City Council Study Session Item #1
Meeting of August 19, 2013

Brief Description: 2014 preliminary budget review

Recommended Action: Provide direction on key issues and preliminary levy

We are pleased to propose to the city council a 2014 levy and budget that has been prepared with these objectives in mind:

- Ensure Minnetonka's position of fiscal responsibility.
- Preserve Minnetonka's standards of excellence.
- Encourage innovative and creative thinking.

As detailed in this report, staff recommends ***increasing the levy for 2014 by 2.87 percent***. This proposal meets a new state-imposed 3 percent cap on levy increases for 2014 while remaining below staff's initial projection of a slightly greater than 4 percent increase.

The lower-than-expected increase is primarily due to the reinstatement of the state sales tax exemption for most local government purchases. Under the proposed budget, the city would be positioned to meet the management challenges and costs imposed by state-mandated public safety pension increases; the federal Affordable Care Act (ACA); expanded maintenance expectations for city gateways and streetscape areas; and implementation of the city's Emerald Ash Borer (EAB) Action Plan.

At this proposed level, ***city property taxes*** for the median-valued home in Minnetonka ($273,200 in 2013) are roughly estimated to ***decrease by less than one percent***. Key numbers related to fiscal disparities, which affect this estimate, have only been approximated by the city assessor. The estimate will be updated when final numbers are provided by Hennepin County.

Of particular interest, the state legislature adopted generous Local Government Aid (LGA) increases in the past session, and a number of our comparable cities will now qualify to receive it for the first time in years. Even though Minnetonka does not currently and will not receive LGA in 2014, the city's proposed levy increase is likely to place Minnetonka in the middle of the pack of comparable cities.

OUR PUBLIC PROCESS

The purpose of this study session is to review key budget issues and provide direction on the 2014 preliminary tax levy and city budget, which will be set by council and certified to the county by September 16, 2013, as required by state law. This is the maximum amount the city can levy for 2014.
This initial budget study session focuses on the big picture. Guided by these initial discussions, detailed budget requests will be reviewed in November, with the final budget adopted in December. The final levy may be less than the preliminary amount, but cannot be greater.

Minnetonka always encourages input on its budget from the public. In addition to the public budget hearing in early December, residents and businesses will again have an opportunity to provide feedback via the city's website, an opportunity that is publicized in the *Minnetonka Memo*. Comments will be shared with council as budget options are considered, and updated information will consistently be posted in the *Memo* as well as on the city's website.

ENSURING MINNETONKA'S POSITION OF FISCAL RESPONSIBILITY

As detailed in the city's adopted Strategic Profile, the city of Minnetonka takes a responsible, long-term perspective with financial planning and management. Decisions are made with the future in mind to ensure the city's ongoing ability to provide quality services at a reasonable price.

2013 Financial Status

During the development of the 2013 levy and budget last year, council requested a mid-year update on the city's financial status as a tool in its discussions regarding the 2014 budget. While staff regularly monitors program and division finances throughout the year, analysis of spending as of June 2013 reveals that operating expenditures for the year are on track; end-of-year revenues are projected to be less than anticipated; and an accounting adjustment related to workers' compensation and fire personnel costs will require an increase for the revised 2013 budget.

Spending. Because divisions and departments monitor and control their spending on a minimum monthly basis throughout the year, spending in 2013 as of mid-year is on track, matching prior fiscal years for the same time period to adjust for regular seasonal variations. As of June 2013, general fund operating divisions had spent 41.5 percent of the total annual budget, which is comparable to the prior two fiscal years at the same time period: 42.7 percent in 2011 and 42.9 percent in 2012. As in many years, some expenses will be adjusted at year-end for a variety of reasons. One specific example is recreational activities impacted by the unseasonably cool spring and summer will be reduced in tandem with revenue reductions noted below.

Revenue. Based on current trends, staff predicts a net decrease of approximately $140,000 (or 0.5 percent) below budgeted revenue for 2013. At this point in the year, reduced income is estimated for permit fees (down ~$120,000); interest revenue is down ~$35,000; and recreation receipts are down ~$35,000 due to weather impacts on activities. On a positive note, the city also expects an ongoing increase in state fire aid associated with actions of the 2013 Legislature, roughly estimated in the revised budget at $50,000. The exact amount will be known in October.

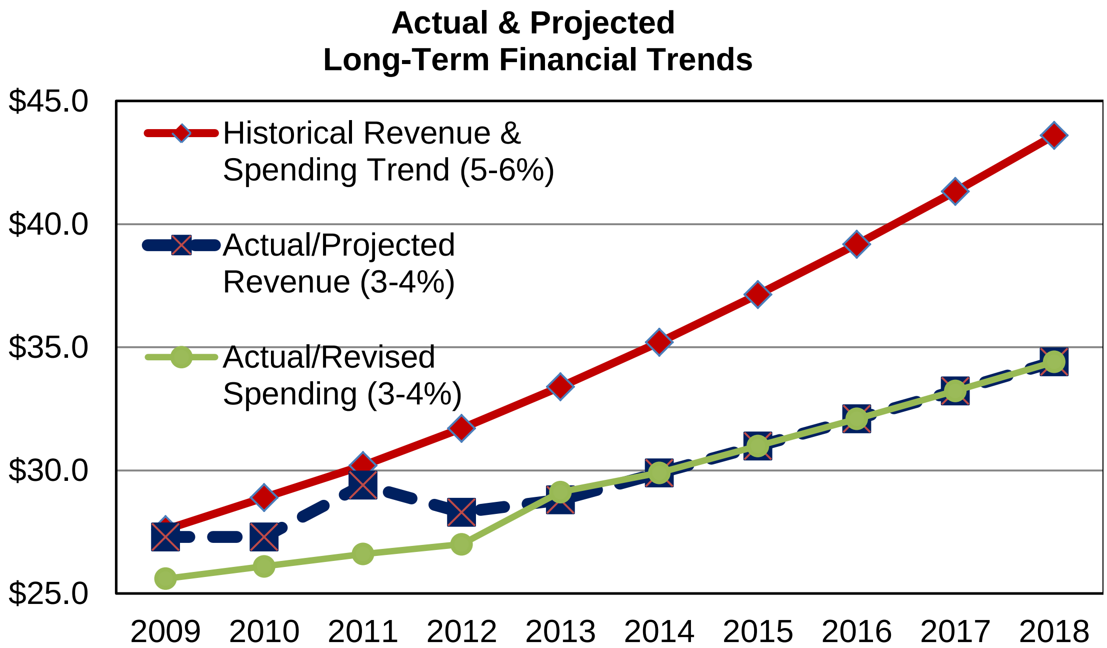
Other Adjustments. One-time adjustments related to an unaccounted rise in workers' compensation insurance costs and pay rates for paid-on-call firefighters will require an increase of the 2013 budget of approximately $120,000. Some of the unexpected increase in general fund balance gained at the end of 2012 was related to these rates. Administrative procedures and staff have been changed to ensure that such adjustments will be unnecessary going forward.

Year-end Projection. The net cumulative impact of the changes forecasted for 2013 will require the city to adopt a revised 2013 budget that projects using up to $260,000 of the general fund balance that remained at the end of 2012, without any impact on the taxpayers. History indicates that for the remainder of the year, departments will responsibly manage costs and the revised adopted budget will likely offset much of this projected increase. However, even if the worst-case scenario of using the fund balance comes to fruition, the general fund balance ending in years 2014 through 2018 is forecasted to remain within the 30 to 50 percent required by the city's fund balance policy, after programmed transfers for one-time costs in the adopted 2014-2018 Capital Improvements Program.

Financial Projections

Revenues. With a forecast for a one-time minor increase in 2014 development fees and permits, revenues are otherwise projected to continue to meet forecasted obligations. The trend is currently estimated to continue through 2018.

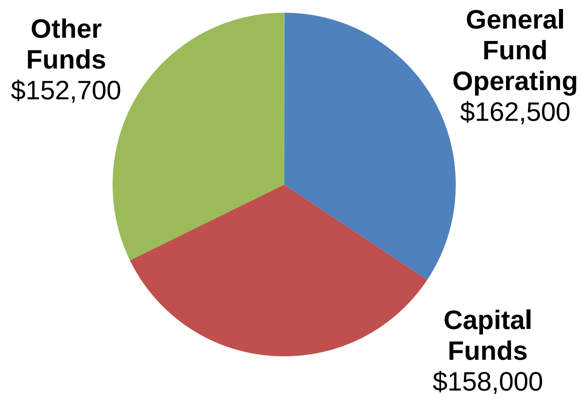
Spending. While the key long-term budget strategies enacted in 2009 in response to the permanent economic changes associated with the recession continue to serve the city well, reinstatement of a sales tax exemption for most purchases by local governments will be of significant assistance in keeping spending within the long-term projected increases. In 2014, the city will implement the city's EAB Action Plan, ensure appropriate maintenance of the city's gateways and streetscapes, and enact management and spending changes to accommodate the federal Affordable Care Act (ACA),.



State Sales Tax Exemption. The 2013 state legislature reinstated a sales tax exemption for most local government purchases, effective as of January 1, 2014. The new exemption will be instrumental in absorbing newly imposed costs as outlined below, beginning in 2014. City enterprises that compete with private businesses, such as the Williston Center and the Ice Arena, will continue to pay sales taxes. Additionally, rules regarding some aspects of the exemption have yet to be clarified by the state and procedures are being developed to incorporate potential sales tax exemptions for contracted project costs.

Nonetheless, the city paid roughly $480,000 during 2012 in state sales taxes that would have otherwise been exempt under the new law. Of that amount, one-third was paid primarily by the water and sewer utility and in small part by storm water fees and cable franchise fees. One-third was paid in the general fund operating budget, while the remaining one-third related to costs in capital funds supported by the city property tax levy.

Sales Taxes Paid by City in 2012



2014 Budget

EAB Action Plan. At a January study session, council discussed an action plan for managing the imminent arrival of the emerald ash borer in Minnetonka and its inevitable devastation of the city's ash tree canopy. The 2014 proposed budget includes additional costs to start the pre-EAB arrival phase of the program. This phase includes chemical treatment of high-value ash trees; continued removal of damaged or unhealthy ash trees in parks and outlots as well as slow, systematic removal and judicious replacement of the other ash trees in those same areas; and thoughtful and cautious citations for removal of damaged or unhealthy ash trees on street rights-of-way under a continued cost sharing (50:50) plan with adjacent landowners.

The first six months' costs of the pre-EAB phase in 2014 will be $162,100, funded in both the operating and capital budgets and in large part absorbed by overall savings from the new state sales tax exemption. The operating budget of the environmental services division includes expenses for two new staff, an assistant forester and an administrative assistant, as well as additional funding for temporary laborers and operating costs including technology and fuel. The adopted 2014-2018 Capital Improvements Program (CIP) includes funding for tree removal, stump grinding, reforestation and capital start-up equipment.

Parks & Trail Maintenance. The 2014 budget adjusts funding to cover costs for an additional seasonal inter-community work crew (ICWC). While the city already uses two year-round crews for park maintenance, a seasonal group will be used during the growing season to maintain streetscapes and planted medians on various roadways and gateways such as Shady Oak Road and County Road 101. Temporary seasonal employees are only available for a very limited amount of time, while a seasonal ICWC contract would cover a longer length of time in order to maintain these high-maintenance areas.

Personnel Expenses. Because the city is a service business, workforce-related changes, including healthcare, have a significant impact on both the city's work and its finances. The city will be negotiating new 2014 contracts for three of its four employee labor unions later this year. For now, it appears that some market wage increases are continuing to be held down due to the recent history of similar economic pressures on our comparable cities.

However, the state legislature adopted additional plans for shoring up unfunded liabilities in the statewide public safety employee pension fund, which require additional contributions in both 2014 and 2015. In 2014, the city's contribution for full-time public safety personnel will increase from 14.4 percent to 15.3 percent of pay. In 2015, the city's contribution will increase to 16.2 percent. Employees will also be required to contribute a larger percentage of their salaries, from the current 9.6 percent to 10.2 percent in 2014 and 10.8 percent in 2015.

Of perhaps even greater significance, substantial reductions in health care premiums in previous years will be reversed by a projected 13 percent increase in 2014, due primarily to new requirements of insurance carriers imposed by the federal Affordable Care Act (ACA). This will affect the city's contribution to the employees' cafeteria benefits plan.

Other provisions of the act impose increased costs directly upon employers, some beginning in 2014 and some delayed until 2015. In anticipation of these new rules, the city has evaluated workforce plans across city programs and adjusted staffing structures on a case-by-case basis to appropriately accommodate the likely requirements of the act, to better serve customers and to accomplish program goals. In some cases (e.g. police community services officers and recreation staff), additional temporary or part-time staff will be hired for fewer hours each. In other cases (e.g. recreation, administration and finance), in lieu of additional hiring, part-time staff will increase hours and will be offered health care benefits. The ongoing costs of these changes will be partially absorbed by the savings provided by the new state sales tax exemption.

Staff is staying informed as new administrative rules on the ACA are released by the federal government and interpreted by our consultant and professional associations. Over the next year, staff also will be analyzing the effect of the ACA requirements on the staffing structure of fire department programs. The new fire chief, who will be on board later this month, will play a key role in making decisions related to these changes for 2015.

Cable Fund. As discussed last year, the Comcast cable franchise renewal now provides an opportunity to channel new dollars toward changing technologies for public, educational and government (PEG) access. The 2014 budget anticipates both revenue and expenses related to the production and playback of PEG programming for Southwest Suburban Cable Commission (SWSCC)-related broadcasts.

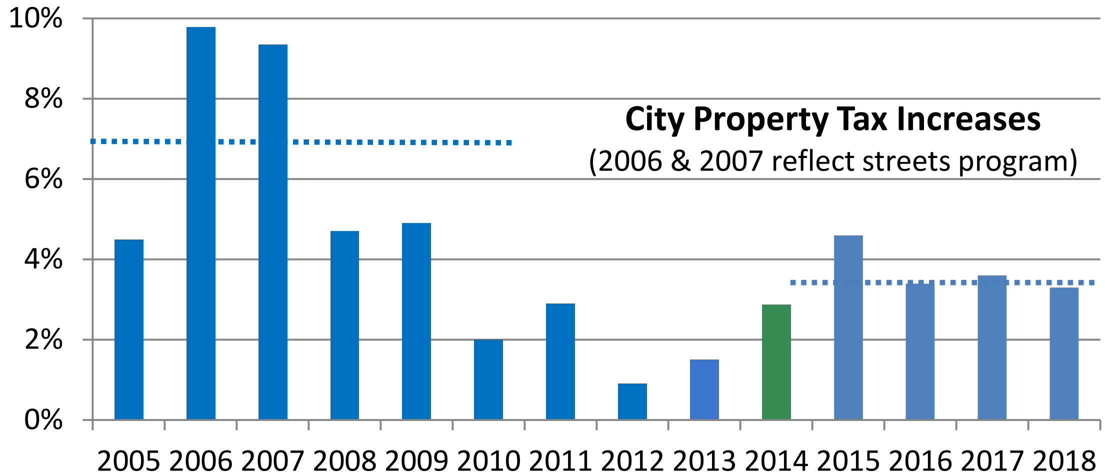
Playback content for the SWSCC PEG programming has transitioned from Comcast to the city of Edina. Comcast provided a one-time capital allotment for the studio, with the other member cities reimbursing Edina for a proportional cost for the operational staff. Production of public access programming is currently taking place at the city of Bloomington's studio facility. The one-year agreement with Bloomington, which expires at the end of 2013, allows public producers to use Bloomington's studio and editing equipment.

The 2014 budget assumes a slight increase in franchise fee expenditures for legal services, playback services through the city of Edina and the potential for continued studio production expenses with the city of Bloomington.

Water and Sewer Utility Fund. The 2014 Utility Fund budget provides for the addition of a utility locator who locates water and sewer infrastructure (pipes, valves and services) for the Gopher State One-call system. These requests come from residents and contractors who perform excavation work and must know the location of the city's services to prevent damage during construction. In order to keep pace with demand in 2013, the city used a contractual service to supplement the city's locator. The increasing volume warrants the addition of another staff person in order to keep pace with locate requests.

2014 PRELIMINARY LEVY

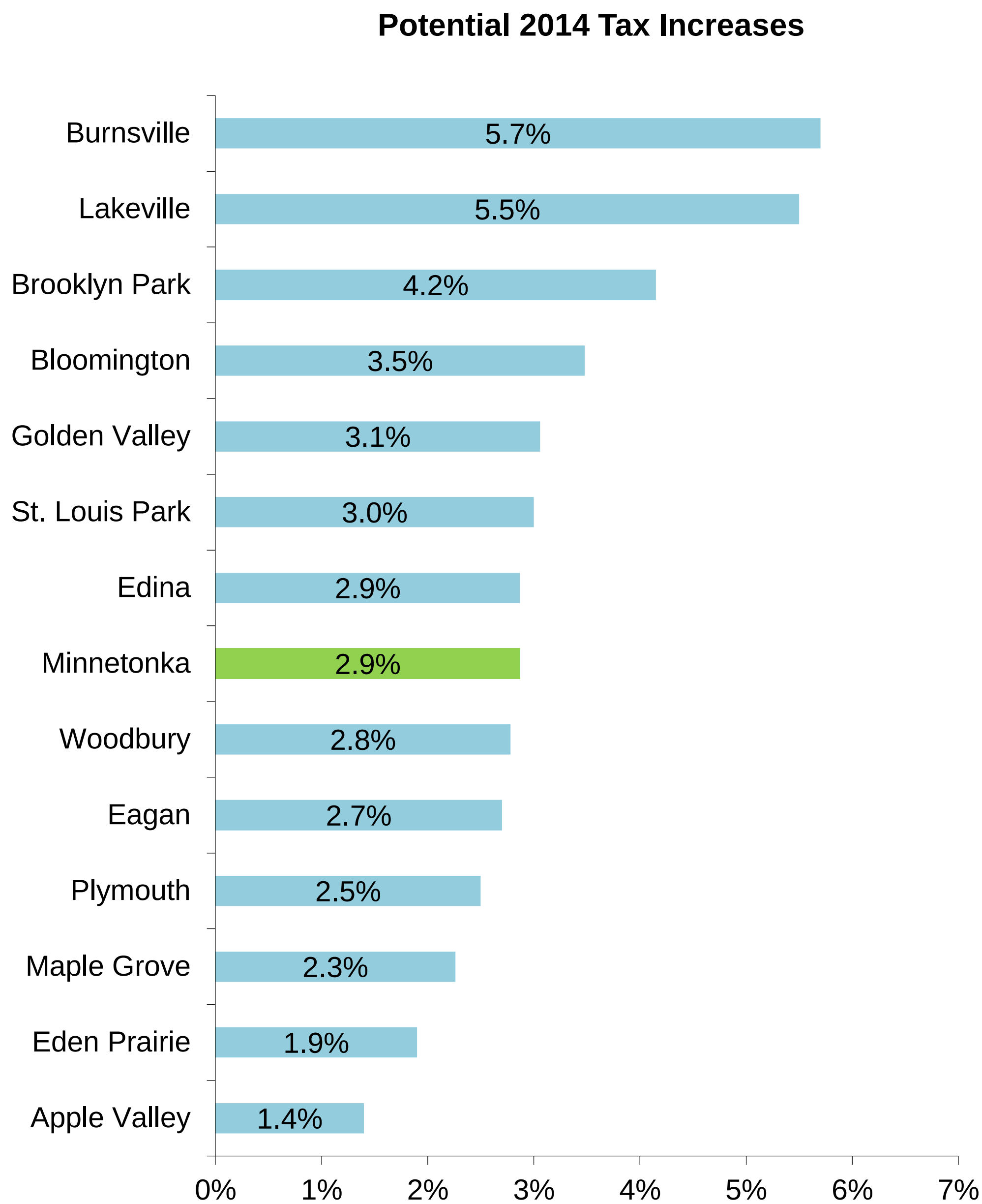
The 2014 proposed operating and adopted capital budgets will require an increase in the city property tax of 2.87 percent, which is within the 3 percent levy cap imposed by the state legislature for this next year. Inflationary costs continue to be low (currently 1.8 percent nationwide, 2.2 percent in the Midwest) and with the savings to be realized with the new state sales tax exemption, 2014 non-personnel operating budgets (other than fuel and LOGIS technology contracts) are held to 2013 levels. The city's 2014 tax increase of 2.87 percent is the third year that will be *substantially below historic averages*.



New costs in 2015 include implementation of the second half of the EAB Action Plan and the second year of increased employer funding for state-mandated public safety pensions. This results in a projected one-time increase in levy funding slightly above the city's otherwise-modest recent increases.

Excluded from these projections are the tax abatement levy for Ridgedale in 2015 and the potential referendum debt levy for the final $2.5 million referendum bonding for the Cullen-Smith open space property purchase. Nonetheless, advance of the street improvement district legislation and further clarification of the state sales tax exemption in the city's favor may reduce the levy pressure for 2015.

Comparisons with Other Cities. The proposed 2014 city levy increase is likely to place Minnetonka in the middle of the pack of comparable cities. The variation in levy changes amongst these communities is greatly affected by whether they are retiring debt or taking on new debt. Further, four of the comparable cities listed below will now receive an allocation of LGA in 2014. For instance, the city of Brooklyn Park will receive more than $1 million in LGA in 2014, when it did not receive any such funding in recent history. As has been the case for over a decade, Minnetonka does not and will not receive LGA in 2014. Equally important, unlike many of these other cities, the city does not rely upon special assessments to fund street reconstruction and maintenance.



Homeowner Impacts. With the proposed levy increase of 2.87 percent, city property taxes for the median valued home in Minnetonka ($273,200 in 2013) are roughly estimated to decrease by a little less than 1 percent. The reasons for the decline are as complex as the state's property tax system. Nonetheless, like last year, it is primarily due to a shift next year in the city property tax burden away from residential properties to commercial properties, a decrease in the city's contribution to the state's fiscal disparities program, and the decline in the median value of single-family detached homes in this city as reported last spring with the City Assessment Report. Current changes in the sale prices of homes do not affect values for taxes payable in 2014.

Discussion Question: Does the council agree that $31,878,598 (2.87 percent increase) should be certified as the city's preliminary levy for 2014?

FLAT HRA LEVY

The city's first levy for housing and redevelopment began in 2009. State law limits levies, and the maximum rate is 0.0185 percent of a city's taxable market value. This equals approximately $1.38 million in Minnetonka. The 2009 levy rate of .00117% raised $100,000 and was solely dedicated to WHAHLT (West Hennepin Affordable Housing Land Trust). Beginning in 2010, the annual levy increased to $175,000 (.00212%) and has remained at that dollar level to accommodate village center master planning and housing programs.

The EDAC reviewed the HRA budget at its August 8 meeting and, on a split vote, recommended adopting a preliminary HRA levy of $150,000. The budget would be $75,000 for the Village Center Master Planning and $75,000 for the marketing efforts now underway. The EDAC acknowledged that both of the housing loan programs should continue as they have shown some increased activity; however, the EDAC recommended no new funding should be added due to the balance that is currently available from previous years' funding.

Based upon staff's review of the housing programs, it appears that while the programs are starting to gain traction, continuing to fund them at the same level as in the past is not appropriate. While there have been more inquiries into the Minnetonka Home Enhancement Program, the Welcome to Minnetonka program continues to be more viable. Staff recommends the continuation of both the Minnetonka Home Enhancement Program and the Welcome to Minnetonka program with no new funds committed to the first program. Funding for 2014 in the amount of $25,000 should be set aside only for the latter program, Welcome to Minnetonka.

Staff recommends maintaining the HRA levy at $175,000 (estimated .00233%) to fund the Village Center Master Planning ($75,000), marketing efforts ($75,000) and the Welcome to Minnetonka program ($25,000). Additionally, the 2014-2018 EIP shows maintaining a $175,000 HRA Levy to accommodate future adjustments needed in the levy, particularly related to WHAHLT funding.

Discussion Question: Does the council agree that $175,000 (no increase) should be certified as the HRA's preliminary levy for 2014?

Summary

Responsible long-term financial planning has continued to position the city of Minnetonka to accommodate the slow economic recovery and federal and state political uncertainties. The preliminary city tax levy will be limited to an increase of only 2.87 percent for 2014. This increase is around the middle of comparable cities. It ensures our position of fiscal responsibility, preserves our standards of excellence, and encourages innovative and creative thinking.

As always, the city of Minnetonka will continue to provide the excellent services our residents and businesses have come to expect, and at a reasonable price, both in 2014 and well into the future.

Originated by:
Geralyn Barone, City Manager
Merrill King, Finance Director