



To: Mayor and Council Members
From: Darin Nelson, Finance Director
Cc: Bill Reynolds, City Administrator
Date: September 3, 2019
Re: Preliminary Levy Workshop

Background

Each year the city must prepare a budget and property tax levy for the following year. Staff has been analyzing revenues, expenditure information and initiatives to prepare a preliminary budget and levy for your consideration.

The City of Shakopee 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.

Over the last three years, the city's estimated market value has increased \$1.2 billion to more than \$6 billion. New construction accounts for \$244 million or 20 percent of this increase. New construction allows the tax levy to be spread across a larger tax base, which reduces tax burden of existing taxpayers.

Staff has proposed budgets with minimal or no impact to residents for the past three years. In fact, for taxes payable in 2019, the city tax levy was reduced from the prior year resulting in a tax cut for most residents and businesses.

That being said, the city is experiencing budget pressures, most notably from increasing infrastructure construction and maintenance costs, as well as general personnel costs, neither of which are unique to Shakopee nor other local governments. Fortunately, these pressures are mitigated by our previous work to financially position our budgets and by right-sizing our operations.

This year's budget focuses on maintaining operational service levels which includes an infusion of tax dollars dedicated to maintaining street infrastructure. The levy also includes an investment in regional park development as a result of the Parks, Trails and Recreation Master Plan and the 2040 Comprehensive Plan.

The 2020 budget also continues focusing on fiscal transparency, long-term financial stability and ensuring our budget accurately reflects how we spend tax dollars.

This past year residential values increased on average 6.7 percent according to data from Scott County with 57 percent of the homes seeing an increase between 5 and 15 percent. As outlined in this memo, staff recommends increasing the city's preliminary levy 5.98 percent. For the average-valued home increasing by 6.7 percent to \$272,600, this equates to a 4.6 percent or \$39 annual increase. Absent any change in value, homeowners can expect a tax decrease of

about \$25 or about 2.9 percent. This preliminary levy will reduce the city's tax rate from 34.943 percent to 33.914 percent.

Development is expected to continue due in part to a renegotiated annexation agreement with Jackson Township and other redevelopment projects just getting underway. However, the pace of development is uncertain, and national economic factors have started to affect local economies. Fortunately, Shakopee has a diversified mix of existing industry that will help weather a potential economic downturn. However, it is anticipated the city is not likely to sustain the growth it has for the last few years.

Schedule for budget and property tax levy development

Date	Who	What
August 20, 2019	Council/Staff	Review Preliminary Capital Improvement Plan (CIP)
September 3, 2019	Council/Staff	Review Maximum Levy, review initiatives and requests
September 17, 2019	Council	Adopt proposed maximum tax levy for City and EDA. Adopt final 2019-2023 CIP
September 30, 2019	Staff	Certify maximum tax levy to the County which will be used for proposed property tax notices
November	County	Proposed tax notices sent to owners
November	Council/Staff	Work session to review budget document
December 3, 2019	Council	Hold public meeting to discuss levy and budget. Review and approve utility rates for 2020.
December 17, 2019	Council	Adopt final tax levy and budget
December 30, 2019	Staff	Certify final tax levy and budget to County and State

Budget Impact Issues

Wages and benefits

All three union contracts expire on December 31, 2019. Initial negotiations have begun with the patrol and sergeant unions. At this point, it is uncertain as to whether the contracts will be settled by year end. Current union contracts included annual 3 percent cost of living adjustments. The preliminary 2020 budget has been built with this continued assumption. Non-union wage increases typically mirror the union increases. The 2019 budget is calculated with a 3-percent-across-the-board wage increase, which is approximately \$510,000.

Health insurance premiums have stabilized after experiencing a 19-percent increase in health insurance premiums in 2018. The city is anticipating health insurance rates will be increasing about 5-percent for 2020 or about \$70,000 following a 1-percent increase in 2019.

As a reminder, the city set aside \$600,000 at the end of the 2017 to aid in transitioning toward self-insurance funding for health insurance. Current market conditions do not warrant a move to self-insurance. However, having dedicated funds set aside will provide the flexibility to react quickly when market conditions necessitate a move.

The 2018 Legislature passed an amendment to the State of Minnesota Police and Fire pension plan to help ensure the fund's long-term sustainability. Part of the legislation includes mandatory employee and employer contribution increase in 2019 and again in 2020. The 2019 budget impact amounted to \$41,000 and the 2020 budget impact adds another \$41,000.

2020 is a presidential election year which will require the hiring of election judges. New for 2020, Scott County is now requiring the city to host absentee and early voting at city hall versus at the county government center as in previous years. 2020 will include the presidential nomination primary in March, the general primary in August and the presidential election in November. In total this will add \$43,500 to the 2020 budget.

The parks maintenance division has been under increasing demands to keep pace with our growing city and meet park maintenance standards. These demands have created a need to add a parks foreman and maintenance operator within this division. The addition of a foreman in the park maintenance division will then mirror the personnel structure within the street maintenance division. As you may recall, the city added a maintenance operator in the streets division last year. Prior to that, the last addition to public works operational staff occurred in 2014. The budget impact for wages and benefits in the park maintenance division is \$191,400.

Internal Rent Charges

The city established internal service funds years ago to account for equipment, buildings, park assets, and information technology infrastructure and equipment. The philosophy behind these funds is they take out the large swings in the tax levy by charging level rents on annual basis, and when replacement equipment or infrastructure is needed the appropriate internal service fund makes the purchase from accumulated reserves. Having this system in place and established is fiscally responsible and sets the city up for long-term financial sustainability.

Last year, staff took an in-depth analysis of the equipment fund after purchasing two fire engines. These fire engines were purchased 20-some years ago for about \$350,000. Over that 20-year timeframe, the fire department was charged a flat annual fee of \$17,500 for each fire engine. Unfortunately, replacement fire engines today cost more than \$600,000. This left a large gap between accumulated rents and the new purchase price. This large difference between the original purchase and the future replacement is common on equipment that lasts for 10 to 20 years due to inflation and other factors.

To ensure the long-term sustainability of the equipment fund staff began charging rent for vehicles that have replacement lives of 10 to 20 years on the estimated future replacement cost rather than the original purchase price. This transition comes with a cost due to higher annual rent charges. In order to minimize the impact, staff is stepping into the full funding of

replacement costs over four years. 2020 will be the second of four years and adds an additional \$63,600 to the 2020 budget.

After performing this cost analysis for the equipment fund in 2018, staff took a closer look at the cost drivers for the remaining internal services funds. The city has major investments in buildings, parks and IT equipment and infrastructure, so ensuring the long-term sustainability of those assets is also crucial. What staff discovered was rents in these funds were either not tied to any cost drivers or were tied to outdated cost drivers that are not relevant to today's operations. Staff also discovered assets that will require future maintenance or replacement were not being accounted for in the rents including items such as parking lots, trails and other building-related furniture and fixtures.

The outcome of this exercise is we now have a complete inventory of equipment and infrastructure with relevant cost drivers that will ensure sufficient funding for future replacement costs. We are also now maintaining an internal running balance of each building's accumulated rents offset by building-related projects. This is beneficial in understanding the lifecycle and the financial costs associated with maintaining these assets. Maintaining and preparing for replacement of these assets comes with a cost. It's a prudent and fiscally responsible cost, but a cost, nonetheless. The budget impact for 2020 amounts to \$348,700 between the building, park asset and IT internal service funds. This will be a one-time adjustment.

Other Services & Charges

Sealcoating costs are increasing \$80,000, along with \$26,000 in additional funds for pond buffer maintenance, tree trimming, and printing/mailing. These additional costs are offset by reductions in other areas resulting in a net increase of \$49,500.

The remainder of other services and charges remains relatively flat. Departments are seeing increasing service costs in this area but are requested to work within their given budget allotment to maintain a reasonable tax increase for 2020.

Revenues

Typically, governmental revenues such as grants, charges for service, and fees and permits are constant with little fluctuation from one year to the next. Obviously, the economy is the biggest factor in revenue fluctuations. The city's building permits have been strong over the past couple years with an influx of commercial and residential development. Development and the coinciding building permits are expected to continue, albeit at a more moderate level, not the hyper level we have seen the last two to three years.

It is fiscally responsible to budget conservatively for building permit revenue. However, we do not want to be ultra-conservative on our forecasts since that can lead to unnecessary tax collections. We have been steadily increasing our building permits budget to more closely match the increasing actual permits for the last couple years. For 2020, we are increasing the building permit revenue budget by \$326,000 or approximately 23 percent. The 2020 building permit budget is \$1.7 million, which is about \$288,000 below the three-year average of \$2 million. As mentioned earlier, we are not expecting to have as many large commercial/industrial building permits issued as available land is becoming scarce and the economy is more uncertain.

The community center and ice arena revenues for 2020 are expected to increase by about 3.8 percent from \$2.2 million to \$2.3 million. These additional revenues aid in offsetting operational costs.

Cable franchise fees saw a decline in revenue for the first time in at least a decade. Revenue fell from \$427,000 in 2017 to \$400,000 in 2018, a drop of more than 6 percent. It appears cable customers are moving away from cable to wi-fi streaming services. In addition, a recent FCC law change allows cable providers to count certain in-kind services towards their franchise fee obligation. This ruling may have additional impact on future revenues. The 2020 budget is reducing the cable franchise fee revenue by \$44,000.

Economic Development Authority

In 2018, the City Council/EDA Commission approved a standalone EDA Levy. This levy was implemented to increase transparency and was considered a budget neutral change. Prior to 2018, annual transfers were made from the General Fund to the EDA to cover EDA operational costs, façade loan funds and other development related activities. This EDA levy eliminates this transfer from the General Fund, thus reducing the city's general levy.

The Shakopee EDA has the statutory authority to levy a small percentage (up to 0.0185%) of the city's estimated market value, which for 2020 would be a maximum of approximately \$892,500. The EDA and City Council can set the levy at any amount up to this cap.

The EDA levy is identified on property tax statements as a separate local tax outside of the city's general property tax. Staff is recommending an EDA levy of \$350,000 for 2020, which is the same levy amount since 2018.

Debt Service

Staff is anticipating the city's total debt service payments to remain stable at approximately \$2.2 million annually. Staff will need the council to approve debt service reduction resolutions on September 17 due to available fund balances in existing debt service funds. A breakdown and comparison of the individual debt levies can be viewed on the next page.

Capital Project Funds

During the CIP work session on Aug. 20, staff discussed the need for additional tax levy dollars in both the capital improvement fund and park development fund in the amounts of \$500,000 and \$200,000, respectively. These funds are needed to meet increasing costs and demands within each of these funds.

Levy Request & Impact

Staff is recommending a preliminary city levy of \$20,380,500, which is an increase of \$1.15 million or 5.98 percent over last year, and a preliminary EDA levy of \$350,000, which is identical to last year. The preliminary levy is the maximum the city can levy; the final levy may be less than the preliminary levy but may not be more.

As mentioned earlier, residential values increased on average 6.7 percent according to data from Scott County with 57 percent of the homes seeing an increase between 5 and 15 percent. For the average-valued home increasing in value 6.7 percent from \$255,400 to \$272,600, this equates to a 4.6 percent or \$39 annual tax increase. Absent any change in value, homeowners

can expect a tax decrease of about \$25 or about 2.9 percent. This preliminary levy will reduce the city's tax rate from 34.943 percent to 33.914 percent.

The city experienced 10.8 percent growth in tax capacity for taxes payable 2020. This is on top of 6.8 and 8 percent growth in 2019 and 2018, respectively. New construction accounts for about 16 percent or \$1,025,000 of additional tax capacity. In terms of levy dollars, the new construction tax capacity allows for the city to increase the levy by approximately \$346,000 without having a tax impact on existing properties.

The breakdown and comparison of the proposed preliminary 2020 levy is as follows:

City of Shakopee Levy Analysis September 3, 2019				
	<u>2019 Final</u>	<u>2020 Preliminary</u>	<u>Increase/ (Decrease)</u>	<u>% Change</u>
City Levy				
General Fund	\$ 16,677,400	\$ 17,136,900	\$ 459,500	2.76%
Abatements	169,500	155,700	\$ (13,800)	-8.14%
Capital Improvement Levy	200,000	700,000	\$ 500,000	250.00%
Park Development Levy	-	200,000	\$ 200,000	100.00%
Debt Service				
2010 A Improve	115,000	69,900	(45,100)	-39%
2016 Abatement	2,068,600	2,118,000	49,400	2%
Total Debt Service	<u>2,183,600</u>	<u>2,187,900</u>	<u>4,300</u>	<u>0.20%</u>
Total City Levy	<u>\$ 19,230,500</u>	<u>\$ 20,380,500</u>	<u>\$ 1,150,000</u>	<u>5.98%</u>
Shakopee EDA Special Levy	<u>\$ 350,000</u>	<u>\$ 350,000</u>	<u>\$ -</u>	<u>0.00%</u>
Total City and EDA Levies	<u><u>\$ 19,580,500</u></u>	<u><u>\$ 20,730,500</u></u>	<u><u>\$ 1,150,000</u></u>	<u><u>5.86%</u></u>

Items to note with the 2020 preliminary levy include:

- \$700,000 or 3.6% of levy increase directed towards capital infrastructure improvements.
- Flat preliminary levy for the Shakopee EDA.

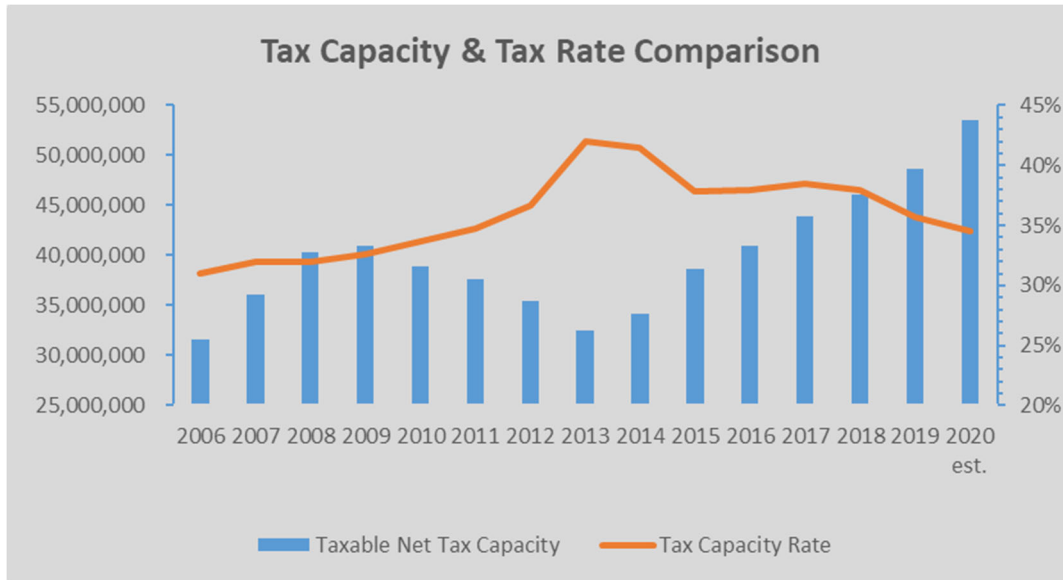
The chart below provides the average percentage change in value for residential properties from taxes payable 2019 to taxes payable 2020. These percentage changes are strictly the averages within each value range. Individual properties valuations will likely be more or less than the averages.

Payable 2019 Value	Properties in Category	Average of Net % Change for pay 2020
<\$100,000	153	12.3%
100000-149999	577	10.1%
150000-199999	3,516	8.3%
200000-249999	2,813	7.6%
250000-299999	1,773	7.3%
300000-399999	2,308	4.6%
400000-499999	755	4.6%
500000-699999	199	5.2%
700000-999999	22	3.0%
>\$999,999	3	1.3%
Grand Total	12,119	6.7%

The chart below provides a comparison of the proposed 2020 levy for three different valued homes including the average value home of \$272,600. This chart assumes the homes in these price ranges increased in value by the same percentage as the correlating range in the chart above. For example, the first home increased from \$174,300 to \$188,800 or 8.3 percent for taxes payable 2020.



The proposed tax levy will drop the city and EDA's combined tax rate from 35.663 percent to 34.568 percent, a decrease of 1.095 percent. This is the 3rd consecutive year of a tax rate decrease. Below is a chart comparing the city's tax capacity and the combined city and EDA tax rate over the past 15 years, including the 2020 preliminary levy.



Staff is still working on receiving preliminary levy estimates from our comparable cities. Staff will have this information available at the council meeting on Sept. 17.

General Fund Preliminary Budget

Below is the 2020 preliminary General Fund budget. The budget incorporates the General Fund portion of the preliminary tax levy along with the budget impact items noted above.

As you have seen in our monthly financial reviews, our building permit volume is on a record pace. We surpassed our annual budget in May after increasing the budget 25 percent for 2019. Having strong development activity is much more favorable than the alternative. However, there is a concern when we have this amount of activity in one year. The major concern is that for large commercial/industrial or large apartment complexes, our expenditures (inspections, plan reviews, etc.) may not occur the same year the revenue is collected. For instance, it may take a couple years to complete a building project and if that building permit was received late in the year, we may still be incurring inspection costs 2-3 years later.

Governmental budgeting and financial reporting require us to close each fiscal year and approve an annual budget, so it can become difficult to balance building permit revenue received on the front end of a project when expenditures will occur over a couple years. This is the case this year. Due to the volume of building activity, we are anticipating we will have approximately \$1.5 million in additional building permit revenue.

Staff is recommending the council formally commit the excess revenues for future years. The excess revenue would then be used over the course of the next few years to supplement the General Fund building inspection costs. The preliminary budget utilizes \$667,400 of those committed reserves for the 2020 budget. This action would then balance the 2020 General Fund budget.

2020 Preliminary Annual Budget
General Fund Summary

	Actual 2017	Actual 2018	Original Budget 2019	Requested Budget 2020
REVENUES				
TAXES	16,771,524.02	16,981,069.68	17,174,900.00	17,569,200.00
SPECIAL ASSESSMENTS	3,874.61	7,416.10	7,300.00	7,000.00
LICENSES AND PERMITS	2,391,941.59	2,606,017.99	1,759,700.00	2,101,000.00
INTERGOVERNMENTAL	1,369,027.55	1,460,417.32	1,431,600.00	1,294,700.00
CHARGES FOR SERVICES	5,653,773.86	6,782,395.19	6,395,700.00	6,752,300.00
FINES AND FORFEITURES	2,718.80	1,814.97	1,000.00	1,700.00
MISCELLANEOUS	163,615.83	268,081.22	198,000.00	209,900.00
TOTAL REVENUES	26,356,476.26	28,107,212.47	26,968,200.00	27,935,800.00
EXPENDITURES				
GENERAL GOVERNMENT	(4,387,638.96)	(4,628,230.83)	(4,714,600.00)	(4,898,170.00)
PUBLIC SAFETY	(11,004,434.14)	(11,626,545.73)	(12,518,400.00)	(13,068,280.00)
PUBLIC WORKS	(5,032,230.39)	(5,671,323.36)	(5,924,400.00)	(6,513,650.00)
RECREATION	(3,111,739.77)	(3,576,444.33)	(3,907,300.00)	(4,242,800.00)
UNALLOCATED	(27,619.38)	(39,823.69)	(131,300.00)	(130,300.00)
DEBT SERVICE	(16,605.00)	(22,140.00)	(22,200.00)	0.00
CAPITAL OUTLAY	(93,341.00)	(276,781.02)	0.00	0.00
TOTAL EXPENDITURES	(23,673,608.64)	(25,841,288.96)	(27,218,200.00)	(28,853,200.00)
TRANSFERS IN	250,000.00	262,525.99	250,000.00	250,000.00
PROCEEDS FROM SALE OF ASSETS	4,660.88	0.00	0.00	0.00
BOND PROCEEDS	79,100.00	0.00	0.00	0.00
TRANSFERS OUT	(1,800,000.00)	(2,187,000.00)	0.00	0.00
TOTAL OTHER FINANCING	(1,466,239.12)	(1,924,474.01)	250,000.00	250,000.00
PRIOR COMMITTED FUNDS	0.00	0.00	0.00	667,400.00
NET	1,216,628.50	341,449.50	0.00	0.00

Summary

The preliminary levy is the maximum levy that can be levied. The final levy can be reduced but it cannot be increased. Between the preliminary levy and the final levy staff will be working on fine tuning the current unknowns.