**Issue:** In preparation for the 2024 Budget, it is helpful to understand long-term revenue and expenditure trends for the General Fund.

**Background:** The 2024-2028 forecast was developed using the same methodology as the previous five-year forecast. Revenues and expenditures were grouped into like-categories and forecast assumptions were developed for each category based on historical data or known information such as the state budget. Those assumptions are applied to the 2023 Budget figures. It is important to emphasize that the forecast is policy neutral as it assumes the same services are provided with the same number of personnel and delivered in the same manner.

The model used to project the annual budget gap the City will face is for planning purposes. It is not meant to suggest that the City will not make any service changes, will deficit or will use fund balance. As in prior years, the budget will be balanced in each year. The model does not include any service level changes and does not assume what decision might be made to balance the budget. It does reflect the policy positions included in the Financial Resiliency policy as described below.

It is important to review the assumptions and sources for forecasted information.

## Base Assumptions

- A 2.0% operating budget increase and a 0.5% debt service increase for a total 2.5% Property tax levy increase is assumed for 2024-2027. It is assumed the City loses its ability to exceed levy limit caps in 2028 and that there is $71 million in net new construction in 2027 limiting the 2028 operating budget property tax levy increase to .75%

| | **Operating Budget Increase** | **Debt Service Increase** | **Total Increase** |
|---|---|---|---|
| 2024 | 2.0% | 0.5% | 2.5% |
| 2028 | 0.75% | 0.5% | 1.25% |

- The approved increases in State Shared Revenue are included and assumed to increase 4% every year with 0% increase in the fifth year assuming a recession that impacts sales tax collections. There is no assumed utilization of the America Rescue Plan federal funds set aside for budget stabilization as this will be presented as a balancing option. Other State and Federal revenue are assumed to be flat over the five-year period

- Inflation assumed to be 3.0% in 2024 and 2.2% in 2025 and 2.1% in 2026 and 2027 based on Congressional Budget Office forecasts.

- Assumed use of General Fund Surplus remains $0.

- Annual cost of living increases in each of the five years based on inflation and current labor agreements. Typically the budgeted cost of living increase is based on the May over May change in the Consumer Price Index which was 3.7%. Given prior year's inflation that exceeded cost of living increases, this was rounded up to 4.0%. We will be out of contract with the Fire Union as of 12/31/23 so estimates are used for their 2024-2028 cost of living adjustments.

- Pension contributions increase 1.5% for employees and for the City for non-represented staff. The Employer contribution increases 6.0% and 4.4% for police and fire sworn employees respectively. This is largely due to higher than expected pay increases state-wide and unfavorable investment performance of the Employee Trust Fund.

- Debt service based on 10-year capital spending reflected in 2023-2027 capital plan. Debt amortization continues to transition to a 15 year debt schedule as compared to a previous 10-year. It should be noted that the 2023-2027 capital plan assumed the implementation of a Transportation Utility.

- Energy and fuel increases based on Department of Energy's 2024-2028 forecast assuming 2023 budgeted consumption.

- Building permit activity based on an approximate 25-year average of $135,000,000 of construction activity.

- Interest earnings based on current portfolio size adjusted for known changes (such as the utilization of American Rescue Plan funds) and current portfolio earnings rate. Future interest rates based on the Congressional Budget Office Treasury bill forecast.

- Assume gradual increase in number of citation issued based on trend since 2021.

- Parking enforcement returns to pre-COVID levels – 4-year average of citations assumed with 2% annual decrease assuming that enforcement drives compliance. Also assume a 5% increase in fees every 5 years with the next increase occurring in 2025

- 3.1% increase in ambulance billed run from 4,220 estimate for 2023 based on activity to date with assumed 1.5% annual increase. Also 2.0% annual increase to 2024 average reimbursement rate per trip.

- No change in number of hotel rooms. Assume 2022 actual average tax revenue per room adjusted annually for assumed continued recovery in business travel based on third-party reports.

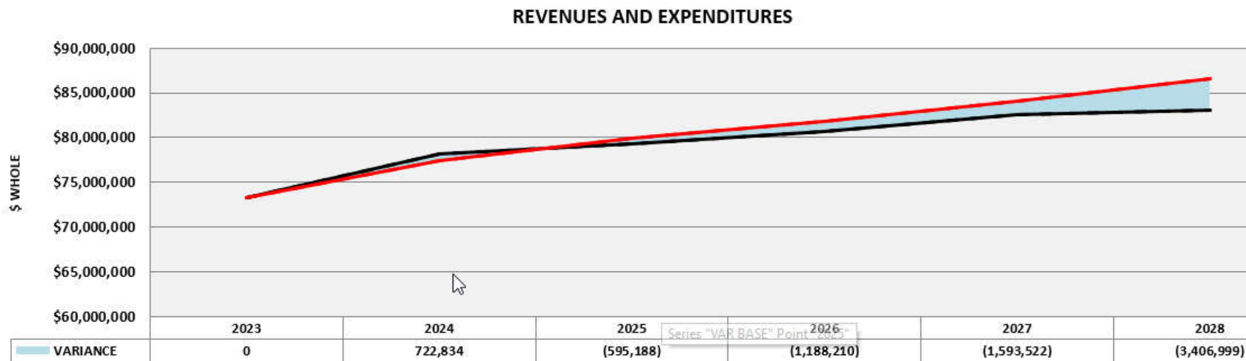
Figure 1 shows a comparison between the 2024-2028 and 2023-2027 forecasts. The new forecast shows a total 5-year gap of $3.4 million or approximately a 21% improvement over the prior five-year forecast including a projected surplus in 2024. This surplus is largely due to faster rising interest rates than assumed and an additional $1.1 million in State Shared Revenue. However, that 2024 surplus quickly returns to a deficit in 2025-2028 as expenditures again begin exceeding revenue growth due to levy limits which remain unchanged. As will be described below 2028 is particularly challenging because of an assumed loss of extra levy capacity.

*Figure 1*

| | 2023-2027 | 2024-2028 |
|---|---|---|
| **2023** | (1,308,418) | - |
| **2024** | (425,989) | 722,834 |
| **2025** | (965,002) | (1,318,022) |
| **2026** | (505,938) | (593,023) |
| **2027** | (1,104,341) | (405,312) |
| **2028** | | (1,813,477) |
| **TOTAL** | (4,309,688) | (3,407,000) |
| | | -21% |

The five year-forecast demonstrates the persistence of a structural deficit that will continue to threaten service levels. This deficit is depicted in Figure 2.

*Figure 2*




Expenditures grow on average 3.4% (down slightly from the 3.5% from the prior forecast) while revenues are growing 2.6% (up slightly from 2.4% in the prior forecast). A 0.8% percentage point differential. It is important to explain that while a five-year period is shown here, the gap would continue if additional years were shown. The only way to permanently fix the gap is to change the trend lines themselves - increase revenue growth, limit expenditure increases or preferably, a combination of both.

As a result of the differential between revenues and expenditures, the City will face an annual budget gap. If fund balance were simply used each year to balance the budget, the gap would grow to $3.4 million by 2028 and unreserved fund balance would drop from $8.9 million in 2023 to $2.8 million by 2028, 3.3% of operating expenditures and far below our policy minimum of 17% (2 months of operating expenditures) as shown in Figure 3. As a result, it is imperative that the budget gap is addressed each year through sustainable changes as the City has successfully done in prior years. A balanced approach is recommended that focuses on expenditure reductions, revenue increases and economic development that grows the property tax base.

*Figure 3*

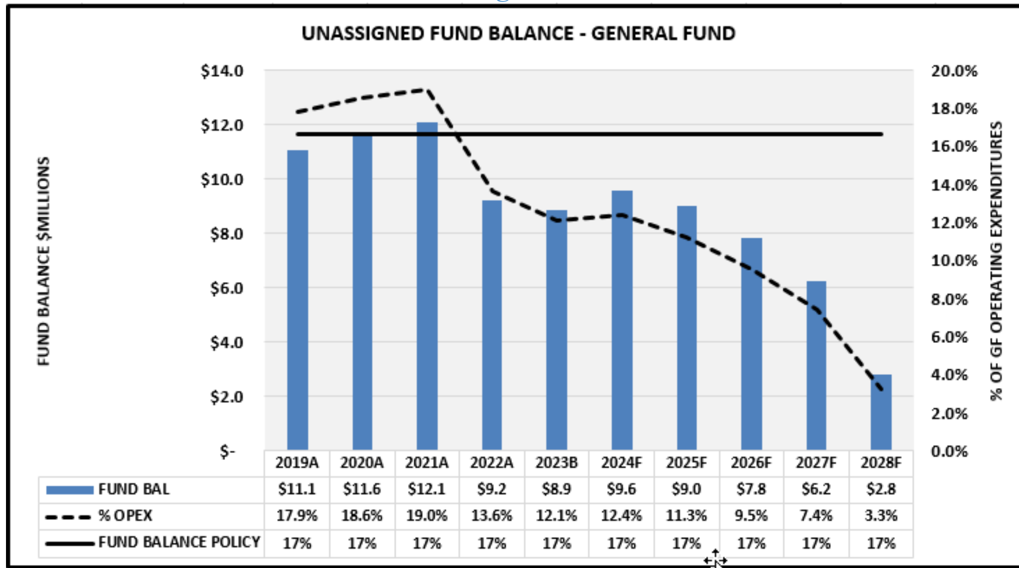
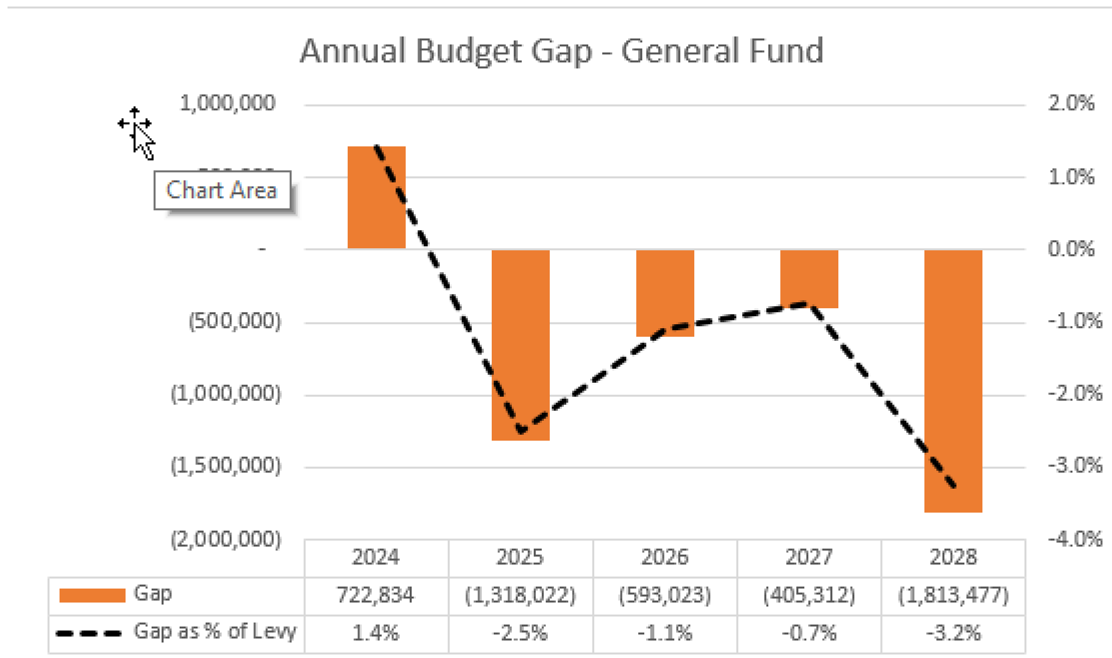



Figure 4 shows the annual forecasted budget gap. If sustainable changes are implemented, it represents the annual budget gap and it ranges from a 1.4% surplus to a 3.2% deficit as a percentage of total property tax levy. While a 3.2% reduction may not seem significant it is important to consider that the City has been actively reducing costs since 2002.

*Figure 4*




It is illustrative to look at the 2024 gap to understand the main drivers of the structural deficit.

***Expenditures***
**Compensation**
An assumed cost of living increase and performance pay is built into each year of the model as well as assumptions related to fringe benefits. In total, wages are expected to increase 4.0% which totals $1.5 million This includes an assumed 4.0% cost of living increase and 2.0% performance pay for non-represented employees. It is important to note that the forecast assumes that step increases (the annual increase in pay that employees earn) are budget neutral; funded through natural turnover, the salary differential between the higher paid incumbent versus the lower paid new hire. However, it is likely in 2024 or 2025, step increases in the police department will not be budget neutral. This is due to the higher than normal amount of turn over and is not included in the forecast.

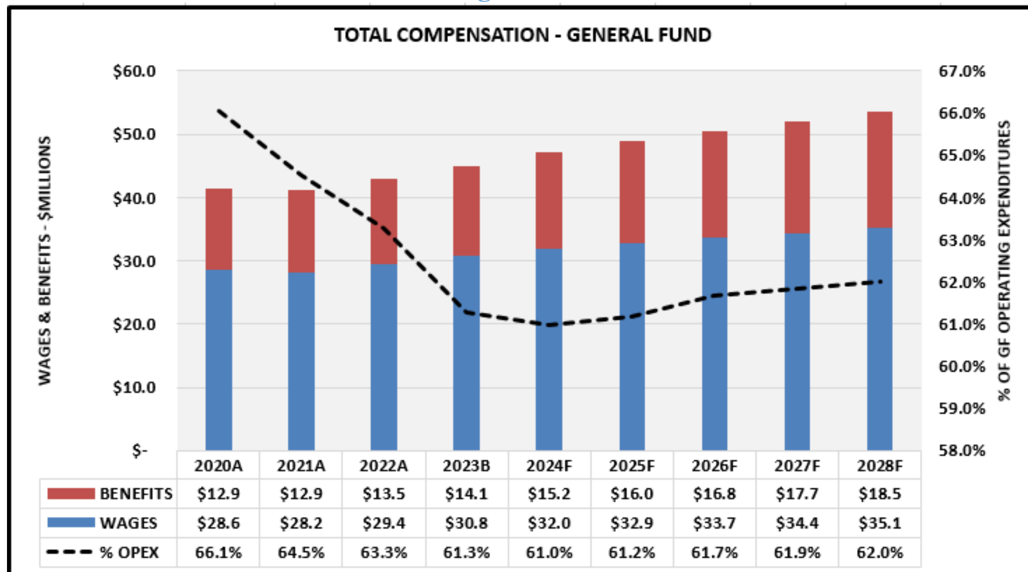
In 2024, health and dental insurance costs charged to the general fund increase 6.7% due to an assumed 5.1% increase in health care claim costs and a 9% stop loss excess insurance increase. This accounts for $540,000 increase in expenditures. Employees are assumed to continue to contribute 15% of total premium.

Pension and social security costs will increase along with salary. However the employer pension contribution rate (which is equal to the employee contribution) is will increase for 2024 from 6.8% to 6.9% for general employees. Due to multiple factors, there is a different employer contribution rate for police and fire. For police, that rate is expected to increase from 13.2% to 14.3% of salary and overtime. For Fire it is expected to increase from 18.1% to 19.1%. The increase in pension rates (along with assumed salary increases) will increase pension costs $548.000. In addition, worker compensation costs are assumed to increase at the rate of healthcare inflation.

In total, benefit costs will increase $1,163,736 or nearly 8.3 % - this is nearly the exact amount of increased state shared revenue. Put more simply, the City will utilize all of the additional revenue from the State to simply pay existing benefit cost increases.

As a result, when including all of these changes, compensation increases 5.1% in 2024 for a total of $2.3 million as shown in Figure 5 and compensation as a percentage of operating expenditures begins to grow.

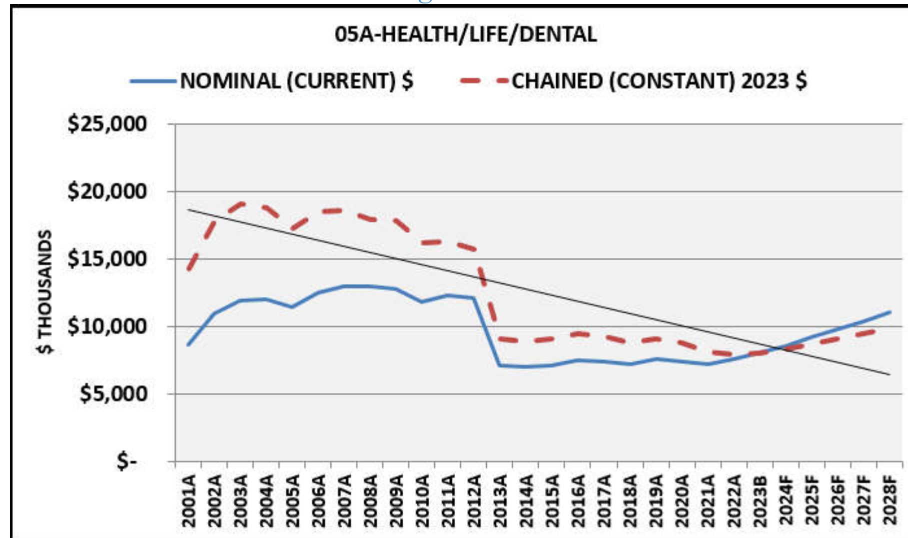
*Figure 5*




| | 2020A | 2021A | 2022A | 2023B | 2024F | 2025F | 2026F | 2027F | 2028F |
|---|---|---|---|---|---|---|---|---|---|
| BENEFITS | $12.9 | $12.9 | $13.5 | $14.1 | $15.2 | $16.0 | $16.8 | $17.7 | $18.5 |
| WAGES | $28.6 | $28.2 | $29.4 | $30.8 | $32.0 | $32.9 | $33.7 | $34.4 | $35.1 |
| % OPEX | 66.1% | 64.5% | 63.3% | 61.3% | 61.0% | 61.2% | 61.7% | 61.9% | 62.0% |

The City has aggressively managed healthcare costs through plan design changes, including changing its third party administrator in 2008, moving to a high deductible plan in 2012, opening an employee clinic in 2016 as well as cost and risk-sharing with employees including changes to deductibles in 2018. In addition, a pension contribution was implemented in 2011. This can be seen in Figure 6 as the cost of health and life insurance in the general fund (the property tax impact) on an inflation adjusted basis is less in 2024 than it was in 2002 despite southeast Wisconsin having the some of the highest medical inflation rates in the country, typically exceeding 10%. However, the five-year forecast does not assume that the City will be able to maintain this historical experience.

*Figure 6*



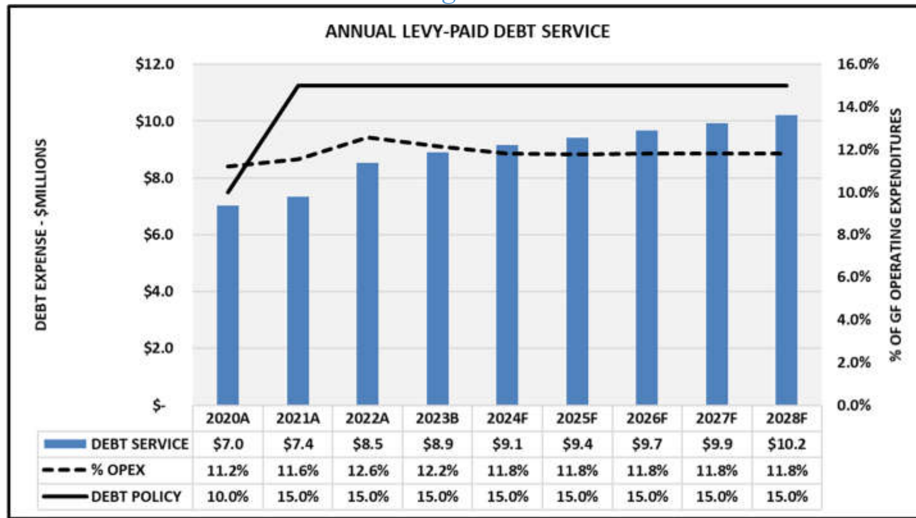

**Debt Service**

As discussed in prior reports and presentations, debt service will continue to increase as the City expands its capital improvement plan to address deferred maintenance and flooding. As part of this plan, levy-paid debt service (e.g. excluding sewer, water and TIF debt) is estimated to increase in 2024 by approximately $242,795 or 34% reduction from 2023. It is important to note that in prior forecasts, debt service was assumed to increase 5-7% annually. The reduction is the result of utilizing $950,000 annually of property taxes generated by the portion of the hospital complex that became taxable in 2022 to cash finance capital (and borrow less). Should the hospitals be successful in their appeal of that decision, the City would have to replace this cash financing with borrowing. It also assumed offsetting $500,000 of annual borrowing with cash from the Transportation Utility which should no longer be assumed.

The impact of this expense over the course of the forecast is based on the borrowing necessary to support the implementation of the 2023-2027 capital budget and is shown below in Figure 7. Increases have been limited to an approximate 1.0% property tax increase per year prior 2022 at which point it transitioned to 0.5% due to the additional revenue described above.

The City raised its stated policy maximum to 15% debt service as a percentage of operating expenditures in 2021 and the forecast remains under this benchmark. Debt service for capital spending is expected to peak in approximately 2032 for levy funded capital assuming current capital spending. It should be noted however, that current capital spending insufficient for the City to adequately maintain its roads and buildings.

Figure 7




| | 2020A | 2021A | 2022A | 2023B | 2024F | 2025F | 2026F | 2027F | 2028F |
|---|---|---|---|---|---|---|---|---|---|
| DEBT SERVICE | $7.0 | $7.4 | $8.5 | $8.9 | $9.1 | $9.4 | $9.7 | $9.9 | $10.2 |
| % OPEX | 11.2% | 11.6% | 12.6% | 12.2% | 11.8% | 11.8% | 11.8% | 11.8% | 11.8% |
| DEBT POLICY | 10.0% | 15.0% | 15.0% | 15.0% | 15.0% | 15.0% | 15.0% | 15.0% | 15.0% |

*Figure 8 –Total Outstanding Debt as a % of Property Value*

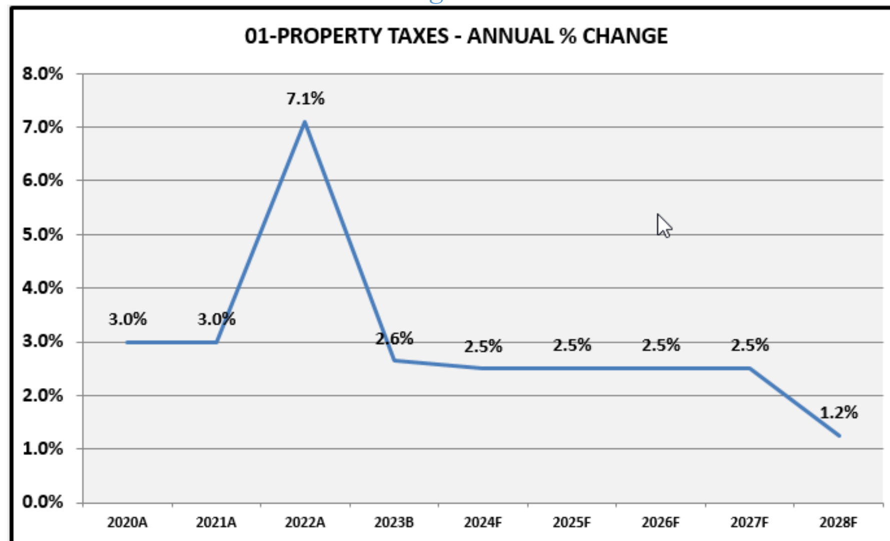
To Be Added

***Revenues***

As discussed above, revenue growth is not keeping pace with expenditures. This is largely due to limitations on the property tax levy which will make up 70% of general fund revenues in 2024 at $53.8 million. For purposes of the forecast, property tax growth is assumed to equal 2.0% from 2024 through 2027 and Figure 8 below shows the projected annual changes. 2022 was high due to the utilization of additional levy produced by the change in tax exempt status of approximately 40% of the hospital campus. The additional levy was used to:

- Create an annual cash financing contribution towards capital
- Reduce the County Fire Contract payment (subject to negotiations with the County for mutual benefit)
- Fund a Human Resources Organizational Development Specialist
- Establish an annual affordable housing contribution to the Community Development Authority
- Mitigate future risk from a successful property tax appeal or legislative change

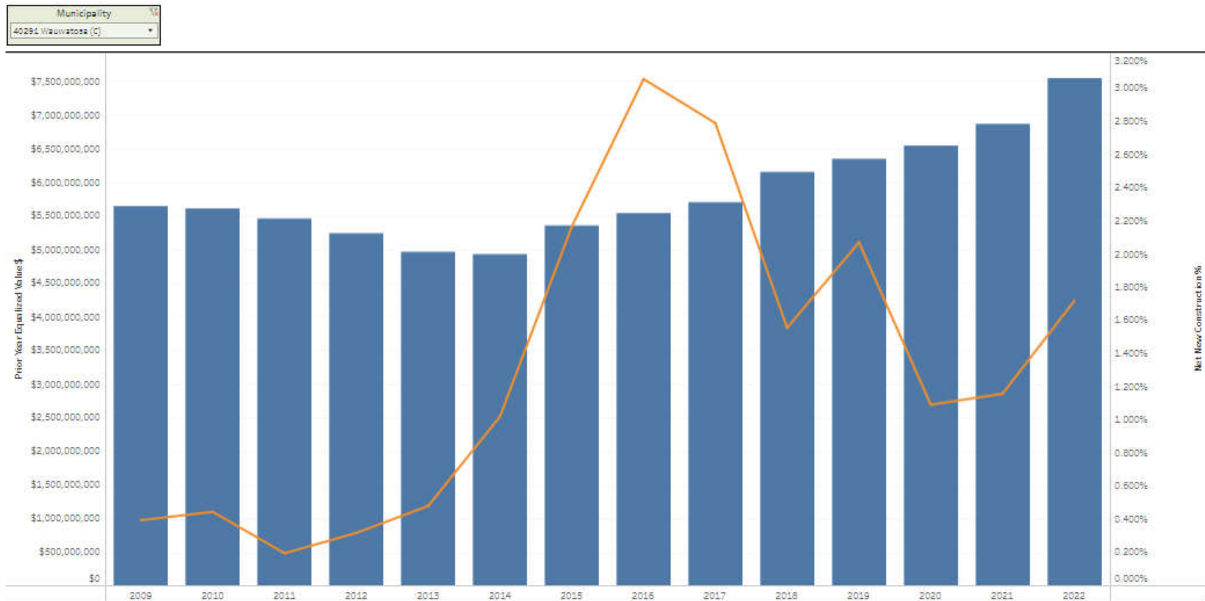
*Figure 9*




Per the Fiscal Resiliency policy, this revenue growth will be achieved through net new construction, carryover or excess debt capacity. However, based on the levy increases shown below, it is important to emphasize, that absent changes in state law, the City will not be able to indefinitely increase the levy above net new construction. The table below, shows when the City's "excess capacity" might be exhausted depending on levels of net new construction achieved.

| Years of Levy Capacity Available Assuming 2.0% for operations: | | |
|---|---|---|
| Net New Construction as % Property Value | Years | |
| 0.50% | 3.91 | |
| 0.75% | 4.69 | |
| 1.00% | 5.86 | |
| 1.50% | 11.72 | |

For purposes of forecasting, it is assumed the excess capacity is used up in 2027 after which the City will only be able to raise the levy by the amount of net new construction plus the increase for debt service, absent a referendum or change in state law. The table below shows the historic amount of net new construction in the City. From 2009 to 2022, the annual average was 1.32% but ranged from .20% to 3.05%. As more redevelopment opportunities are realized, achieving higher rates of net new construction becomes increasingly difficult.




*From State of Wisconsin Department of Revenue, Division of Research and Policy - https://public.tableau.com/app/profile/research.policy*

Figure 11 shows the levy adjusted for inflation per capita. On an inflation adjusted basis, the amount of property tax levy per capita is forecasted to be $1,008 in 2024 as compared to $974 in 2002. From 2002 through 2024, the compound annual growth rate adjusted for inflation is 0.5%.

*Figure 11*

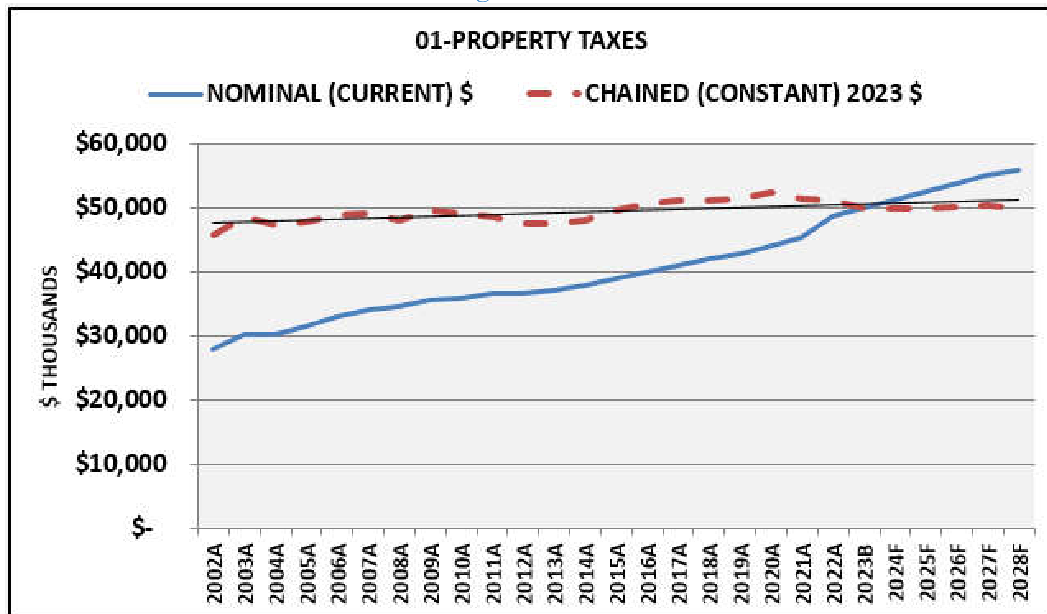
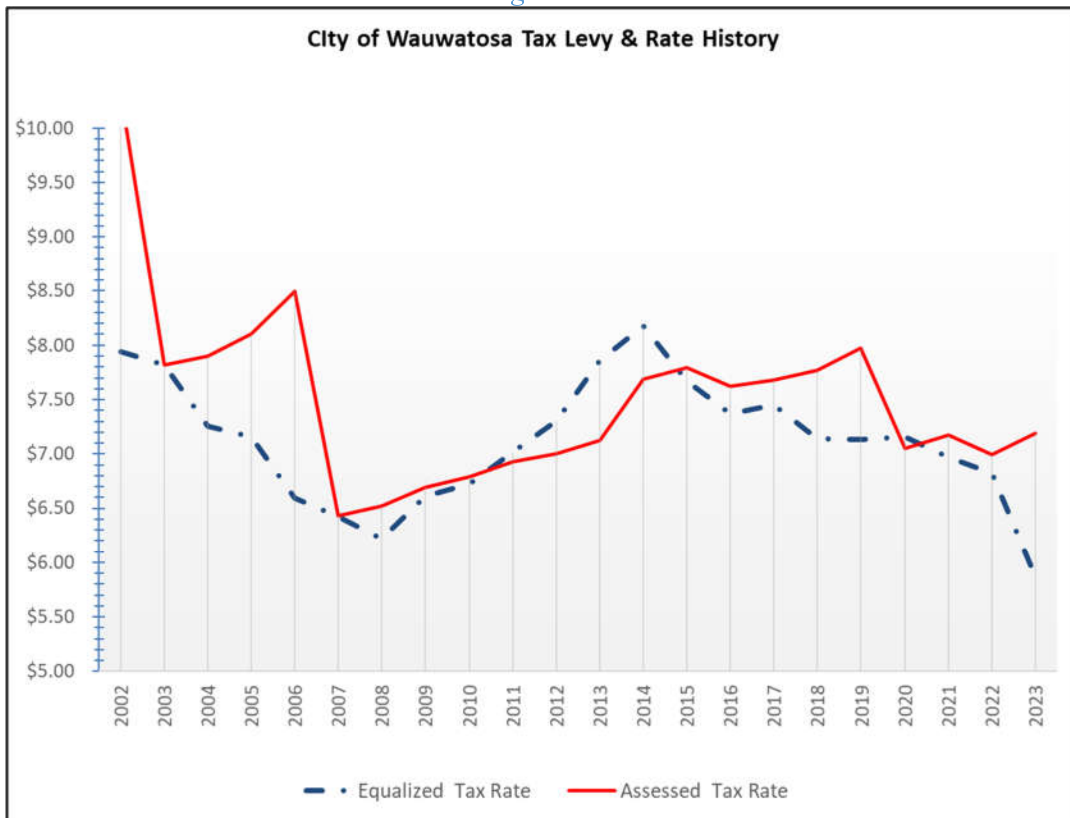


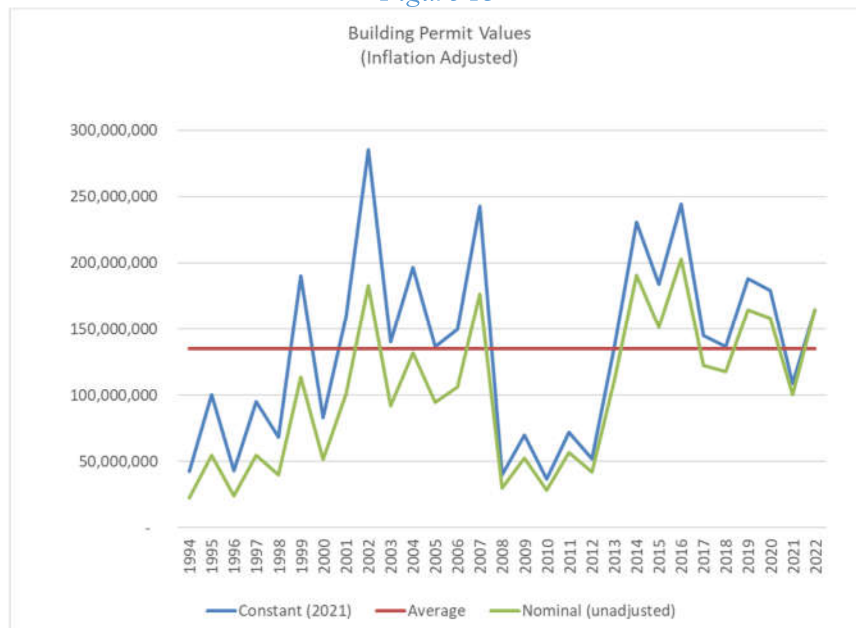

Figure 12 shows the tax rate history since 2002 through 2023. The equalized tax rate (dashed blue line) is a more accurate depiction of the historical trend. The equalized tax rate has been decreasing since 2014 as property tax base growth exceeds levy increases. The 2023 assessed tax rate based on the 2023 levy is 26.0% less than the 2002 rate.

*Figure 12*



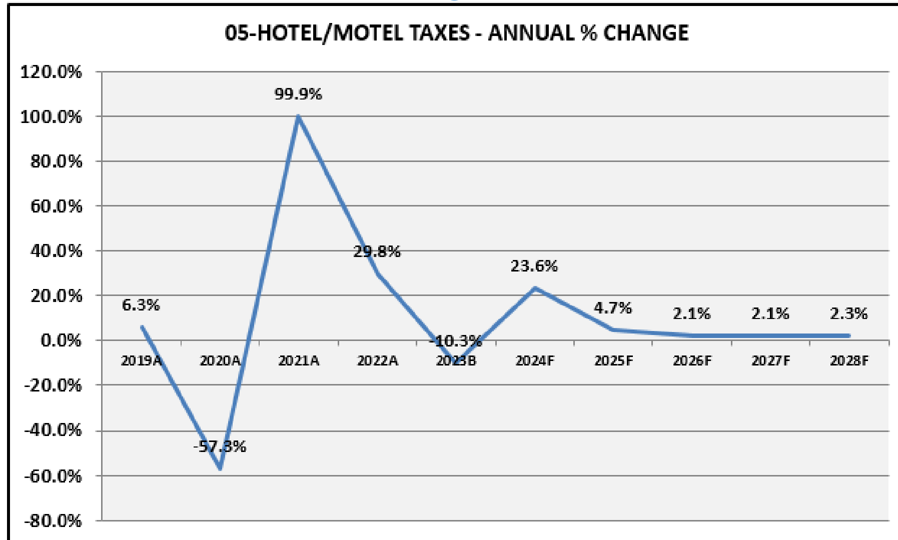

Building permit construction value is a predictor of subsequent years net new construction and the health of the local economy. Figure 13 depicts this activity since 1994. 2022 was above the historical average; however, 2023 is looking to be closer to the historical average.

*Figure 13*



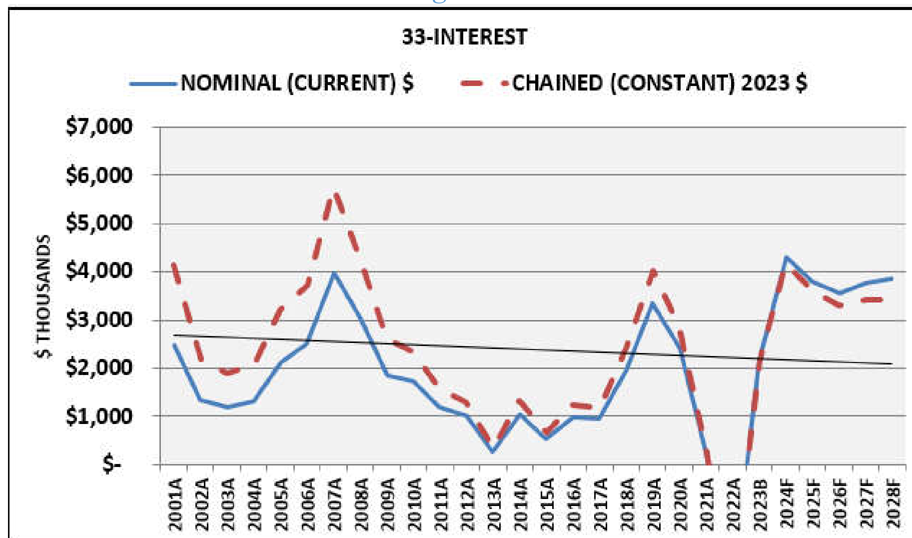
Hotel/Motel revenue does not have a direct impact on the General Fund as the City typically collects the maximum allowed for retaining in the general fund and that is not expected to increase for several years. However, hotel motel revenue is a good indicator of the health of the local economy and the Tourism Commission's programing depends on this revenue. Hotel/motel tax revenue suffered a 57% decrease in 2020 after 3 successive years of increases. It enjoyed a strong recovery in 2021 and 2022. While the 2023 budget assumed a slowdown in this revenue growth, it appears this revenue will exceed budget and is forecasted to enjoy another rebound in 2024 as more business travel resumes.

*Figure 14*




To combat inflation, the Federal Reserve has rapidly increased interest rates over the past year. In addition, the City's average cash balance has increased, temporarily, due the American Rescue Plan Funds which were disbursed to the City in 2021 and 2022 and are being spent down through 2026. As a result, a rapid rise in interest earnings is projected peaking in 2024 as shown below resulting in revenue levels not seen since prior to the Great Recession. This is a significant positive contributor to the 5-year forecast although a portion of this revenue is recognized in other funds.

*Figure 14*



**Balancing the Forecast**
The Financial Resiliency Policy directs us to provide strategies for balancing the five year forecast. Staff propose the following:

*American Rescue Plan Budget Stabilization* – The City received approximately $24 million in funds from the federal American Rescue Plan and $1,650,000 was allocated to a budget stabilization fund to be used to back-fill the budget during the time in which revenues are anticipated to recover. $1,000,000 was used in the 2022 and 2023 Budgets. $300,000 is assumed to be used in 2025 in order to help smooth the budget gap into 2026. A portion of the remaining funds will be used to offset lost rental revenue while the Muellner building is likely closed for remodeling in 2024 or 2025.

*Health Insurance Adjustments*
No adjustments are assumed in 2024 due to worsening claims experience in 2023 and retention and recruitment challenges. $303,496 in savings is anticipated in 2025 through better than forecasted claims experience. Plan design changes or additional savings are forecasted in 2026 and 2028 to mitigate half the forecasted increase.

*Recognizing State Shared Revenue*
The City will receive $1,143,711 of additional state support in 2024 increasing at an assumed 4.0% annually thereafter. This, along with increasing interest earnings described earlier results in a $722,834 projected surplus in 2024. In order to "push" this surplus into subsequent years to mitigate deficits, I propose we transfer $500,000 of existing General Transportation Aids to the Capital Budget to cash finance additional road construction. This amount would gradually be reduced to $240,000 in 2025, $220,000 in 2026 and $40,000 in 2027. This has the effect of phasing in the new state aid over 3 years.

*Increasing Fund Balance by $500,000 in 2024*
In order to replenish surplus used in 2022 to offset mark-to-market losses, it is assumed the City would transfer $500,000 into fund balance. This has the effect of increasing expenditures in 2024.

*Departmental Levy reductions*
As in prior years, levy reductions will be allocated across City Hall, Public Works, Police and Fire. Departments will be required to submit levy reduction plans which must include expenditure reductions or revenue increases based on the amounts below.

| | 2024 | 2025 | 2026 | 2027 | 2028 |
|---|---|---|---|---|---|
| **Dept Levy Reductions** | 377,000 | 374,000 | 371,000 | 365,300 | 1,500,000 |

At this time the actual levy reduction initiatives are not known. Staff had been assuming a Transportation Utility would be a strategy to help balance most of the 2024 and 2025 gaps but that should no longer be assumed. For illustrative purposes, staff will present the potential impact of the 2028 gap, assuming that the City faced a hard levy cap.

**Recommendation:**
While this report is for informational purposes only, it is important that City staff and the Financial Affairs Committee take the long-range projections into account when making decisions for addressing the 2024 Budget.

As in the past, the City's goal is to focus on strategic budgetary changes as opposed to indiscriminate line-item adjustments. It is also important to emphasize that despite facing budgetary challenges, the City is an excellent financial condition with adequate reserves and an excellent record of strong financial management practices.

However, it is extremely important to note a fiscal cliff is approaching due to the assumed exhaustion of excess levy capacity. Whether or not this happens in 2028 as forecasted is uncertain, but without a change in state law or community approval of a referendum, it is certain we will eventually face this precipice despite increased state aid. The detrimental impact on service levels cannot be understated.

Staff will develop the Executive Budget based on the assumptions included in this report so we do request feedback on those key assumptions, in particular levy increases, cost of living adjustments' and the strategies for balancing the forecast.