

City Manager's 2018 Budget Message

October 12, 2017

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

FROM: Mark Slown, City Manager

SUBJECT: 2018 Budget Message

Executive Summary

It appears that the 2017 approved budget will conclude well. The 2018 proposed budget is financially solid. However, the City of Ishpeming is entering a new period of financial distress. In this period, the City budget will experience limited revenue growth. The limited growth will fail to keep up with continuously and significantly increasing fixed and often unavoidable costs. Tough choices will be made in the next few years. Some tough choices have already been made to prepare this proposed 2018 budget as the City merely begins to enter this new period of financial distress. For example, our thrifty staff has already cut about \$400,000 of much needed spending from the General Fund portion of this proposed budget. Other fund budgets were similarly reduced to obtain a compromise between needs and available funding. Simply put, the City does not have the funding to accomplish all our goals. As this message will explain, this situation will get worse in the years ahead. Until the Michigan Municipal Financial System is reformed or new revenues are found, cities, like Ishpeming, will continue to experience financial distress.

General Summary and Outline of Budget Message

There are three major sections to this budget message

1. Review and Outcome of 2017
2. Proposals for 2018
3. Future Financial Problems and Opportunities

Section 1 is a review of the City's expected financial position at the end of the current year.

Section 2 describes financial plans to continue existing City services and all ongoing major initiatives. Unfortunately, the 2018 level of effort is not sustainable. The major initiatives are placing stress on the City staff's human limits and City's financial capacity; they take time and money away from the day-to-day responsibilities of the Departments. For example, DPW must stop routine work to complete numerous construction MISS DIGs associated with the USDA projects. Never-the-less, the 2018 budget continues all critical infrastructure work (including street repairs) in the second year of the USDA Water System Improvement Project, concludes the SAW grant program, continues blight elimination efforts, continues to modernize the City's

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General Summary and Outline of Budget Message (continued)

technology, and establishes a major new fund--the DPW Equipment Fund. Once all these large projects are completed, employees may be able to return to a more normal workload.

Also, in this 2018 proposed budget, the City continues to replace worn out equipment. Unfortunately, we do not have enough funding to keep pace with the rate of equipment deterioration. This budget proposes to purchase a One Ton Dump Truck for DPW. Please refer to the "Report on Bond Referendum Proposal for Fire and Public Works Equipment" for discussion of DPW equipment needs.

Section 3, addresses major systemic financial opportunities and problems in human-power needs, equipment needs, healthcare, and retirement funding issues for the 2019 budget and beyond. This section may actually be more important than my comments about the 2018 proposed budget because our financial problems are growing over time. As the MML report, dated January 2017, states: "Michigan's municipal finance system is broken." The City of Ishpeming will suffer the consequences of this broken system in the years ahead, unless reforms are implemented at the State level or new sources of revenue becomes available.

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Section 1 Expected Outcome of 2017

The starting place for the 2018 budget is the projected outcome of the 2017 budget. With about two months to go, staff expects to complete the 2017 budget in all funds without major financial problems.

2017 General Fund

Staff projects the Fund Balance for the General Fund at the end 2017 to be \$689,575. This balance is down from \$936,884 (at the beginning of 2017) due to purchase of major new pieces of DPW equipment, adjustments in the DDA budget, and some unexpected expenses. The General Fund experienced higher than expected expenses in the Cemetery, Workers Compensation, Police vehicle repairs, Fire Department communications expenses, Tree Removals, Street Lighting, Zoning, Al Quaal, Street Lighting, and Parks. Some departments experienced lower than expected expenses: City Council, DPW Administration, Alley/Sidewalks, and Tube Slide.

With voter approval we have purchased a new Sutphen "Quint" fire truck for about \$850,000, including associated costs. Through competitive bidding, the interest costs for the Quint were lower than expected. The lower interest rate means that the average millage expected to pay the bond debt will be about .75 mills (instead of .85 mills). This will mean lower than expected taxes for our taxpayers in future years.

2017 Major and Local Streets

For 2017, the Fund Balance for Major Streets is expected to be up to \$108,778 from \$45,668. This increase was a conscious effort to increase the Major Street Fund Balance to have money available in 2018 to repave the second lane of USDA projects streets (where the USDA project will only pay for one lane of paving).

For 2017, the Fund Balance for Local Streets is also up from \$96,193 to a projected \$148,936. Again, this increase was a conscious effort to increase the Local Street Fund Balance to have money available in 2018 to repave the second lane of USDA projects streets (where the USDA project will only pay for one lane of paving).

2017 Fire Fighter Longevity Fund

In 2017, the Fire Fighter Longevity Fund was established as a City controlled fund to provide a longevity payment upon the retirement of those fire fighters meeting the conditions of the City Council approved policy. The Fund is projected to end 2017 with \$232,360 in Fund Balance. This level of funding should be sufficient to make all policy directed payments for many years to come. I would like to thank the Fire Department leadership team for their cooperation in this matter.

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2017 Waste Disposal Fund

The Waste Disposal Fund (Garbage Fund) planned spend down continued in 2017 with the fund balance expected to end the year at \$291,282. In 2019, this fund must conclude the planned spend down of its Fund Balance. City Council may wish to discuss the transitional period, as a rate increase of \$5 per customer per month will be needed in 2019 to keep the fund healthy.

2017 Downtown

For 2017, the DDA Fund Balance is over \$1,041,601, but 90% of it is restricted and unavailable for discretionary use. The DDA should end 2017 with about \$108,399 in unassigned Fund Balance. Almost all of this money will be needed to get the DDA through the next three years of increasing bond payments. Also, in 2017, the lack of DDA funding impacted the City's Manager's budget because some wages for Cathy, Jim, and Mark previously were paid from the DDA budget; however, this funding was significantly reduced to balance the DDA budget. Therefore, these wages must be paid from the Manager's portion of the General Fund budget in 2018.

2017 Public Improvement Fund

In 2017, the Fund Balance for the Public Improvement Fund is projected to decrease a little from \$163,414 to \$143,965. This level of Fund Balance is about right for this budget, giving the fund reserves available in an emergency situation, for special short notice capital opportunities, or if an expensive item fails unexpectedly.

2017 Water and Sewer Funds

Water and Sewer Funds are projected (respectively) to end 2017 with a net unrestricted position of negative \$1,870,574 and \$465,828. The Water Fund Deficit Elimination Plan was on track in

2017 to be resolved in 2021 through a combination of the USDA project and planned rate increases.

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

With the 2017 expected to conclude as planned, the City of Ishpeming can now face the challenges of the 2018 proposed budget.

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Section 2
2018 Proposals

Taxable Values and Millage Rate

Based on information from the County Equalization Department, the City's 2017 taxable value (the 2017 value is used to compute the 2018 collection) is \$117,543,304. The City Council has adopted a tax levy (Millage) as follows with revenues shown, projected by the County Assessor:

Tax category	Millage	Tax Revenues*
Operations:	13.4433	\$1,577,034
Retirement:	1.5300	\$179,358
Public Improvement:	4.4810	\$525,332
Fire Equipment	.9000	\$105,370
Total:	20.3543	\$2,387,094

*Tax Revenues are subject to change based on Board of Review, Tax Tribunal, or other adjustments. At this point in time, it is almost certain there will be some reductions; however, they are not expected to be major reductions. Also, these numbers will be reduced by the DDA recapture.

2018 General Fund

At this time, staff projects total revenues of \$2,735,748 and expenses of \$2,794,911, with \$59,163 coming from Fund Balance for a balanced budget. **There are no staffing changes proposed in this budget for 2018.** Funding for the contractual obligation to increase Union wages by .45 cents per hour is included in the proposed budget. Funding to make an equal increase for non-union employees is also included. I am proposing to reduce our annual contribution to UPSET from \$8,000 in 2017 to \$4,000 in 2018. I am proposing to include \$5,000 as a payment to the Lake Superior Community Partnership (LSCP) which is for economic development services to the community. Most other revenues and expenses remain the about the same in 2018 as in 2017. A total of about \$400,000 in specific department requests for funding were denied to prevent further depletion of the Fund Balance. Some, but not all, of these denied requests are documented in the budget worksheets. Specific recommendations to change City fees will be forth coming to City Council in a separate document. If the proposed budget is executed as planned, the Fund Balance will be about \$630,412 by the end of 2018, a decrease of \$59,163. The \$630,412 amount will be about 23% of planned expenses of the General Fund.

2018 Major and Local Street Funds

If asked, many people would agree that the conditions of our streets is generally not very good. This is not the fault of DPW; it is a lack of funding. As funding has been available, the City has repaired many street segments, but far too many street segments remain to be rebuilt. Despite

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2018 Major and Local Street Funds (continued)

the recent increase in Act 51 funding, Major and Local Street Funds are still inadequate. In 2018, we expect to receive a total of about \$863,000 from all sources to pay for maintenance and repairs for 45 miles of major and local streets in Ishpeming. State of Michigan action to increase funding, 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. Also, we do not want to repave a street unless the underground infrastructure is also repaired. If we do this, we are just wasting taxpayer money.

To address the shortage of funds, the City Council has an option to propose a voter millage for street repairs; although, I do not recommend doing so at this time. Per the City Charter, City Council also has the power to impose special assessments on the adjacent property owners to specific street segments. The property owners must pay all or some of the cost as determined by Council. As most people cannot afford these costs, I do not recommend this funding option; however, if property owners complain too much about the condition of their street, then maybe they will be willing to pay for the repairs.... It is my understanding that general tax revenues were never intended to pay for Street repairs; although, that is an option as well. Bottomline: without additional dedicated street funding, the condition of our streets will continue to slowly decline.

On the positive side, the USDA Water Improvement Project has begun to replace deteriorated streets. At the time of drafting this message, work has begun on Superior Street and will soon be completed on Cliffs Street, Battery Street, and Hazel Street. Many additional street segments will be replaced in 2018 as part of the USDA project. Unfortunately, there are street segments that are in extremely poor condition that are **not** included in the USDA project. With very limited funds available to make repairs, many of these street segments will remain in deteriorated condition for years to come.

The City continues to spend about \$30,000 on patching potholes each year. Some street segments have more patches than original paving. To reduce the cost of pothole repairs, we will have to improve the quality of most City streets. We simply do not have the funds to do that. While City residents will benefit tremendously from the USDA project and associated street improvements, the cost of pothole repairs will remain high as other older streets continue to fail.

In 2018, staff proposes Major Street expenses of \$440,723 with revenue of \$578,040. The unspent revenue of \$137,317 will go into the Fund Balance, resulting in a Major Street Fund Balance of \$246,095 at the end of 2018.

Staff plans to use some of this money in 2018 to complete full-width paving of streets in the USDA project which are currently funded for only one lane of new pavement. Staff will bring details of the specific paving proposals to Council over the next few months and the budget may be amended as Council directs.

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2018 Major and Local Street Funds (continued)

In 2018 the Local Street Fund, we plan to spend \$309,337 with revenue of \$285,800. The difference of \$23,537 will come from Fund Balance, resulting in an expected Local street Fund Balance of \$125,399 at the end of 2018.

Except for street repairs associated with the USDA Water Improvement Project, no special construction projects are planned for Major or Local Streets in 2018. If we are able to work out a deal for the mine rock stockpile or sell other major assets, the City may be able to add some Street work to the budget as an amendment. Please keep in mind that we do **not** want to repave a street until we are also able to improve the underground infrastructure. To do so would waste valuable resources.

2018 Garbage Fund

This will be the last year that the City will be able to continue to spend down the Fund Balance of the Garbage Fund. The fund is expected to spend \$635,500 with revenues of \$476,200. The 2017 ending Fund Balance of the Garbage Fund (\$291,282) will be drawn down by \$159,300 to \$131,982 by the end of 2018. Beginning in 2019, the City will be required to add back \$5.00 per customer per month to keep the fund healthy. This is a subject the Council may wish to discuss during the budget workshop.

2018 Downtown

In 2018, the Downtown Development Authority (DDA) Fund will continue cutting back on expenses and reducing the number of meetings they will hold as an economy measure. With about \$227,980 in revenue and \$232,753 in expenses, the DDA will have to use \$4,773 from the Fund Balance. There is less than \$20,000 in discretionary spending in the DDA expense budget. Most of this will pay for beautification work and limited City services. While the DDA does have some substantial fund balance reserves, most of these reserve funds are obligated and not available for use. DDA debt payments will decline after 2021. At that time, DDA will have more discretionary funds available to benefit the community and pay for City services.

2018 Library Special Fund

These are funds that were collected from donations to make improvements in our historic Library. About \$41,998 remain in this fund at the time of the preparation of this budget message. Some of these funds have been planned to be used for tuck pointing the building, chimney repairs, and resealing roof membrane joints to extend the life of the roof.

2018 Public Improvement Fund

The fund has expected revenues of \$494,404 and expenses of about \$491,415, resulting in an increase of \$2,989 in the fund balance. The fund balance of the Public Improvement Fund is expected to be \$146,954 at the end of 2018. This amount is 29% of the 2018 revenue. Staff is seeking to build up sufficient funding to pay for large capital purchases in the future.

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2018 Public Improvement Fund (continued)

The 2018 Public Improvement Fund budget includes the following capital expenditures:

City Hall - \$10,000 for building repair and improvements.

Cemetery - \$34,000 for various projects.

Police - \$30,000 for building repairs and a used vehicle.

Fire - \$32,900 for building repairs and for replacement of equipment.

Public Works - \$50,000 for a one ton dump truck.

Parks - \$5,000 for improvements.

Al Quaal - \$24,500 for building improvements and picnic tables for the new pavilion.

Library – \$35,800 for building improvements, books, periodicals, video and audio products, and computer work stations.

Contracted Services - \$35,000 for demolition, curb, and sidewalks.

Transfers Out -\$151,300 to pay building debt

Bond and Interest Payments - \$82,915.

Some Department requests for Public Improvement funds were eliminated or reduced (see individual worksheets) to limit the proposed Public Improvement Fund expenses to about \$491,415.

2018 Sewer Fund

The Sewer Fund is expected to have \$1,999,080 in total expenses against \$1,847,500 in revenues, requiring \$151,580 from Fund Balance. About \$500,000 of these expenses are sewer repairs being done as part of the USDA Contract Number Three. Expenses of \$417,000 are expected for the SAW grant project. The unrestricted Net Position of the Fund is estimated to be about \$314,248 at the end of 2018.

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2018 Water Fund

The Water Fund is working its way out of a deficit position created several years ago by extreme cold weather conditions and by previously unreimbursed expenses related to the USDA project. The major expenses in this fund are the capital investments of the USDA Water Improvement Project. The combination of the deficit and the USDA project create an unusual budget for 2018. Revenues are expected to be \$10,912,398 with expenses of \$10,685,483, resulting in a net increase of \$226,915 in Fund Balance. This positive balance is helping to eliminate the deficit, but the deficit will not be completely eliminated until 2020. The USDA project is critical to the long-term health of the community, but it requires a great deal of extra work especially from DPW and the Finance Department employees. This project is contributing to employee overtime expenses.

2018 DPW Equipment Fund (661)

This is 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 the important fleet. The Fund has a \$30,000 fund balance to begin from moneys dedicated to future equipment purchases as part of the 2017 budget amendment process. One of the main purposes of this fund is to gain visibility over specific uses of equipment revenues and expenses so that in the future funds will be clearly dedicated for vehicle replacement. The revenues for this fund are expected to be \$540,050 with expenses of \$530,050, increasing the fund balance to \$40,000. Please keep in mind that this fund is going to experience “growing pains.” That means that the numbers are very likely to change from these projections.

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Section 3 Future Financial Problems and Opportunities

As described above, the City will be entering a period of financial distress, unless certain issues or opportunities can be favorably resolved. Topics of discussion here are about some of these important financial considerations for the future. The areas addressed below are not technically part of the 2018 budget; however, they need to be addressed going forward, or the City will likely experience significant financial problems in the future.

New Revenue Sources

To keep up with cost growth, the City needs new or additional revenue. Here are some possibilities:

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 cost of the Library out of other sources of revenue. While I do **not** recommend this levy for 2018, the City Council may consider using this millage as a source of funding in future years if expenses continue to climb and revenues remain flat. 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.

B. Headlee Override/Truth-in-Taxation Hearing

With the correct legal process (the City Attorney should advise), 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 mills. Currently, we levy 17.9243 mills between General Operating and Public Improvement Fund (only these two millages are impacted by the Headlee Amendment). Therefore, using this process could gain the City more than 2 mills of new revenue. I am **not** recommending this process for 2018; however, it may be necessary in the future.

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. Again, I am **not** recommending this for 2018, but it may be needed at some point in the future.

Employee Healthcare

Healthcare costs continue to increase. In 2018 our expected cost increase is 7.02% which is about \$21,419. This assumes that the Unions agree to switch to the "UP Blue" Plan which means they have to get a referral from their regular doctor to see a new specialist. If the Unions do not agree to the UP Blue Plan, the premium cost increase will be 14.43%, or about \$44,005.

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Employee Healthcare (continued)

Per our labor agreement, the City pays the full cost of any increase under 8%. Therefore, I think the Unions will agree to this change. We are planning a meeting soon to discuss the situation.

Assuming the Unions agree, in 2018 City of Ishpeming will continue to pay the full cost of employee healthcare premiums. Under Public Act 152, the City Council must vote in 2017 by a super majority (4-1) to continue this total support into 2018. 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. The Municipal unit paying 100% of the employee healthcare premium is not the trend. Most municipal employers have established a policy of some form of premium sharing. Because healthcare costs continue to increase while our revenue is stagnant, some form of healthcare premium cost-sharing with our employees is going to be necessary.

Also, the City pays a "true up" to our employees. The "true up" is calculated annually based on the actual employee use of a healthcare "Wrap Plan." A Wrap Plan is an additional insurance plan "wrapping" the basic healthcare plan (Blue Cross) to buy down deductibles on an as needed basis, lowering the total premium expense. Currently, our Wrap Plan uses a tipping point set at 33% of total wrap liability. With more than 33% use of wrap liability, the employees pay the difference back to the City. With less than 33% wrap liability, the City refunds the difference to the employees. For the last three years, each employee has been receiving a payment annually, because the employee use has been running about 16% of wrap liability. The payments to employees under this "true up" are costing the City about \$20,000 per year; however, it is not a one-way-street. The wrap plan saves the City money on total healthcare premium costs. It is difficult to determine exactly how much we save. I am asking Vince Babcock (of 44 North, our Third Party Administrator (TPA) for Healthcare) to obtain an estimated amount of saving. According to Vince Babcock, the healthcare we have now is not available from Blue Cross/ Blue Shield without the Wrap Plan. To the best of my knowledge, while other municipal employers use a "Wrap Plan," no other municipal employer in the U.P. provides this "true up" payment as a benefit to employees. One way to save the City money would be to eliminate the "true up" feature or to change the tipping point to a lower level—the current average of 16% would be a more neutral point going forward.

In future years, if healthcare premiums continue to increase--as they have over the last several years, averaging about 6-8% each year--the City will not be able to afford to make the payments without cuts to services or new revenue. An alternative would be to negotiate for lower cost healthcare plans and increased employee contributions to pay part of the healthcare premiums.

MERS

This is the most difficult issue/opportunity facing the City. MERS has informed the City that we could, depending on investment returns, expect increases in our annual required contribution (ARC) in the amount of about \$100,000 each year for the next several years. Jim has reported to me that MERS will require the increased ARC payments to address the current MERS unfunded

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MERS (continued)

liability, which is about \$7,885,000. For 2018, we are planning to make an ARC payment of \$631,140. MERS is informing us that this ARC payment will increase to about \$891,000 by 2023 and continuing to grow to as much as \$1,300,000 annually by 2032, depending on mortality rate and investment return. Clearly, the City cannot afford expenses like these without deep cuts to services or significant new revenue. I believe that a combination of all techniques--including concessions from the employees, service cuts, new revenue/taxes, and smart money management—will be necessary to weather this storm. I have asked Jim Lampman and MERS representative Terra Langham to meet with me, Department Heads, and union representatives to review the facts and discuss the way forward.

Final Note: City Staff worked together, diligently, and carefully to create a proposed budget that meets the needs of the City and is also financially prudent. Thank you to all the staff.

Mark Slown
City Manager