend to reduce public participation and civic involvement particularly when they represent a high subsidized housing component. From both a financial and social involvement perspective, the City needs to address redevelopment of obsolete rental areas in a serious effort.

3. Based upon this Cost of Service study as well as many regional economic studies, it is SPP's recommendation that Tax Increment Financing and tax abatement programs not be used for retail development projects on undeveloped land. The State of Ohio stopped allowing tax abatement participation in retail projects for the same reasons

highlighted in this study. The financial benefits derived do not compensate for the lost property tax revenues. The one exception to this would be the use of Tax Increment Financing for a mixed-use downtown redevelopment project that would include a retail component.

4. At present the City utilizes its Community Development Block Grant Funds in a widespread manner. In order to be able to create critical masses needed for successful redevelopment efforts, the CDBG funds should be used in a much more targeted fashion.

5. The report has noted the lack of investment in open space and recreation facilities in Middletown. In addition to the consideration of a dedicated property levy on this issue the City should revise its Zoning and Subdivision regulations to create more productive open space as new development occurs. This is also important in the area of new office park development. The GEM Report noted the need for high quality office park environments from a marketability perspective. It is more likely that this will occur if zoning requirements include environmental quality issues. These items are an insignificant cost in the overall office park development, but will substantially increase marketing potential and income tax potential.

6. In older industrial Cities, full income tax credit was often given as a benefit to residents. The high proportion of income -tax paying jobs offset the full credit policy. For the last ten years the relationship between residents and local employment has changed substantially. The highest and most enduring expenditures for the City are occurring in the areas providing direct resident services i.e., Police and Fire Protection. These costs will continue to grow with the population. Since all residents use these services, it is appropriate that all residents contribute to their funding in a more direct way. The City should consider elimination of a portion of the income tax credit as a means of dealing with this issue.