

MEMORANDUM

Date: September 9, 2019

To: Mayor & Members of the Common Council

From: William Jones, City Administrator
Thomas Watson, Finance Director
Kaitlyn Krueger, Assistant to the Finance Director

Subject: Preliminary Draft Budget Documents - Fiscal Year 2020

INTRODUCTION

Over the last several years, the Common Council and City staff have convened a workshop meeting in July to formally kick-start the City's annual budget development process, which typically takes place from late summer into early November, when the budget is adopted. This year, in lieu of the July workshop meeting, City staff has worked to develop a preliminary draft budget for the Council to review before it comes together to formally consider and deliberate on the budget that will be adopted for fiscal year 2020, which begins on January 1. Additionally, staff in the City Administrator's Office and the Finance Department have worked to compile other additional information that is typically presented as the budget development process commences. Accordingly, this preliminary draft budget binder contains a number of documents, as enumerated below:

- A Mid-Year Financial Update for Fiscal Year 2019
- An Update on Balances in the City's General, Capital and Other/Special Revenue Funds
- A Mid-Year Personnel Update for 2019
- The Preliminary Draft Budget for 2020
- A Five-Year Capital Plan for Fiscal Years 2020-2024
- A Ten-Year Financial Forecast Spanning Fiscal Years 2019-2028
- Information (Memoranda, Minutes) Pertaining to the Calculation of the City's Mil Rate

Each of these included items are outlined further throughout the remainder of this memorandum.

FINANCIAL UPDATE: FISCAL YEAR 2019

Attached is a summary page and a detailed report comparing General Fund budget to actual during the first six months of FY2019. The values shown are unaudited. With only half of the year's revenues and expenditures incurred, it is challenging to forecast definitive trends at this point in time. Through mid-year, most revenue lines have tracked according to plan, given the collection patterns at this point in the fiscal year. However, Building Permit revenues are trending below budget and will bear further monitoring. The 'Other Revenue' line item typically realizes gains in the latter half of the fiscal year. Following are some additional points of consideration related to the enclosed 6-month revenue summary.

- Property taxes are collected in January, February and August.
- The timing of the City's State Shared Revenue payment varies from year to year, and is typically collected in June or July.
- Food and Alcohol License renewals are due by June 30 of each year.
- General Fees include Dog Licenses, Copies and Sale of Supplies.
- Public Safety Fees (e.g. Ambulance, Court) increase as the year progresses.
- Other Revenue includes Cell Tower Leases, Cable TV Fees, an annual Workers' Compensation Dividend and Fund Balance Transfers (as may be budgeted).

On the expenditure side, most departmental budgets are tracking at or below the fifty percent benchmark. Listed below is additional background information related to why certain budgets may be shaded yellow or red.

- Common Council spending on Misc. Services (Special Events) typically happens in the first half of the fiscal year. This year, additional funds (unbudgeted) were also expensed for a farewell salute to longtime Mayor/Alderman Abendroth.
- Without any further elections in 2019, no additional expenses are anticipated.
- The Finance Department's chargeback for Liability Insurance is performed at year end.
- Human Resources is tracking over budget due to added recruiting and testing expenses.
- The Fleet Division is experiencing a higher rate of spending for repair parts and supplies. Fuel costs were also trending above budget during the first part of 2019.
- The Building Maintenance Division is experiencing higher repair and utility costs.
- Consulting services in the Engineering Division are \$25,000 higher than budgeted due to additional development; these expenses are generally reimbursable to the City.

Staff will continue to monitor budget conditions for material variances as the year progresses, and provide a third quarter update to the members of the Common Council in mid-October, prior to its adoption of the 2020 budget.

PERSONNEL UPDATE: FISCAL YEAR 2019

Enclosed is a 2019 Personnel Update provided by the City Administrator's Office. In addition to offering a snapshot regarding recent hiring efforts in the wake of employee retirements and resignations during the period 2016-2019, this report also examines other human resource initiatives that have been undertaken by the organization in recent years. Additionally, the update also highlights some of the considerations that have been factored into the preliminary draft budget that has been prepared for Fiscal Year 2020.

FUND BALANCE UPDATE: GENERAL, CAPITAL & OTHER/SPECIAL REVENUE FUNDS

The City has numerous funds to capture and track activities for dedicated purposes. Enclosed is a Schedule of Fund Balances listing these funds, excluding the City's utility funds for sewer and water. The schedule presents individual balances for each enumerated fund as of December 31, 2018, as well as their projected balances as of December 31, 2019.

Following is a short description of each fund:

General Fund (0110)

The General Fund is the operating fund of the City. It is used to account for all financial resources, except those required to be accounted for in another fund. Appropriations in the General Fund lapse at year end to the fund balance, unless specifically authorized for transfer to another fund by the City Council. As indicated in the table, the fund balance in the General Fund is forecasted to increase from 13% to 13.5% by the end of 2019. As affirmed in 2018, City policy stipulates a minimum fund balance range of between 10-12%.

Special Revenue Funds (0210, 0220, 0230)

Special revenue funds are used to account for and report the proceeds of specific revenue sources that are restricted or committed to expenditures for specified purposes other than debt service or capital projects. The City has created Special Revenue funds for its Police Auxiliary (formerly Reserves), Special Events (e.g. Taste of Mequon), Police Asset Forfeitures, Park Impact Fees, the Mequon Nature Preserve, and the City's Revolving Loan Program. Notably, the balance in Park Impact Fees, which continues to grow with the addition of new residential housing/units throughout the City in recent years, can only be utilized for park improvements, land acquisition or other "new" enhancements. These proceeds are thus restricted, in that they cannot be used to fix, repair or replace "existing" park amenities.

Debt Service Funds (0310, 0320, 0330)

A Debt Service Fund is used to account for the accumulation of resources for, and the payments of, the City's general obligation long-term debt principal and interest. The City has dedicated debt service funds for the City's general obligation debt and two of the City's active tax increment districts (TIDs). The two TID debt service funds currently have negative fund balances but are projected to turn positive by the time of their respective closures in the mid- to latter 2020's.

Capital Project Fund (0410)

This fund is used to account for the expenditure of funds designated for infrastructure improvements, vehicle replacement and the maintenance of other long term assets. Approximately half of the 2018 fund balance relates to currently active capital projects. The remainder is in the form of a receivable due from TID#3 for several inter-fund advances made to cover scheduled debt service. As the Council will recall, in the initial years of TID#3, increment did not build as quickly as projected. The inter-fund loan from the Capital Project Fund allowed these general obligation debt service payments to be covered without requiring the City to raise taxes to cover the shortfall. Staff anticipates TID#3 will have the financial wherewithal to repay the Capital Project Fund before the TID closes. The projected increase in the 2019 estimated year end projects balance is related primarily to unspent proceeds from the 2019A G.O. Notes issued for road and parking lot improvements during the 2019-2021 construction seasons.

10-YEAR FINANCIAL FORECAST: FISCAL YEARS 2019-2028

The City's Financial Policies also require an annual review of a five-year budget forecast. Doing so is conducive to long term financial planning by highlighting possible budgetary

challenges in the forecast period. Attached is a ten-year forecast covering fiscal years 2019-2028.

Several assumptions were made in developing this forecast, as follows:

- The 2019 adopted budget serves as the baseline year in the forecast model.
- Salary and benefits are assumed to increase an average of 2.5% per year.
- Non-personnel costs are assumed to increase an average of 3% per year.
- Debt service payments (principal & interest) owed for any long-term debt incurred by the City for capital projects (e.g. roads, facilities) remains exempt from State levy limits.
- Debt service for the City's general obligation debt within this analysis excludes TID debt. Based on recent history, it is likely the City will issue debt for road construction again in 2022, 2025 and 2028. The \$5.1M 2019A general obligation note issued earlier this year was used as a proxy for these anticipated future road borrowings. At this time, no other long-term debt for capital projects has been factored into these projections.
- Debt service for the Sewer Utility includes only debt issued for the East Trunk Sewer project and does not provide for any new debt over the term of the forecast.
- With the exception of investment income, other non-tax revenues are assumed to increase 2% per year.
- Even though the Milwaukee Metropolitan Sewerage District (MMSD) is not subject to levy limits, the annual capital charge to the City is expected to increase 2% per year.
- The City's total levy of approximately \$22M covers its four major funds: General, Debt Service, Sewer and Capital Projects. The City has significant levy headroom before it approaches State levy limits. However, the City has strived to tie levy increases to a corresponding amount of new growth in the tax base. This model assumes the City will maintain that discipline going forward. Total net new construction growth has averaged 1.5% per year over the past five years. For this analysis, it is assumed the City will consistently grow its non-TID tax base by 1.5% per year.
- TID#2 will close and the estimated \$20M increment will be added to the City's tax base in 2025, and thereafter be accounted for in the 2026 budget.
- TID#3 will not close and contribute to the tax base within the modeled time frame.

Upon examination of the 10-year forecast, staff has identified some conclusions and considerations that may warrant additional focus or discussion in the coming years. These include the following:

- Over the next ten years, it is likely the U.S. economy will undergo at least one recession, which could lead to a regression in local permit revenue and/or construction activities.
- Annual debt service is projected to increase significantly in 2022 and average approximately \$3.1M through the end of the forecast. (See Line 27)
- Given the recommendations of the recent City facility and fleet studies, the model is not allocating enough resources to self-fund these particular capital expenditures, at least in the first five years of the forecast. (Line 30)
- The assumptions used in this model may be overly simplistic. For example, the model calculates a small surplus for 2020. However, initial department requests for 2020

- resulted in a deficit of several hundred thousand dollars at the start of the budget cycle.
- With annual inflationary pressures of 2.5 - 3% and the City's tax base growing at 1.5%, the City will have a challenging time maintaining existing service levels without a new source of funds or the willingness to consistently adjust taxes above the nominal rate of growth in the tax base. The outcome is a structural deficit that the City must overcome each year before it can entertain any new programs or initiatives. (Line 58)
- Should the City wish to issue general obligation debt for a new capital project, it will require increasing the tax levy accordingly.

PRELIMINARY DRAFT BUDGET: FISCAL YEAR 2020

Also enclosed for the Council's review is a preliminary draft budget for Fiscal Year 2020, which begins on January 1. This document is being provided to the Council nearly four weeks earlier than in recent years, as part of an effort to provide members with detailed revenue and expenditure figures well in advance of its meetings as the City's Appropriations Committee, which are scheduled during the first part of October.

This year, the City's various operating departments were tasked with the process of preparing their draft budgets in early July. Subsequently, draft budgets were submitted to the Finance Department in early August, and the process of putting together a very early draft of the 2020 budget commenced. By mid-August, this first version of the City budget, which contained a number of conservative revenue and expenditure estimates in areas such as state aid, health insurance and property taxes, resulted in a working deficit of nearly \$850,000. Besides the significant number of assumptions built into the initial budget, the document contained other inflationary adjustments, be they compulsory (e.g. bargained wage adjustments for police/fire, employee pension contributions, health insurance premiums, other contracted increases, etc.) or anticipated (e.g. utilities, salt, 2020 elections, non-union wage adjustments, etc.) that contributed to the early shortfall. Additionally, the Public Safety IT Specialist authorized for 2019 was only funded at approximately 50% of this position's eventual cost, with the reminder needing to be accounted for in the City's new budget for 2020.

Once the initial budget was compiled, a series of meetings were convened by the Finance Department and the City Administrator's Office with each department to review their respective submittals. These meetings, which constitute a "technical review" of each the 23 departmental or divisional budgets submitted for consideration, are intended to provide the City budget team with a better understanding of the cost drivers that are contributing to changes within the next year's budget, while also serving as an opportunity to correct any oversights. This ensures that authorized positions and corresponding benefit costs are accurately accounted for (i.e. not double-counted, under counted, etc.) and that other proposed or anticipated changes related to personnel or service delivery costs are appropriate. Following the completion of these meetings during the third week of August, the working deficit was lowered by \$200,000, to a figure of \$650,000.

Following this technical phase, the City budget team initiated a detailed analysis of all revenues and expenditures, comparing the amounts proposed for 2020 with actual figures

from the three most recently completed fiscal years (2016, 2017 and 2018). Upon completion of this review, which was completed at the end of August, additional revenue and expenditure adjustments totaling nearly \$260,000 were identified and applied to the working draft. A spreadsheet detailing revenue and expenditure adjustments applied during this stage of the budget development process is also enclosed. Furthermore, several of the initial estimates formulated in early August were further refined, upon receipt of actual budget numbers (e.g. health insurance, workers' compensation, liability insurance, etc.). Based upon additional fact-finding and further research, estimates related to cell tower revenues and forfeited permit deposits were also adjusted. In total, such efforts to date have resulted in a further reduction of the overall deficit by another \$370,000.

To date, the preliminary draft budget contains an operating deficit of approximately \$180,000. Following receipt of final assessed values for property and manufacturing from the City Assessor in the wake of the Board of Review's annual meeting on September 3, as well as absolute revenue figures from the State of Wisconsin for Shared Revenue and Transportation Aid, it is anticipated that the working deficit will be further reduced by another \$50,000-\$75,000. All told, this would leave the proposed operating budget for 2020 with a likely deficit of \$100,000 - \$125,000. Depending upon the final figure, such a shortfall could be eliminated by using one, or a combination of, the following options:

- A tax rate adjustment (a \$0.01 increase = \$46,000 in new recurring revenue)
- Further expenditure reductions
- The use of fund balance

Understandably, this component of the budget development process will require continued monitoring as the Council and staff move through a series of planned budget meetings in September and October. To the extent that any material developments (either positive or negative) warrant further consideration by the Council, staff will provide such as additional information becomes available.

FIVE-YEAR CAPITAL PLAN: FISCAL YEARS 2020-2024

Each year in July, City departments are required to review and update five-year capital improvement plans relating to their individual accounts or projects. After receiving the updated capital plans at the beginning of August, the Finance Department reviews and consolidates these updates and any new requests into the City's 5-Year Capital Improvement Plan. The attached documents include the proposed 2020 Capital Budget, a consolidated 5-Year Capital Improvement Plan and individual project or account submissions as proposed by the City's departments. As is evident from the materials, the majority of proposed expenditures within these documents originate from the City's three largest departments - Police, Fire and Public Works/Engineering.

For 2020, capital project funding requests from department heads totaled \$3,040,000, an increase of \$86,500 from the \$2,953,500 that was requested in 2019. The largest request this year was \$1,010,000 for Public Works Equipment Replacement, which is based on a recommendation from EMG in the fleet analysis study that was completed last year. To

provide additional context, a recent history of previous capital requests received from City departments, and the corresponding amounts that were eventually allocated and approved within the budget, is provided below. As indicated below and within the enclosed documents, there have been a number of projects or proposed expenditures over the last five years that have either been underfunded or not funded at all. On the positive side, the City has continued to support an upward trend in allocating additional monies towards its operating (or pay-as-you-go) capital budget since 2015. Of particular note below, the \$1,376,819 allocated for capital projects in 2018 included a one-time fund balance assignment of approximately \$350,000 from the City's General Fund, in connection with repaving Donges Bay Road between Cedarburg and Wauwatosa Roads.

Year	Departmental Capital Requests	Actual Funding Amount
2019	\$2,953,500	\$1,155,000
2018	\$2,127,300	\$1,376,819
2017	\$2,343,750	\$967,374
2016	\$2,188,750	\$920,739
2015	\$2,507,500	\$868,047

For 2020, staff is recommending a capital budget of \$1,205,500 with specific allocations as attached, an increase of \$50,000 from 2019. As the Council will recall, this year's operating budget included \$50,000 to fund an update to the City's Park & Open Space Master Plan. With this project now lapsing in 2020, staff recommends reallocating the same amount to the Park Planning & Improvements account within the Capital Budget, so as to establish an initial source of recurring revenue for repairs and improvements and repairs that are anticipated in the new Master Plan that will be completed later this year.

The draft capital budget also proposes a reallocation of \$32,538 currently contained within the Parking Lot Resurfacing account to Information Technology projects, specifically for security upgrades and the replacement of desktop computers utilized by employees throughout the organization. With the triennial issuance of bonds for road improvements, the City's parking lot resurfacing costs have now been integrated into these debt issues. As IT capital projects were last funded in 2016, staff is of the opinion that this transfer would be the most beneficial as the organization commences its migration to Office 365. As requested by Police Chief Pryor, a reallocation of \$20,000 from the Portable/Mobile Radio capital account to Mobile Data Terminals is also reflected in the Capital Budget as well.

MIL RATE CALCULATION METHOD

Late last year, it was brought to staff's attention that a discrepancy existed between budgeted mil rates discussed at Appropriations/Sewer Utility Commission meetings in the fall of 2018 and the effective final tax rates that were published on property tax bills payable in 2019. This difference resulted from staff's inclusion of the assessed value of the City's 4 active TID Districts as part of the total available tax base used to calculate budgeted mil rates.

Subsequently, this matter was reviewed by the Finance-Personnel Committee at its meeting last January (see enclosed memorandum date January 3, 2019 and corresponding meeting minutes from January 9, 2019). Also enclosed is a memorandum dated September 9, 2019, from the Finance Department explaining how staff has modified the process for calculating the City's mil rate in 2020, wherein any increase in assessed value within the City's four active TID Districts will not be counted within the revenue base by which the property tax rate is derived.

NEXT STEPS

As indicated in the 2020 budget development schedule, a copy of which is enclosed, these documents are being distributed ahead of a series of meetings that will commence next week as outlined below.

Tuesday, September 17: Workshop #1: Administration, Police, Fire, Library
Tuesday, September 24: Workshop #2: Community Development, Public Works, Parks
Tuesday, October 1: Appropriations Committee Meeting
Tuesday, October 15: Appropriations Committee Meeting (if Necessary)

As additionally noted in the attached schedule, staff will be distributing a copy of the draft budget document to members of the Council next Friday, September 20. Consistent with past practice, this document will also be posted online on the City's website and be available for public inspection at City Hall during the remainder of the budget development process.

In the meantime, staff again looks forward to the opportunity over the next several weeks to engage with members of the Common Council, as we work collaboratively to develop and finalize a 2020 budget that is responsive to the needs and priorities of both the community and the organization.