

City Manager's 2021 Budget Message

October 14, 2020

TO: Mayor Tonkin, City Council Members, Key Staff, and General Public

FROM: Craig H. Cugini, City Manager

SUBJECT: 2021 Budget Message

Executive Summary

The City of Ishpeming 2021 budget reflects many challenges affecting the city. For many years, the City has experienced limited increase or declining revenue with continued growth in expenses. The City's revenue has failed to keep-up with continuously and significantly increasing fixed and unavoidable costs. This is compounded by further reductions in estimated revenues plus unexpected increases in costs related to the COVID-19 pandemic. Uncertainty remains as to the future funding levels from the State of Michigan as the State faces its own budgetary challenges. Tough choices have already been made to bring this budget proposal before you and to attempt to sustain the City's financial position. In 2019, the final approved budget for the General Fund showed a reduction of fund balance of \$(190,916); however, due to slightly higher revenues than estimated and a concerted effort by staff to reduce costs, the final 2019 result was an addition of \$3,916 to fund balance. For 2020, The General Fund budget showed a reduction in fund balance of \$(143,085); however, management is currently estimating ending 2020 with a reduction of fund balance of \$(111,048), which is \$32,037 better than originally planned. For the 2021 budget year, the General Fund budget show a reduction in fund balance of \$(196,969). Staff will continue to focus on cost saving measures and work to improve performance over current expectations.

The City must find and leverage a sustainable path. The MERS unfunded liability is the largest of the financial problems facing the City, but by no means the only one. The City of Ishpeming negotiated with the unions to close the MERS defined benefit pension plan to new hires after January 1, 2020; however, the existing liability continues to grow exponentially. The funded level of the MERS defined benefit pension plan decreased from 48% as of 12/31/2018 to 46% as of 12/31/2019. The annual required contribution to the MERS defined benefit pension plan for 2021 is estimated to be \$888,336, which is a \$79,736 increase from 2020. Our Team of Directors and myself are investigating various options to try to slow the growth of the unfunded liability.

Outline of Budget Message

There are three sections to this budget message:

1. Expected Outcome of 2020 – summary of the expected financial position ending 2020
2. Proposals for 2021 – highlights of proposed financial plans for on-going services
3. Financial Problems and Opportunities – looking at some options for the future

Note: This budget message does not review every fund. To keep the message brief, I cover only major funds or funds with specific issues / concerns.

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Section 1 - Expected Outcome of 2020

2020 – 101 General Fund

Staff projects the Fund Balance for the General Fund to be \$786,702 at the end of 2020, a decrease of \$111,048, which is \$32,037 better than originally planned at the beginning of the fiscal year.

2020 – 202 Major Street Fund and 203 Local Street Fund

Fund Balance for Major Streets is expected to increase by \$208,067 to \$606,996 at the end of 2020. We have been building up the fund to pay for future street construction work. Fund balance for Local Streets is expected to decrease by \$184,657 to \$82,717 at the end of 2020. Our community has seen increases in snowfall over the last two winter seasons which contributed to increased winter maintenance costs. These costs exceeded the level of funding provided by the Michigan Department of Transportation.

2020 - 206 Special Fire Fund (Fire Truck Purchase)

Fund Balance for the Special Fire Fund is expected to increase \$22,646, ending 2020 at \$67,674. This fund is used to record the tax revenue for the voted millage used to purchase a fire truck as well as recording the payments on the fire truck.

2020 – 211 Fire Fighter Longevity Fund

Fund Balance is expected to end the year at \$226,306. Any payments out will be made per policy covering Fire fighter retirees.

2020 – 226 Garbage Fund

The Garbage Fund balance is expected to end 2020 at \$151,145, down \$59,815. The planned spend-down of this fund was begun in 2014. In 2018 Council began to raise rates to end the decline. Staff is proposing raising rates in 2021 to increase revenues in order to meet the continuing tipping fee increases at the Marquette County Solid Waste Management Authority. Rate increases related to the Marquette County Solid Waste Management Authority tipping fees is discussed in greater detail under 2021 – 226 Garbage Fund below.

2020 – 248 Downtown Development Authority (DDA)

For 2020, the DDA fund balance is expected to end at \$714,128, down by \$17,263, which is close to the original planned spend down of \$18,209. Of this, \$558,707 of the DDA's fund balance is restricted.

In 2021, the DDA is embracing the concept of improved future planning and will be looking forward in its budget planning and execution for supporting businesses and drawing revenue to Downtown. The unrestricted available balance will have grown slightly as the DDA pay-off of Malton road has

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peaked.

2020 - 401 Public Improvement Fund

In 2020, the Fund Balance for the Public Improvement Fund is projected to decrease \$144,183 to \$153,788. The City of Ishpeming made significant investments in buildings and equipment in 2020 which included converting to a new general ledger software, installing a new roof on the Public Works building, and investing in needed equipment and repairs for the Police Department, Fire Department, Library, etc. The City of Ishpeming drew down on the Public Improvement fund balance in 2020 to achieve these investments in the city.

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2020 – 590 Sewer Funds

Sewer Fund is projected to end 2020 with an unrestricted net position of \$479,852, which is up \$37,265. The City has been working towards the goal of beginning a sewer infrastructure replacement project in the future.

2020 – 591 Water Fund

The Water Fund is expected to end 2020 with an unrestricted net position of \$(861,774), which is an increase of \$327,870 over the prior year's deficit. While the Water Fund remains in a deficit position, progress has been made in eliminating the deficit such that, as of December 31, 2019, the City of Ishpeming is no longer required to file a deficit elimination action plan with the Michigan Department of Treasury. The USDA project is in its final phase and will be closing out soon. The City of Ishpeming was also awarded a Financially Distressed Communities Grant from the State of Michigan in the amount of \$250,000 to be used to purchase water meters and radio read units, which is currently being executed.

2020 – 661 Motor Pool Fund

This fund was established in 2018 with an initial fund balance of \$30,000. It is expected to end 2020 with an unrestricted net position of \$563,260, up \$237,568. The goal is to continue to work on growing this fund with ultimate goal of replacing vehicles and equipment without borrowing money to do so.

The City's other funds remain healthy and are operating as planned. Please refer to the details budget sheets in the budget proposal document.

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Section 2 - 2021 Proposal

Taxable Values and Millage Rate

Based on information from the County Equalization Department, the City's 2020 taxable value (the 2020 value is used to compute the 2021 tax collection) is \$125,409,487. The City Council has adopted a tax levy (Millage) with revenues:

Tax category	Millage	Tax Revenues*
Operations:	13.1795	\$1,664,285
Act 345 Retirement:	2.4762	\$285,402
Public Improvement:	4.3930	\$523,405
Fire Equipment	0.8822	\$105,210
Total:	20.9309	\$2,578,302

*Note: Tax Revenues are subject to change based on Board of Review, Tax Tribunal, or other adjustments. It is certain there will be some reductions; however, they are not expected to be major. City revenues are reduced by the DDA recapture which is estimated to be \$248,845.

2021 - 101 General Fund

Staff projects General Fund revenues of \$2,816,665 and expenses of \$3,013,634, adding \$196,969 from Fund Balance to provide a balanced budget. The proposed budget freezes staff wages to the 2020 level.

The COVID-19 pandemic has led to reductions in revenues from sources such as rental income; however, it is yet uncertain as to how a prolonged pandemic will impact revenues or how stable the funding from the State of Michigan will be. The expenses remain on par with 2020, with some exceptions such as the previously mentioned increase to MERS. The City of Ishpeming is soon opening negotiations with the AFSME and POAM unions, which may have an impact on the 2021 budget. At this time, the outcome of the health insurance renewal for 2021 is still unknown. The proposed budget includes annual contribution to UPSET of \$10,000 and a payment of \$9,000 to the Senior Center.

To preserve the City's financial position, I recommend we set future budget meetings to discuss area we can reduce costs and develop plans for long-term sustainability of the City's operations. If the proposed budget is executed as planned, the fund balance will be about \$589,733 at the end of 2021. This fund balance level is about 19.6 percent of the 2021 expected expenses-a decline of about six percent from 2020.

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2021 – 202 Major Street Fund and 203 Local Street Fund

Condition of some City streets has significantly improved due to the USDA project. Unfortunately, we still have a lot of streets needing help. Due to action of the State in prior years, our Major Street funding is up somewhat; however, the City's winter maintenance costs have drastically increased in the last two years due to increased snowfall. The 2021 budget anticipates another year of high snowfall, but our intent is to try to reduce overtime costs and reduce the overall winter maintenance costs. The increased winter maintenance costs have been a drag on the Local Street budget.

State of Michigan action to increase funding a couple years ago, while a positive step, did not fully correct the state- wide shortage in road funding. Even with the increased Act 51 revenue, the City is unable to keep up with basic maintenance expenses, purchase equipment and supplies, and apply the appropriate repairs to maintain deteriorating streets. As such, this budget proposes transferring \$300,000 from the Public Improvement Fund to the Local Street Fund in order to put \$400,000 towards new street paving projects in 2021.

In 2021, this budget shows Major Street revenues of \$783,275 and expenses of \$867,608, which includes a \$300,000 transfer to the Local Street Fund preservation of the local street system as allowed under Act 51. This will draw \$84,333 from the fund balance, resulting in a Major Street Fund Balance of \$522,663 at the end of 2021.

In 2021, the Local Street Fund, we plan to spend \$918,216, which includes \$400,000 of street paving, with revenue of \$931,066, which includes \$300,000 from the Major Street Fund and \$400,000 from the Public Improvement Fund. The difference of \$12,850 will be added to fund balance, resulting in an expected Local Street Fund Balance of \$95,567 at the end of 2021.

2021 – 226 Garbage Fund

In 2021, the fund is expected to spend \$795,130 against revenues of \$795,130. The projected 2021 ending Fund Balance of the Garbage Fund is \$151,260, up \$115, basically break-even. Staff will be recommending an increase in the Residential Waste Disposal Fee in 2021 of \$1.00 per month for a monthly fee of \$21.90, up from a 2020 fee of \$20.90. The Marquette County Solid Waste Management Authority tipping fee has gone from \$49.50 per ton in 2019 to \$59.50 per ton for its fiscal year 2020-2021. Marquette County Solid Waste Management Authority is projecting an annual \$2.00 increase in the per ton tipping fee until it reaches \$69.50 in its 2025-2026 fiscal year. This planned fee schedule by Marquette County Solid Waste Management Authority will require annual increases to the City of Ishpeming garbage customers. The Council may wish to discuss this rate increase during the budget workshop.

2021 - 248 Downtown Development Authority (DDA)

In 2021, the Downtown Development Authority (DDA) Fund continues with reduced spending because of high bond payment levels, although the DDA bond payments peaked in 2020 and will now decline over the next couple years. Therefore, in 2021 the DDA is going to utilize fund balance to make some investments into the downtown knowing that it will replenish fund balance in future years

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as the bond payments decrease. This means that expenses will be higher than the revenues in 2021. With about \$250,095 in revenue in 2021 and \$313,773 in expenses, the DDA will have to use \$63,678 from the fund balance to fund A&E design for a skate park, assist in a forest management plan, renew the façade grant program, and invest in new holiday lighting projects.

2021 - 401 Public Improvement Fund

The fund expects revenues of \$524,405 and expenses of about \$524,405, resulting in an increase of \$0 in the fund balance. The Public Improvement Fund has committed debt payments of \$223,654, which leaves \$300,751 available for use in 2021. As previously mentioned, the available \$300,000 will be transferred to the Local Street Fund to go towards street paving. All other spending that normally would come from the Public Improvement Fund will be placed on hold until the 2022 fiscal year.

2021 - 590 Sewer Fund

The Sewer Fund is expected to have \$1,637,000 in revenues against \$1,165,428 in expenses, giving a boost of \$471,572 to fund balance by the end of 2021. Recently, Council approved the feasibility of obtaining grant funding and/or low interest loans in order to move forward with a much-needed sewer infrastructure project. Currently, the ordinance for the Sewer Fund requires an annual 5 percent increase in the sewer rate.

The most likely course of action is to seek a USDA Loan / Grant. The current projection is that the City could see a grant value of approximately \$3M with a Loan of \$1M. The replacement of the infrastructure will continue the previous efforts and strengthen our lifecycle management and longevity. The Council will be asked to give serious consideration to this plan as our infrastructure is in serious need of replacement / repair.

2021 - 591 Water Fund

The Water Fund is in deficit, but the deficit has now been reduced to such a level that the City of Ishpeming is no longer required to report the deficit to the Michigan Department of Treasury. The deficit was created several years ago by extreme cold weather conditions and by previously unreimbursed expenses related to the USDA project. The plan is to continue working to fully eliminate the deficit in the Water Fund. In 2021, revenues are expected to be \$2,341,550 with expenses of \$1,841,575 resulting in net income of \$499,975 and an ending unrestricted net position \$(361,799), a deficit. Currently, the ordinance for the Water Fund requires an annual 5 percent increase in the water rate.

2021 - 661 Motor Pool Fund

This was a new fund for the City of Ishpeming in 2018. It consolidates the revenues and expenses related to DPW equipment operations and maintenance from several other funds, including: General Fund, Public Improvement Fund, Water Fund, Sewer Fund, and Street Funds. The idea of this fund is to provide direct public visibility of the funds used with this important fleet. This fund has grown since its inception, and the City has been able to purchase a couple significant pieces of equipment

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from this fund. Total revenues for this fund are expected to be \$888,000 with expenses of \$863,110, including depreciation, resulting in an ending unrestricted net position of \$588,150. These 2021 expenses also include \$200,000 for equipment purchases.

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Section 3 Financial Issues and Opportunities

As described above, the City continues to look at opportunities to obtain grant funding, look for ways to grow revenue, and seek solutions to some of the financial challenges. Topics of discussion here are about some of these important financial consideration for the future. The areas below are items that could be considered in future budget meetings as we seek a sustainable path for the City of Ishpeming.

New Revenue Sources

To keep up with cost growth, the City needs new revenue. Unfortunately, **none** of these may be put in place for the 2021 fiscal year. All would require action in 2021 to implement in 2022.

A. Library Millage

Under Act 164, the City Council is authorized to levy 1 mill to pay for public library expenses. The City currently does not levy this tax, but pays for the entire cost of the Library out of other sources of revenue, including the General Fund. The soonest that the City could use this millage as a source of funding in the 2022 budget. The idea of this millage is that by dedicating this new specific tax to the Library, the City will free up tax revenue for other needs. This increase in taxation would bring in about \$120,000, costing the average tax payer about \$50 per year.

B. Headlee Override

With the correct legal process (see attached Fact Sheet and sample ballot language), the City has a legal means to override the Headlee Amendment, returning the millage rate for the City of Ishpeming to the maximum constitutional rate of 20.9 mills. Currently, the City levies 18.4547 mills between General Operating and Public Improvement Fund. Therefore, using this process could gain the City about 2.4 mills (or about \$280,000) of new revenue. This action requires a public vote, which could be defeated.

C. Voted Millages

Similar to the Fire Truck Ballot Proposal, the City has the authority to place a wide variety of specific ballot initiatives before the voters. This choice could help with various expenses, including providing funding for road improvements or park maintenance.

Reducing Costs Via Employee Healthcare

While the City of Ishpeming reviews its healthcare costs on an annual basis in order to obtain the best outcome, healthcare costs continue to be a significant portion of the budget. The City Healthcare Committee should convene in order to explore options to further reduce this cost while maintaining reasonable healthcare for employees.

Reducing Costs Via Employee Healthcare (continued)

Under Public Act 152, the City Council must vote in 2020 by a super majority (4-1) to continue this total support into 2021. Per State law, if this policy is not continued the City must move to either an 80/20 cost share or to pay not more than a fixed "cap" per employee. The State of Michigan sets the cap annually. Either of these options would force the employees to pay a substantially larger share of healthcare costs in the form of payroll deductions. Some form of healthcare premium cost-sharing with our employees is going to be necessary in the future.

MERS

As with numerous other communities, the unfunded defined benefit pension liability is the most difficult issue facing the City of Ishpeming. From 2020 to 2021, our annual required contribution (ARC) has increased from \$808,600 to \$888,336, which equates to an increase of 9.9 percent totaling \$79,736. The most recent actuarial report shows the unfunded liability to be more than \$10,000,000 as of December 31, 2019. Future ARC payments are projected to increase above \$1,000,000 in a few years, depending on mortality rate, investment return, and other factors. Clearly, the City cannot afford expenses like these without deep cuts to services or significant new revenue. As previously stated, the MERS defined benefit pension plan has been closed to new hires after 01/01/2020. While this stems the long-term problem with MERS, in the short-term the \$10,000,000 liability is being amortized now over a closed 19-year amortization period. The City of Ishpeming needs to make developing a plan to address this issue a top priority before the annual payments become untenable.


Craig H. Cugini
City Manager