



City of CHARLOTTE

MEMORANDUM

TO: Mayor Lewis and City Council Members

FROM: Gregg Guetschow, City Manager

SUBJECT: FY 2019-20 Budget

DATE: May 13, 2019

Pursuant to the provisions of the Charter, I am transmitting herewith the proposed budget for the fiscal year that begins July 1, 2019.

SUMMARY

- Eliminate one patrol officer position that is currently vacant;
- Fill one vacant patrol officer position by sending a candidate to the Police Academy;
- Fund a portion of police pension expenditures by imposing a special assessment pursuant to PA 33 of 1951.
- Fund expenditures for debt service incurred for the purchase of fire trucks by imposing a special assessment pursuant to PA 33 of 1952;
- Seek voter approval for an override of Headlee Amendment tax limitations to fund retiree health insurance costs;
- Increase fees for water and sewer services by an estimated 7%;
- Implement program to identify and replace water service lines that do not comply with the State lead and copper rules;
- Establish a Brownfield Redevelopment Fund to account for revenues from the Spartan Motors brownfield project; and
- Establish an Information Technology Pool Fund to better track IT expenditures and to equitably distribute costs across operating funds.

BUDGET OVERVIEW

As the City's auditors reported earlier this year, the City remains in sound financial condition. Actions are necessary, however, to address a variety of factors that could reverse that assessment and significantly impair the City's ability to provide essential public services.

The City's fiscal condition is affected on both the revenue and expenditure sides of the equation. Reductions in state shared revenues that took place in 2001 have resulted in the loss of \$300,000 annually for a total \$5.4 million over the period. In addition, the affects of Proposal A and the Headlee Amendment, two

tax limitation measures, in the aftermath of the decline in taxable values in 2008 and 2009 have resulted in losses in property tax revenues over the past decade and little hope that we will ever recover those losses. Although the City has been prudent with its spending over the last decade, increased costs in areas such as pension and health insurance that have exceeded the rate of inflation have resulted in significant fiscal stress.

The outlook for the next two decades is not encouraging. It is unlikely that the state will restore state shared revenues to their pre-2001 levels. We have seen an increase in new home construction during the last few years but the tax revenue that results is modest. Some new commercial investment is occurring but major investments in the industrial sector are likely to require tax abatements if we are to attract them.

I do not believe we must take additional measures to reduce costs and increase revenues if we are to maintain a fiscal condition sound enough to provide the essential services citizens desire. None will be popular.

Police Department Staffing.

Over the last decade, staffing in the Police Department has been cut by 25%. These reductions have had consequences in terms of the level of service that the City has been able to provide its residents. Despite this concern, I am recommending the elimination of one of the two positions that is currently vacant. The elimination of the second vacant position would help further in cost reductions but would force the elimination of the school resource officer position, an important contributor to the overall quality of police services in the community and one which is financed in cooperation with Charlotte Public Schools.

Staffing in the Police Department, as in other Michigan municipalities, is a challenge. There are too few good candidates applying for the positions that are open. Smaller cities such as Charlotte are not able to offer compensation and promotion opportunities necessary to attract quality applicants with experience. Chief Sherman is recommending that the City embark on a plan of employing cadets during the time that they are attending a police academy and then bringing them on as full-time employees when they have achieved the necessary certification. The proposed budget includes funding for this initiative.

Pension and Other Post-Employment Benefit (OPEB) Funding.

I have previously reported to Council that the City will be required to submit to the Michigan Department of Treasury a corrective action plan to address deficiencies in its funding of pension and retiree health insurance obligations. The City has taken several actions since 2010 to reduce future costs associated with these programs. Retiree health insurance participation was frozen in 2010 limiting future participation in the plan to those already covered and to a small number of

then-current employees to whom promises of coverage had been made. Beginning July 1, 2012, the defined benefit pension plans were closed to new hires and increased employee contributions to those plans were implemented. New hires were enrolled in hybrid plans that capped employer contributions annually to 16.2% of pay for public safety employees and 10% of pay for all other employees.

These measures, while helpful in managing the City's long-term benefit costs do not address the costs associated with financing obligations associated with promises made in the past. The present value cost of the retiree health insurance benefit for the dozen covered employees was calculated to be \$1.9 million as of June 30, 2018. The unfunded actuarial accrued liability for all of the City's pension plans as of December 31, 2017 was \$9.6 million.

The City's obligations for retiree health insurance will be affected in the future primarily by increases or decreases in premium costs for the benefits provided to retirees under the age of 65 and are expected to top out at about \$150,000 in present day dollars, slightly above the \$135,000 included for this benefit in the proposed budget.

Addressing the unfunded actuarial accrued liability for the City's pensions plans, on the other hand, will require a dramatic increase in annual contributions over the next 20 years. The computed annual employer contribution for 2020, as shown in the December 31, 2017 actuarial valuation was just under \$900,000. Assuming a 7.75% annual rate of return on the investment of fund assets, that annual contribution will increase to about \$1.9 million by 2040. Worse, the Municipal Employees Retirement System has just announced its intent to revise downward its annual rate of return beginning to 7.35%. This will have the effect to accelerating employer annual contribution rates over the same 20-year period.

The status of the pension and retiree health insurance plans reflects the outcome of some poor choices made by City officials in the past. Bemoaning these choices does not undo them, however, and tough decisions must be made if the City is to remain in sound fiscal condition. Budget cuts we have made over the last decade have exhausted opportunities for further operating costs reductions. The City's fund balance remains at a reasonable level of 20% but it is our desire to increase this in anticipation of state revenue sharing reductions that will likely arise when the economy experiences another recession.

My recommendation is that consideration be given to appropriating funds from the \$200,000 reserve designated for retiree health insurance to meet a portion of this year's cost for this benefit. I am also recommending that Council seek an override of the Headlee Amendment tax limitation. If approved by voters, this would generate about \$150,000 per year. Revenues derived through this additional millage would be deposited in a trust to fund the benefit. When the

benefit is fully funded, revenues derived through the override millage would then be dedicated to funding the pension deficit.

Pension costs have increased significantly over the last decade due, in large measure, to a significant benefit increase granted police officer in 2005 and 2006. Unfunded accrued liabilities increased from \$2.4 million as of December 31, 2004 to \$9.6 million on December 31, 2017. Despite a solid 2017 return on investment of more than 13%, the mature status of the City's plan saw more money going out than coming in further increasing the unfunded liability. Investment return for 2018 was negative so we can expect another jump in this liability. There were 44 active employees in 2017 compared to 65 retirees and beneficiaries and 14 vested former employees. A significant portion of the City's annual pension cost, then, is for benefits owed to former employees, not its current employees.

A significant portion of the City's total pension cost is attributable to benefits owed current and former police officers. A little-used special assessment tool is available to cities such as Charlotte with fewer than 15,000 residents to fund costs associated with public safety operations. I am recommending that Council approve such an assessment to cover \$200,000 in costs for police pensions.

Fire Apparatus Funding.

For several years, the City has used inter-fund loans to pay for its 50% share of new fire truck purchases with the Rural Fire Association paying the other half of the cost. With the delivery of the latest vehicle to be purchased, debt service for this equipment will increase by \$50,000 in FY19-20 to \$84,511.

The same special assessment mechanism referenced in the previous section can also be utilized to pay for the purchase of public safety vehicles and equipment. I am recommending that Council impose a special assessment for this purpose.

Water and Sewer Utilities.

It has been several years since City staff has recommended an increase in the fees charged for water and sewer services. Over the last few years, as Council is aware, investments in underground utility infrastructure has occurred in conjunction with street reconstruction projects. These investments, in combination with those needed to upgrade facilities at the waste water treatment plant have drawn on cash reserves in the Utility Fund.

At the same time, the State has passed new requirements related to materials used for water service lines supplying private properties with potable water in order to reduce contamination by certain metals. The so-called lead and copper rules mandate that the City examine service lines in areas of the community built

during the era when lead and galvanized pipes were used for service lines and to replace them where they are found. This will be a significant undertaking for the City, the cost of which will be borne by all rate-payers.

We are still formulating a final recommendation but preliminary work supports an increase in utility rates of as much as 7%.

Brownfield Redevelopment Fund.

The brownfield plan approved for Spartan Motors led to the redevelopment of two parcels on the company's campus. The design of brownfield projects provides for a company's investment in eligible environmental projects to be recouped through the capture of property taxes on the redeveloped sites. In other words, the company spends money to make a site suitable for a new use, increasing its value, and getting that money back overtime by getting back the property taxes that it pays.

The operation of brownfield projects generates some funds that are kept by the City to reimburse it for administrative costs and to establish a local brownfield revolving fund to be used for similar clean-up projects. In this budget a new Brownfield Redevelopment Fund is implemented to receive and account for these administrative costs and revolving fund assets. No expenditures of these funds are contemplated in FY 19-20.

Information Technology Pool Fund.

City Council members might be familiar with the Motor Vehicle Pool fund that is used to account for costs related to vehicles and other equipment used by the Department of Public Works. The primary advantage of such a fund is in recognizing the costs associated with the use of equipment – fuel, depreciation, maintenance, etc. – are attributable to more than one fund and activity spread throughout the budget. In order to properly allocate equipment costs, rental rates are established for each piece of equipment and those charges then become costs of the fund and activity where the equipment is used.

Information technology has become a significant component of the City's business operations. It encompasses far more than desktop computers to include telephones, cellular phones, laptops, and the programs that run on various computers. The budget contemplates the creation of an Information Technology Pool Fund where purchase and maintenance costs are charged with the revenue source based on a plan that allocates these costs according to how much equipment is used by various departments. These charges appear in the Telephone and Internet line item in the various activities in the budget.

Other Matters.

A look to the future of the organization should extend beyond the annual financial side of the budget to consider the context within which the City organization operations. A few comments about the bigger picture are in order.

As I noted before, we are in an economic growth period that has set a record for its duration. Unemployment rates at historic lows are also observed. Concerns about larger economic forces have, from time to time recently, led to warnings about recession, a condition that, as noted earlier could affect the City's revenues. At the same time, we have now begun to see signs of wage growth that have not been present heretofore. These various mixed messages about the condition of the economy have implications for the City.

Most apparent for us has been the difficulty we are experiencing in attracting interest in filling vacant positions in the organization. I noted earlier the challenge of hiring police officers. The same is true in public works as well. There are fewer applicants applying for positions and fewer candidates of a caliber that we wish to have as part of the City workforce. A particular challenge for us is that our wage scale has become less and less competitive overtime, particularly in such a vibrant economy. Our starting wages for clerical and public works positions is below \$15.00 per hour and will only grow by 2% per year for the next two years. Even if we wished to increase that wage at the end of the current contract, I do not believe that the budget will permit it.

Similar lack of wage competitiveness is found at the department head level as well. In the longer term, I think the City will find it increasingly difficult to attract the kind of talent that it needs in order to maintain the quality of leadership that has been provided to date.

I think it will be necessary to look at the entire compensation package – wages and benefits -- to evaluate whether opportunities exist to shift the cost balance between the two so as to offer better starting salaries.

We have been particularly hurt in the last few years by double digit increases in the cost of health insurance. We will be exploring this matter further in the next couple of months to ensure that the costs we are paying are appropriate.

I have previously noted the challenge of unfunded accrued liabilities in the pension plans we offer. We are not currently eligible to sell bonds to meet address these liabilities. This is due to our not offering a true defined contribution plan. As we enter the next round of labor contract negotiations, we will be evaluating the need to shift to away from hybrid plans to defined contribution plans to provide us the flexibility we need.

A final area of concern has to do with planning for leadership succession. Some department heads are already eligible to retire. Others will reach that milestone in coming years. It is essential that we are proactive in planning for the next

generation of administrators that will be joining the City if we wish to continue the work that we have started. Such a plan could entail costs not currently in the budget.

The final matter which needs to be acknowledged is the valuable assistance provided by department heads in preparing the budget document. This budget is the first for which the new general ledger software was used and entailed a learning experience for all of us. This tool proved valuable, however, as we could quickly make adjustments as we reviewed the budget. While no budget document is perfect, I believe that this one represents a good effort to provide Council the information it needs to make difficult choices among competing demands for limited resources.