

**Township of Macomb
Macomb County, Michigan**

**Five-year Water and Sewer Fund Forecast
June 30, 2010 - June 30, 2014**

Township of Macomb

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To the Board of Trustees
Township of Macomb
Macomb County, Michigan

We have compiled the accompanying schedule of Water and Sewer Fund historical and forecasted financial operations of the Township of Macomb (the "Township") for the years ending June 30, 2010 through June 30, 2014, in accordance with attestation standards established by the American Institute of Certified Public Accountants.

The schedule does not present all significant financial measures that would be presented in fund financial statements. Accordingly, this forecasted information is not designed for those who are not informed about the Township's Water and Sewer Fund financial position and results of operations.

A compilation is limited to presenting forecasted information that is the representation of management and does not include evaluation of the support for the assumptions underlying the forecast. We have not examined the forecasted information and, accordingly, do not express an opinion or any other form of assurance on the accompanying schedule or assumptions. Furthermore, there will usually be differences between the forecasted and actual results, because events and circumstances frequently do not occur as expected, and those differences may be material. We have no responsibility to update this report for events and circumstances occurring after the date of this report.

The accompanying forecasted information and this report are intended solely for the information and use of the Township of Macomb and are not intended to be and should not be used by anyone other than the Township of Macomb.

Plante & Moran, PLLC

July 7, 2010

PROJECT BACKGROUND

Plante & Moran, PLLC was retained by the Township of Macomb (the “Township”) to compile a five-year financial forecast for the Water and Sewer Fund (the “Fund”).

PROJECT SCOPE

The analysis and development of the financial forecast will provide the Township with the following:

- Estimation of future financial conditions
- Financial “framework” from which to evaluate the future financial condition of the Township
- A rational basis for identifying areas of greatest concern and devising fiscal strategy
- An automated tool to facilitate the analysis of financial and operational objectives

To assure a comprehensive evaluation, we collected and evaluated information from a variety of sources. Information was obtained from the following:

- Collection of information from internal sources within the Township
- Collection and review of operational, financial, capital, and other applicable information
- Discussions with and data collection from expert sources, including governmental representatives and other relevant sources

The forecast has been developed using the best available information concerning financial trends and conditions. Changes in economic conditions and regulatory provisions could have a significant impact on the forecast. Based upon a review of the above information and discussions with the Township’s finance manager, the forecast was developed using certain key assumptions and should not be evaluated without a thorough understanding of the assumptions. The assumptions and the accompanying rationale are documented in the assumption section of this report. These assumptions provide a basis for estimating future years’ revenues and expenditures. The underlying assumptions used in the estimations are likely to change and the costs projected are likely to differ from actual amounts.

CHALLENGES AHEAD

This projection forecasts that the Township will face some future challenges that need to be considered when analyzing the financial condition of the Water and Sewer Fund and its ability to fund annual expenses as well as capital needs. There are many uncertainties related to the system’s capital needs and the future costs of water and sewage disposal.

One of the most significant uncertainties relates to the creation of the Oakland-Macomb Chapter 21 Inter-County Drainage Board. This entity has taken over responsibility for the repair and maintenance of the 21-mile-long interceptor system that services Macomb County and Oakland County from the Detroit Water and Sewerage Department (DWSD) and has significant capital improvements planned to the system in the near future. In addition, Macomb County has independently taken over 21 miles of interceptors in Macomb County from DWSD and also plans to make capital improvements. As a portion of these costs will most certainly be passed on to the users of the system, this should be closely monitored and taken into consideration when developing future water and sewer rates.

PROJECT SUMMARY

The results of the analysis should be considered within the appropriate context. Essentially, the financial results for future fiscal years should be viewed only as financial estimates, derived from the best available financial information at this particular point in time. Considered in this light, the financial plan provides a benchmark from which to monitor and evaluate ongoing financial trends and results.

For the purpose of the Water and Sewer Fund, operating income and the level of projected unrestricted net assets are typically used as the barometer to measure likely future financial strength. In general, operating income is used to determine if current system users are paying for the full cost of operating the water and sewer system. Unrestricted net assets are used to measure the current financial condition of the Fund. A decreasing unrestricted net asset balance indicates a situation whereby the Township will have to monitor the financial situation closely in the coming years to ensure fiscal stability.

The Township's Water and Sewer Fund had total net assets of approximately \$215.9 million and unrestricted net assets of approximately \$42.7 million at June 30, 2009. Total net assets are projected to decrease approximately \$19.8 million and unrestricted net assets are expected to decrease approximately \$11.5 million from fiscal year 2009 through 2014.

The projected decrease in net assets is primarily due to the estimated operating losses in the Fund. Historically, charges to residents for water and sewer service have not been sufficient to fully cover all of the operating expenses of the Fund. In previous years, the Fund has been able to accumulate cash reserves despite these operating losses because approximately \$4 million of the operating expenses relate to depreciation of the Fund's capital assets, which is a non-cash expense. Additionally, the collection of tap-in fees charged on new construction projects in the Township, which are non-operating revenue, has provided cash in-flow during times of significant growth in the Township. During the three-year period of July 1, 2005 through June 30, 2008, the Township collected over \$5.5 million in tap-in fees, but only \$280,000 was collected during the 2009 fiscal year. In light of the slowed real estate market in southeastern Michigan, this projection assumes that this revenue will be \$600,000 in 2010 and \$100,000 thereafter. Overall, this projection estimates that the Water and Sewer Fund will continue to sustain operating losses and will deplete cash reserves by over \$2 million per year without a change to the current rate-setting methodology.

As a result, sound decision making will be required as the Township strives to provide high quality water and sewer services at a reasonable cost to residents. This financial forecast is intended to be used as a "road map" of future events and of potential outcomes. It is intended to assist the Township of Macomb in the process of developing water and sewer rates and financial strategies to ensure ongoing financial stability in the Water and Sewer Fund.

Township of Macomb

Water and Sewer Fund Summary of Significant Forecast Assumptions

Summary of Significant Accounting Policies - All forecasted revenues and expenses are reported on the full accrual basis of accounting. Revenue is recognized when it is earned and expenses are recorded when incurred.

This financial forecast presents, to the best of management's knowledge and belief, the Township's expected financial position and results of operations of its Water and Sewer Fund for the forecast periods. Accordingly, the forecast reflects management's judgment as of July 7, 2010, the date of this forecast, of the expected conditions and its expected course of action. The assumptions disclosed herein are those that management believes are significant to the forecast. There will usually be differences between forecasted and actual results, because events or circumstances frequently do not occur as expected, and those differences may be material. The comparative historical information for the years ended June 30, 2008 and 2009 is extracted from the Township's audited financial statements for those years. Those financial statements should be read for additional information.

- Estimates for subsequent years were developed using compounding inflation building off of the 2009 actual amounts per the 2009 audited financial statements. Exceptions to this method are noted in the specific assumptions on the following pages.
- Annual inflation factors through fiscal years 2010-2014 are based upon projections obtained from the United States Congressional Budget Office (CBO). An inflation factor of 2 percent is used for each year. The Consumer Price Index (CPI) rose 4.1 percent in 2008, but decreased .4 percent in 2009 and is expected to rise 1.7 percent in 2010. However, the CBO forecasts the CPI to increase 2.1 percent on average between 2011 and 2014. For this reason, a 2 percent inflation rate was used for the remaining years.
- Data has been collected and financial estimates have been developed utilizing a number of expert sources including the Township finance director, various department heads, and other professional sources.

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Water and Sewer Fund Summary of Significant Forecast Assumptions (Continued)

REVENUE ASSUMPTIONS

Sale of Water Revenue - Volumes are expected to remain consistent with the 2009 level and the customer water rate is expected to increase by the same percentage rate as the system's wholesale water rate, as described below, with the exception of 2010 when the actual rate increase was 1.9 percent.

Sewage Disposal Charges - Volumes are expected to remain consistent with the 2009 level and the customer sewer rate is expected to increase by the same percentage rate as the system's wholesale sewer rate, as described below.

Charges for Services - Revenue is expected to remain flat at the 2009 level.

Interest Income - For the purposes of this projection, the estimated interest income for the fiscal years 2010 through 2014 is calculated as the average cash balance of \$35,000,000 multiplied by a 1 percent rate of return, given the currently available interest rates.

Capital Contributions - Tap fees are assumed to be \$600,000 for 2010 and then \$100,000 per year thereafter, given the declines in construction activity. Developer contributions are expected to be \$1,000,000 per year, also in light of reduced construction activity. These developer contributions represent donated capital assets and do not provide cash flow to the Fund.

EXPENSE ASSUMPTIONS

Most expenses were increased by the inflation factors outlined in the general assumptions section of the executive summary. Any assumptions that varied significantly from the general assumptions are as follows:

Salary and Wages - Salary and wage expenses have been forecasted to remain consistent with 2009 for years 2010 through 2014. In addition, the level of employees in fiscal year 2009 is assumed to remain consistent through 2014.

Health Expenses - Health expenses are expected to increase by 10 percent in 2010, 16 percent in 2011, and then 10 percent in each subsequent year, based on inquiries with Township personnel.

Contributions to the Health Care Fund - Contributions are based on 10 percent of payroll expenses.

Cost of Water - Volumes are expected to remain consistent with the 2009 level and the wholesale rate is expected to increase by 10.2 percent in 2010, 13.4 percent in 2011, and 10 percent per year thereafter.

Cost of Sewer - Volumes are expected to remain consistent with the 2009 level and the wholesale rate is expected to increase by 2 percent in 2010 and 5 percent per year thereafter.

Interest Expense - Expense is based on actual interest payments due on existing outstanding debt as of June 30, 2009.

Capital Outlay - Cash financed capital outlay is estimated to be \$500,000 per year.

