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This report is about change.

For years now, the City of Missoula has been able to count on end-of-year savings and solid revenue streams to build its fund balance.

In 2008, that changed. The General Fund's fund balance, the cash we save for a rainy day, shrank from $2.1 million to $1.2 million. We brought in less money, which accounted for about 80 percent of the hit to the fund balance, and we were caught in a crunch of unexpected one-time expenses and increased costs.

We adopted a budget a couple of months ago that addressed most of the challenges we wrestled with in the FY2008 budget, including increased utility, energy and fuel costs, soft revenues, and one-time, unbudgeted expenses. But that budget is subject to change, as well.

We're seeing, as are most local governments around the state and nation, weakening revenue streams and continued cost increases. I don't want FY2009, or FY2010, for that matter, to be a repeat of FY2008. We need to rebuild our fund balance in FY2009 and be on solid footing for a conservative FY2010 budget. Toward that end, I've asked our staff to identify $1.7 million in savings for 2009, which will help prevent any further decline in the General Fund's fund balance. By reducing our spending, we guarantee our expected budget savings of $1.2 million and address expected declining revenues of $500,000 in certain fee-based areas. That's a big change for us.

And we'll continue that change in FY 2010. We'll bring you a budget that will guarantee fund balance because we've learned we can't rely on savings alone to build our rainy day account. That change in direction will likely require that the FY2010 budget baseline will be smaller than the FY2009 baseline. In other words, outside of payroll commitments, we probably won't grow much or expand services in FY2010.

More about that fund balance. Since FY2003, the City has made a conscious effort to rebuild the General Fund balance, with some success. It's much easier to grow that fund when revenues are strong and newly taxable values are solid. In FY2008, we planned to grow the fund balance from $2.1 million to $2.8 million, a modest goal based on our experience. But a number of unexpected factors changed our plans.

We paid more than $280,000 in retirement costs in FY2008. Our hydrant fees, which continued to accrue while we awaited a final order from the Public Service Commission, cost us $261,000. Fuel, energy and utilities cost $82,000 more than our budget anticipated. These one-time costs totaled $623,000, and we don't expect them to be a factor in FY2009.

On the revenue side, tax collections were short by $443,000, and fines/citations were $325,000 short of budget.

Given this set of circumstances, we've held off fully funding the Capital Improvement Program in FY2008 to ensure a fund balance of $1.2 million. We'll either need to fund the CIP more aggressively in FY2010 and FY2011 or pull back on projects. That amounts to about $600,000. Projects not started in the CIP will be reviewed this fall to determine whether they should be deferred or eliminated to reduce their dependency on the General Fund. In addition, any project savings in the CIP will be used to reduce funding needs for other CIP projects.

My administrative leadership team and our staff have been great about meeting the challenges of this change. Charged with finding 3.7 percent savings in their operations, most departments got there. Because some departments' expenses are almost all personnel, they simply couldn't provide services and meet the target. Others are making changes in operations to ensure they maintain service on the ground, eliminating non-critical programs and finding new revenues and less-expensive supplies. We've included an overview of those savings with this report. We've also included revenue and expense reports for your information.

The City's 2009 budget continues to be structurally balanced, and the City will maintain a healthy fund balance going into fiscal year 2010, with a goal of increasing the $1.2 million by several hundred thousand dollars this fiscal year and in each of the next three years.

I believe the City of Missoula is a lean operation, and finding savings is no easy feat. But we're in a better position in Montana in general and Missoula in particular than many of our colleagues around the country. New York State and California are facing multi-billion-dollar shortfalls, the City of Oakland is shutting down offices one day a month to help tackle a $42 million deficit and King County, Washington, is dealing with a $93 million shortfall. We're saving money to build our fund balance, and the State of Montana seems on solid footing with a rainy-day account of its own.

In the meantime, I'm continuing conversations with the Department of Revenue, the Governor's Office, legislators, the League of City and Towns and our senators to ensure that we're working together. Our staff has assembled a list of projects we could begin immediately if a federal stimulus package provides funding, and we're scheduling meetings with the Department of Revenue to develop tools that give us more predictability.

In addition, there's the possibility that our efforts to sell our Riverfront Triangle property could help immediately rebuild the depleted fund balance and reduce our CIP debt.

There was also good news in FY2008.
The City recently received an improved credit rating from Standard & Poors for its financial management assessment (FMA) which resulted in an FMA of "strong," the

highest rating a City can receive from Standard & Poors, the city's credit rating agency. The City's credit rating is an integral component in financing infrastructure projects and has led to an improved credit rating for the city's voted general obligation debt from A to AA.

Standard & Poors has this to say about the City's "strong" FMA assessment: "A Financial Management Assessment of 'strong' indicates that practices are strong, well embedded, and likely sustainable. The government maintains most 'best practices' deemed critical to supporting credit quality and these are well embedded in the government's daily operations and practices. Formal policies support many of these activities, adding to the likelihood that these practices will be continued into the future and transcend changes in the operating environment or personnel."

Standard & Poors has established an analytical methodology that evaluates established and ongoing management practices and policies in the seven areas most likely to affect credit quality. These areas are:

Revenue and expenditure assumptions
Budget amendments and updates
Long term financial planning
Long term capital planning
Investment management policies
Debt management policies
Reserve and liquidity policies

The City of Missoula was evaluated as having superior policies and practices in all of the areas above. That's thanks to you, in no small part, for adopting policies we recommended.

Full-time equivalent employees (FTE) is a key indicator mirroring the growth of the City of Missoula. Total FTEs grew from 380 in fiscal year 1999 to 511 in 2009, for a 34.4 percent increase over this period. Please note that 27 of these new FTEs in FY2007 are for staffing of the new aquatics facilities recently opened up to the public, and these FTEs are predominantly paid from the revenues generated by these facilities. If these FTE were backed out of this calculation, (as they are predominantly self supporting), the actual growth of new FTEs would be 28 percent.

Looking forward, for FY2009, the City is budgeting for 511 FTEs. One of the principal challenges continually facing the City is the on-going financial obligation of new employees necessary to meet the service demand that accompanies the rapid growth of the city. All indications are that the growth Missoula has experienced in the past will continue for the foreseeable future, but at a significantly reduced rate over the next two years.

As a general rule, all real and personal property in the State of Montana is subject to taxation by the state and its counties, municipalities and other political subdivisions. This rule is subject to exceptions in the case of specified classes of exempt property. The increase in taxable values for the City of Missoula does not coincide with the increase in market values because of adjustments to the percentage ratio by the Montana Legislature and by changes in tax policy implemented through property tax amendments. The adjustments by the Legislature were designed to prevent local taxes from increasing at the same rate as property values. The taxable values (as opposed to market values) more accurately reflect the ability of the City to increase tax revenues. The City's taxable value increased from $77 million to $101 million from 1999 to 2008, an increase of only 31 percent, which is less than half the increase in the market value of the same property.

Missoula continues as the dominant trade and service center in western Montana. It is the second largest trade center in the state. The employment data show that Missoula outperformed the state early in the decade, but recent growth has been in line with statewide averages.

Debt Financing. The debt service funds have a total fund balance of $2,654,557, all of which is reserved for the payment of debt service. The City of Missoula’s total debt was increased by $36,207 during the 2008 fiscal year, as debt reductions were approximately equal to new debt incurred.

State statutes limit the amount of voted general obligation debt a governmental entity may issue to 2.5 percent of its total assessed valuation. The current debt limitation for the City of Missoula is $85,308,000 (2.5% of $3,412,313,000), which is significantly in excess of the City of Missoula’s outstanding general obligation debt. As of fiscal year end, the City of Missoula was only utilizing 21 percent of its legal, voted general obligation bond limit. In addition, the City was utilizing 60 percent of its legal debt limit for non-voted General Fund debt (2% of General Fund revenues).

The special revenue funds have a fund balance of $3,208,509, all of which is unreserved and available for spending in their designated areas of appropriation.

Proprietary funds.
Sewer rates were not increased this past year, but they are budgeted to increase in FY2009, due to planned expansion of the wastewater plant. The City's sewer fund is in good financial shape today and has been for the last three decades. Sewer user rates are proposed to be increased in FY2009, most likely in line with the inflationary costs experienced by the sewer operating budget and in response to the debt service needs to accommodate the proposed construction at the wastewater plant. Sewer rates have not been increased in eight years.

The City's internal service fund for health insurance benefits has a fund balance of $1,981,873, which is well in excess of three months of claims experience, the targeted amount for the health plan's fund balance.

Fiduciary Funds. The main agency fund that the City presently accounts for is the newly created Business Improvement District, which has a year-end fund balance in excess of $250,000.

Missoula Parking Commission. The Missoula parking Commission had a cash balance of $3,790,493.

Missoula Redevelopment Agency. The Missoula Redevelopment Agency closed out Renewal District I two years ago, which was the sunset year for the downtown urban renewal district. The agency will move forward with substantially smaller budgets until the other two newer districts can be developed in a manner similar to the outstanding growth that occurred in the original district. The first phase of redevelopment of the downtown mill site along the Clark Fork River was initiated with the issuance of $3.6 million of tax increment bonds in Urban Renewal District II. This project will move into the second phase of development in FY09. The groundwork was put in place to accomplish the move of Safeway from its present location to the old city maintenance shops site, freeing up the current location for the expansion of the campus of St. Patrick Hospital. This will be accomplished in the fall of 2008.

Major Initiatives. Over this last year a number of major projects were either initiated or completed. They included:

Over the Fall of 2007, the City started extending the sewer from North Grove Street (near River Road) south to the intersection with Third Street and then west on Third Street to the intersection of Tower with Third. This project will be completed in the fall of 2008.

The City's Parks and Recreation Department worked in cooperation with the competitive swim community to build a 50 meter pool at Playfair Park to replace the old 50-meter pool at McCormick Park, which was removed in the fall of 2006. This pool successfully opened in the spring of 2008.

Our fire station projects are nearly complete, including a new station in the Miller Creek area and reconstruction and remodeling of other facilities.

AWARDS

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the City of Missoula for its comprehensive annual financial report (CAFR) for the fiscal year ended June 30, 2007. This was the eleventh consecutive year that the City of Missoula has received this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA for consideration.

The City of Missoula also received the Distinguished Budget Presentation Award from The Government Finance Officers Association for its 2007 budget document.

In conclusion, FY2008 was a year of change, and we're responding appropriately to that change. Like the rest of the nation, we're watching and waiting as the financial crisis plays out. We'll be conservative, but practical, and make decisions based on facts and figures, not fear.