

Issue: In preparation for the 2025 Budget, it is helpful to understand long-term revenue and expenditure trends for the General Fund.

Background: The 2025-2029 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 2024 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% property tax levy increase for the operating budget and 0.5% for debt service for a total 2.5% Property tax levy increase is assumed for 2025-2029. It is assumed the City loses its ability to exceed levy limit caps in 2029 and that there is \$127 million in net new construction in 2028 limiting the 2029 operating budget property tax levy increase to 1.3%

Property Tax Levy Increase Assumptions

	Operating Budget Increase	Debt Service Increase	Total Increase
2025-2028	2.0%	0.5%	2.5%
2029	1.3%	0.5%	1.8%

- Per the Department of Revenue, a 2.3% increase in State Shared Revenue and assuming the change in CPI thereafter. A 3.4% decrease in Expenditure Restrain Aid is assumed due to the growth in the City's property value. Other State and Federal revenue are assumed to be flat over the five-year period
- There is no assumed utilization of the America Rescue Plan federal funds set aside for budget stabilization.
- Inflation assumed to be 2.5% in 2025 and 2.6% in 2026 and 2.2% in 2027-2029 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 is estimated to be 2.75%. Given prior year's inflation that exceeded cost of living increases, this was rounded up to 3.0%. We are out of contract with the Fire Union as of 12/31/23 so estimates are used for their 2025-2029 cost of living adjustments.
- Pension contributions decrease .15 percentage points for employees and for the City. This is due to an increase in the 5-year investment returns earned by the Wisconsin Retirement Fund.
- Debt service based on 10-year capital spending reflected in 2024-2028 capital plan. Debt amortization continues to transition to a 15 year debt schedule as compared to a previous 10-year.
- Energy and fuel increases based on Department of Energy's 2024-2028 forecast assuming 2024 budgeted consumption.
- Building permit activity based on an approximate 25-year average of \$138,000,000 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 citations issued based on trend since 2021.
- Parking enforcement continues gradual increase but does not return to pre-COVID levels. Peaks in 2025 and a 2% annual decrease assumed thereafter as enforcement drives compliance. Also assume a 10% increase in fees in 2026 and a 5% every 5 years thereafter.
- 1.5% increase in ambulance billed run from 4,320 estimate for 2024 based on activity to date. Also 2.0% annual increase to 2024 average reimbursement rate per trip.
- No change in number of hotel rooms. Assume 2023 actual average tax revenue per room adjusted annually based on third-party reports.

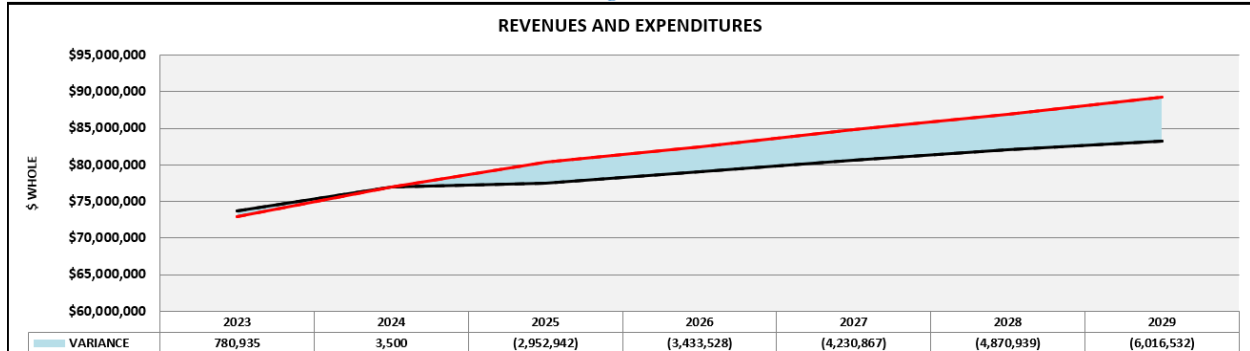
Figure 1 shows a comparison between the 2025-2029 and 2024-2028 forecasts. The new forecast shows a total 5-year gap of \$6.0 million or approximately a 77% worsening over the prior five-year forecast. Reasons for the worsening will be described below.

Figure 1

	2024-2028	2025-2029
2024	722,834	-
2025	(1,318,022)	(2,956,442)
2026	(593,023)	(480,586)
2027	(405,312)	(797,339)
2028	(1,813,477)	(640,071)
2029		(1,145,593)
TOTAL	(3,407,000)	(6,020,031)
		77%

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



Over the five year period, expenditures grow on average 2.5% (down from the 3.4% from the prior forecast) while revenues are growing 2.1% (down slightly from 2.6% in the prior forecast). A 0.3% 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 \$6.0 million by 2029 and unreserved fund balance would drop from \$9.8 million in 2024 to 0 by 2027 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

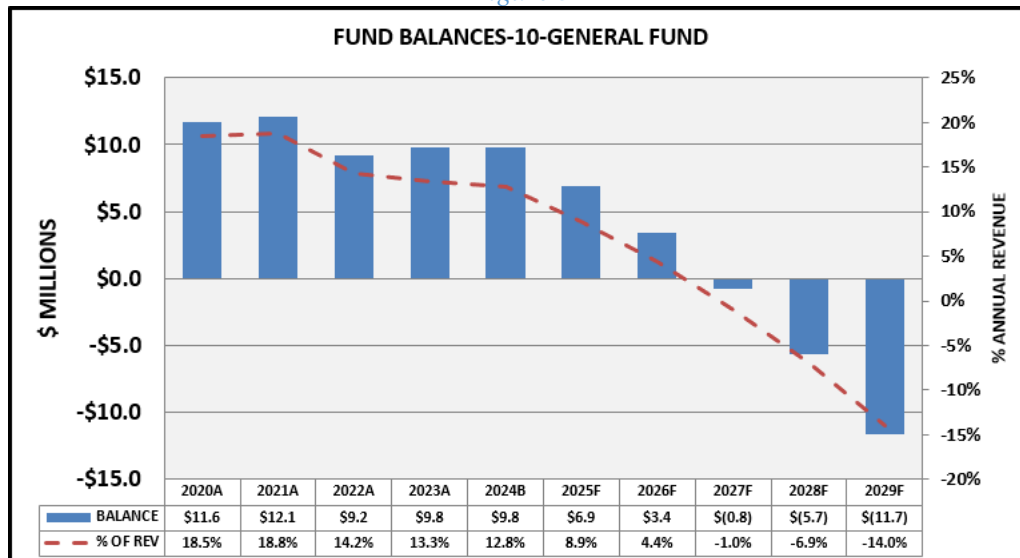
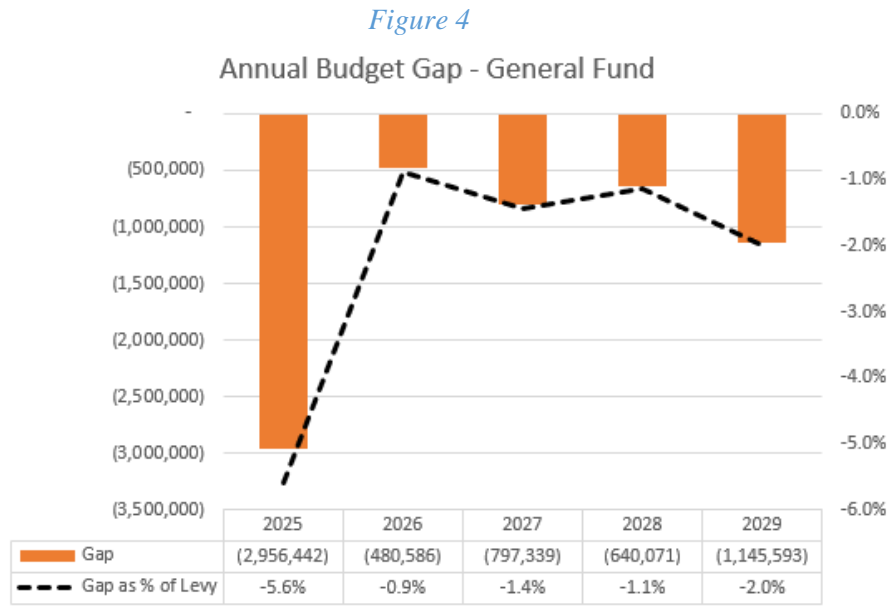


Figure 4 shows the annual forecasted budget gap. If sustainable changes are implemented, it represents the annual budget gap and it ranges from a 0.9% to a 5.6% deficit as a percentage of total property tax levy. While this may not seem significant it is important to consider that the City has been actively reducing costs since 2002.



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

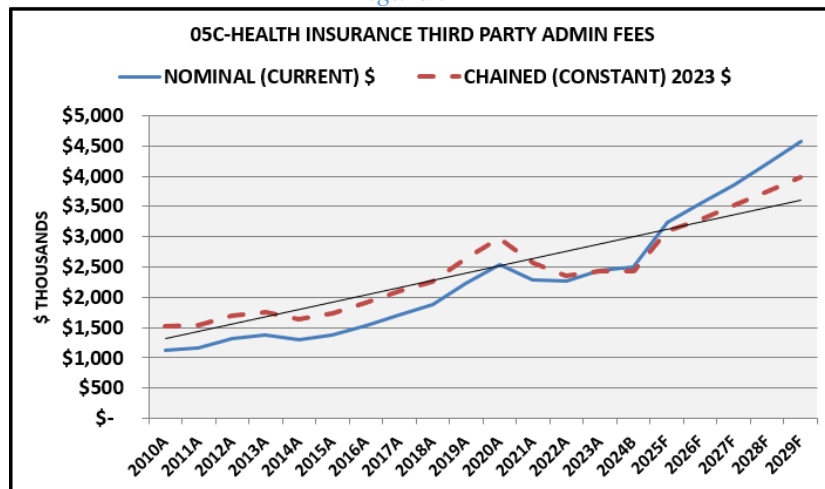
Expenditures

Compensation

An assumed cost of living increase and implementation of the new compensation plan is built into each year of the model as well as assumptions related to fringe benefits. In total, wages are expected to increase 3.9% which totals \$1.2 million. This includes an assumed 3.0% cost of living increase for non-represented employees and a contractual increase for the police union that is estimated at 4.8%. Since the fire union is out of contract, the terms of the police union contract were assumed. 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 2025 or 2026, 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 2025, health and dental insurance costs charged to the general fund increase 16.4% due to an assumed 3.0% increase in health care claim costs and a 30% stop loss excess insurance increase. This accounts for \$1.2 million increase in expenditures. Employees are assumed to continue to contribute 15% of total premium. The huge increase in stop loss excess insurance is due to negative large claim experience in late 2023 and 2024. In the first quarter of 2024, the City had 6 claimants with claims exceeding \$100,000 compared to 1 during the same period in 2023. The chart below shows the dramatic increase in the cost of this insurance.

Figure 5

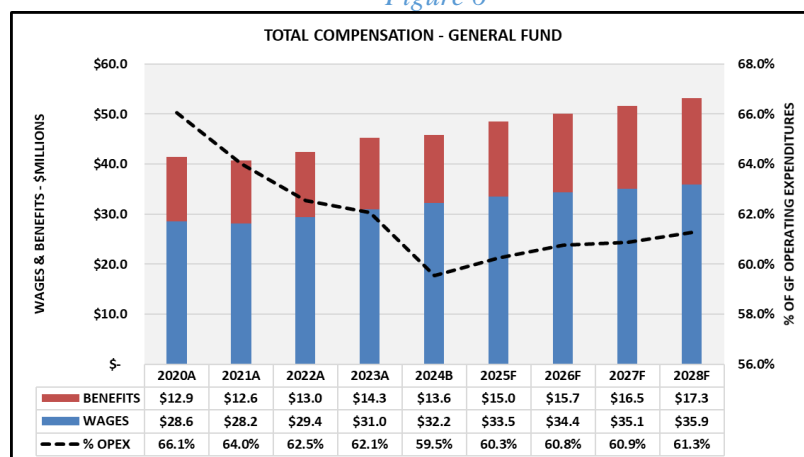


Pension and social security costs will increase along with salary; however that increase is mitigated to 2.5% by an assumed reduction in the employer pension contribution rate (which is equal to the employee contribution) from 6.9% to 6.75% for general employees. Due to multiple factors, there is a different employer contribution rate for police and fire but this rate too is assumed to decrease by 15 percentage points. This is due to above assumed interest earnings over the past five years by the Wisconsin Retirement System. In addition, worker compensation costs are assumed to increase at the rate of healthcare inflation.

In total, benefit costs will increase \$1.4 million or nearly 10.4 %.

As a result, when including all of these changes, compensation increases 5.8% in 2025 for a total of \$2.65 million as shown in Figure 6 and compensation as a percentage of operating expenditures begins to grow. To put this in perspective, the City will receive a decrease of \$40,369 in State Shared revenues. Act 12 passed last year by the State which was acclaimed as a generational increase in state shared revenue did not fundamentally change how broken local government funding is in the state of Wisconsin.

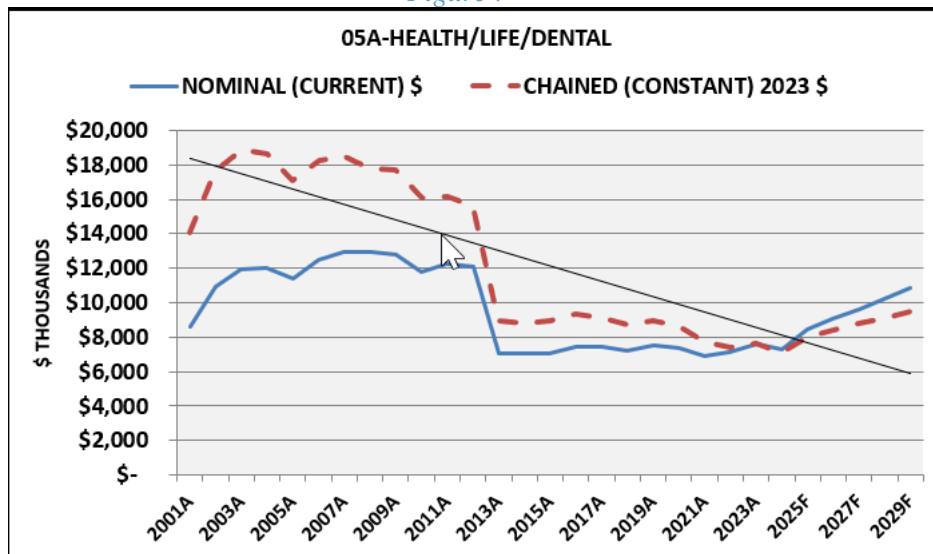
Figure 6



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 and most recently, migration to a narrow network in 2024. In addition, a pension contribution was implemented in 2011. This

can be seen in Figure 7 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 7



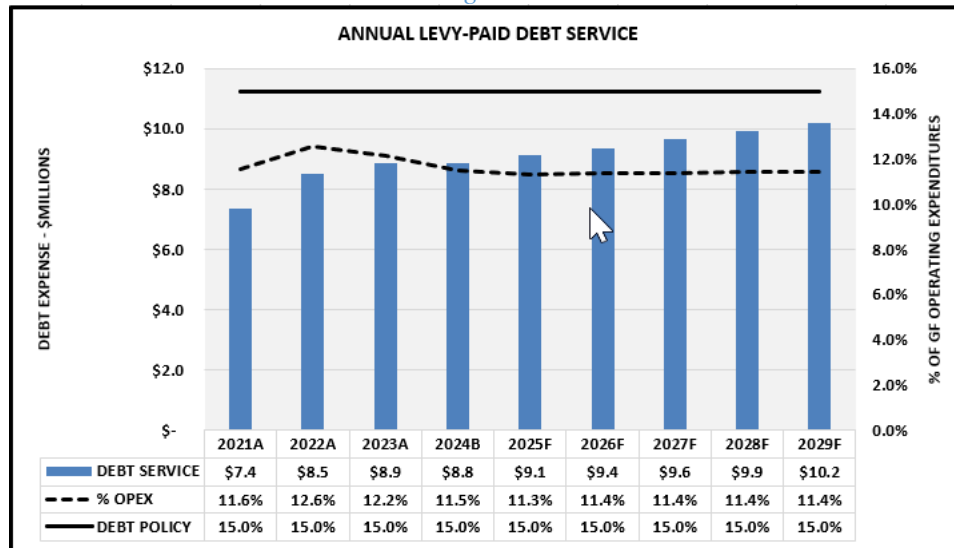
Debt Service

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 2025 by approximately \$298,193 or 3.4% increase from 2024. 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.

The impact of this expense over the course of the forecast is based on the borrowing necessary to support the implementation of the 2024-2028 capital budget and is shown below in Figure 8. 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 2037 for levy funded capital assuming current capital spending. It should be noted however, that current capital spending is insufficient for the City to adequately maintain its roads and buildings.

Figure 8



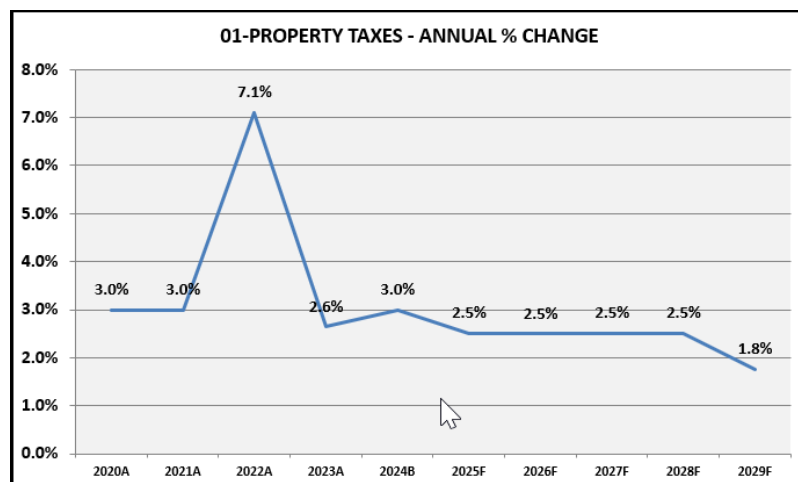
Revenues

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 67% of general fund revenues in 2024 at \$51.5 million. For purposes of the forecast, property tax growth is assumed to equal 2.5% from 2025 through 2028. As described above, it is assumed we exhaust our excess levy capacity in 2028 and are limited to our net new construction growth percentage. Figure 9 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
- 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



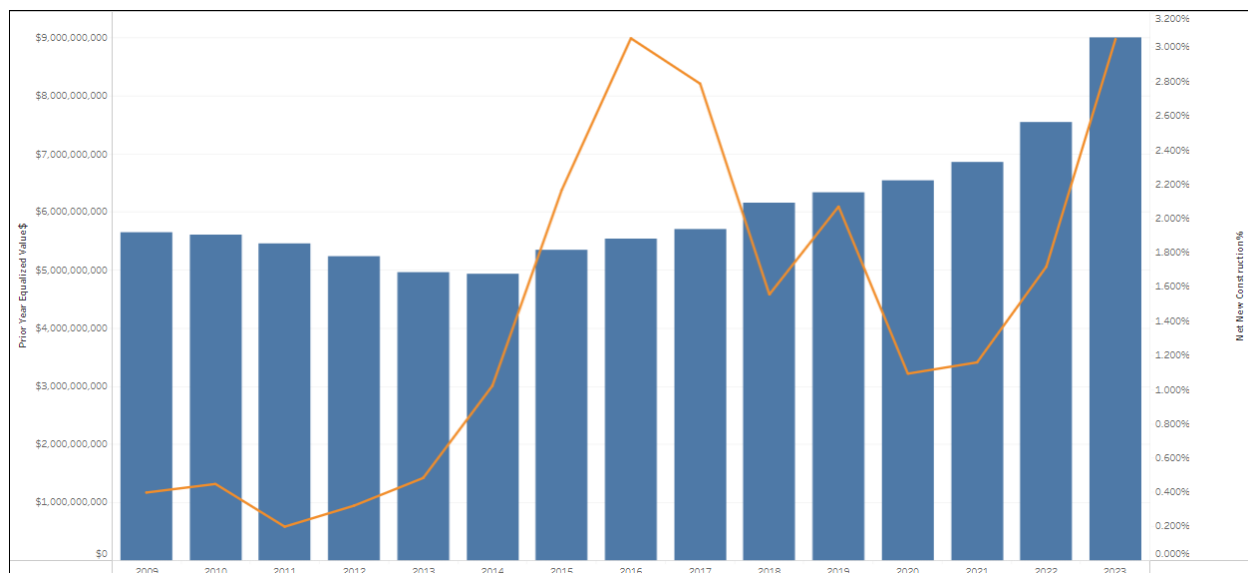
Per the Fiscal Resiliency policy, this revenue growth will be achieved through net new construction, carryover or excess debt capacity. However, based on the levy increases shown below, it is important to emphasize, that absent changes in state law, the City will not be able to indefinitely increase 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.

Figure 10

Years of Levy Capacity Available Assuming 2.0% for operations:		
Net New Construction as % Property Value		Years
0.50%		3.72
0.75%		4.47
1.00%		5.58
1.50%		11.17

For purposes of forecasting, it is assumed the excess capacity is used up in 2028 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 2023, the annual average was 1.4% but ranged from .20% to 3.05%. As more redevelopment opportunities are realized, achieving higher rates of net new construction becomes increasingly difficult.

Figure 11



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

Figure 12 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 \$1,017 in 2024 as compared to \$965 in 2002. From 2002 through 2024, the compound annual growth rate adjusted for inflation is 0.2% despite a significant increase in calls for service across almost all areas.

Figure 12

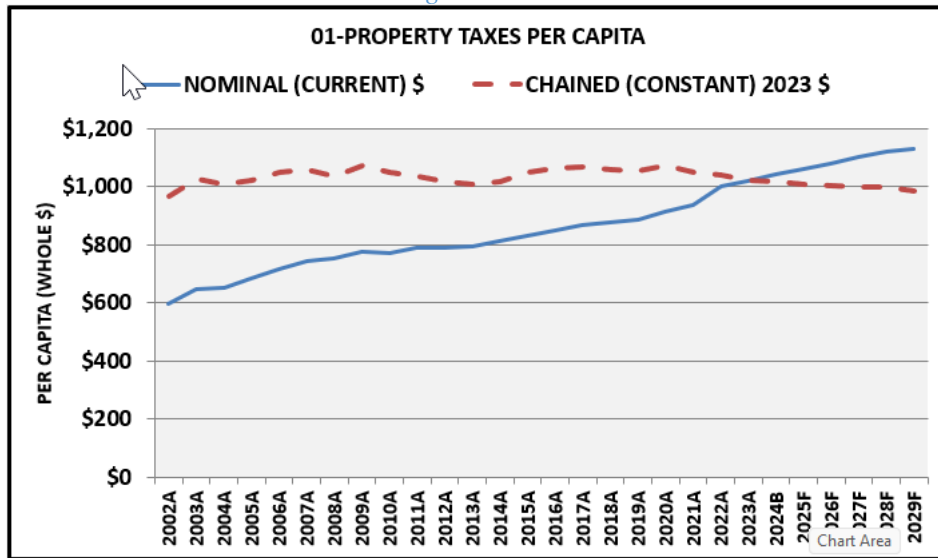
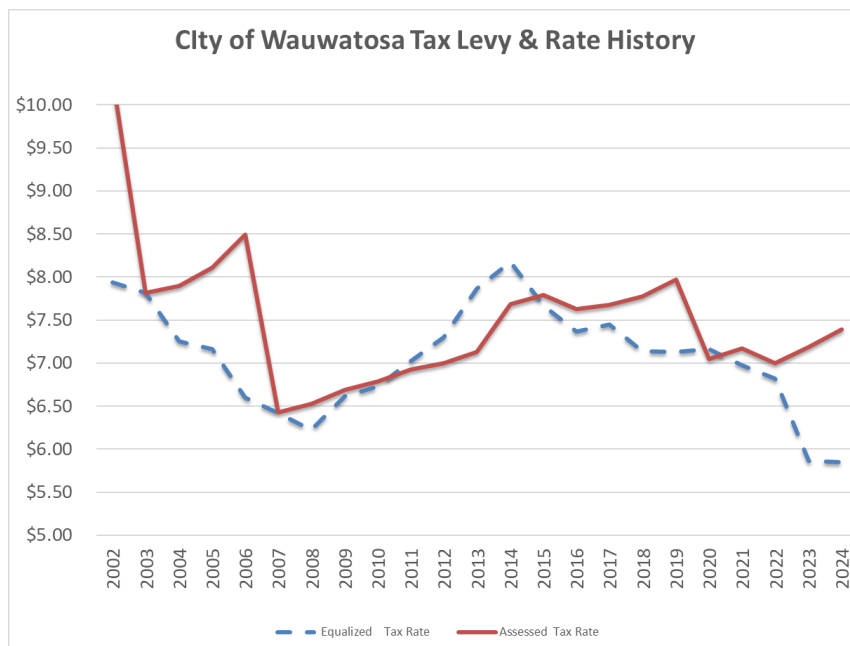


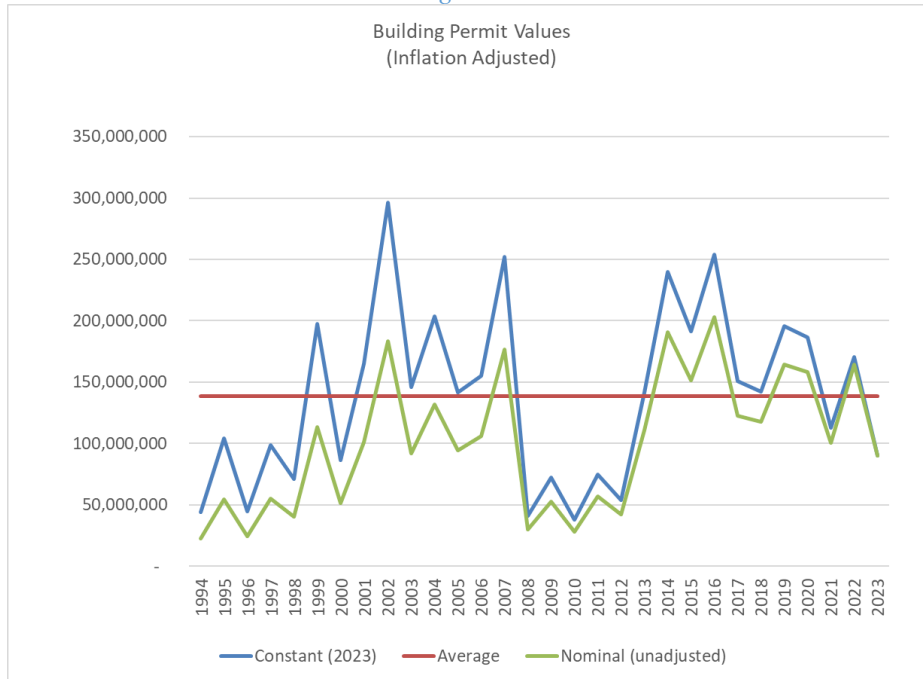
Figure 12 shows the tax rate history since 2002 through 2024. The equalized tax rate (dashed blue line) is a more accurate depiction of the historical trend. The equalized tax rate has been decreasing since 2014 as property tax base growth exceeds levy increases. The 2024 assessed tax rate based on the 2024 levy is 28.0% less than the 2002 rate.

Figure 13



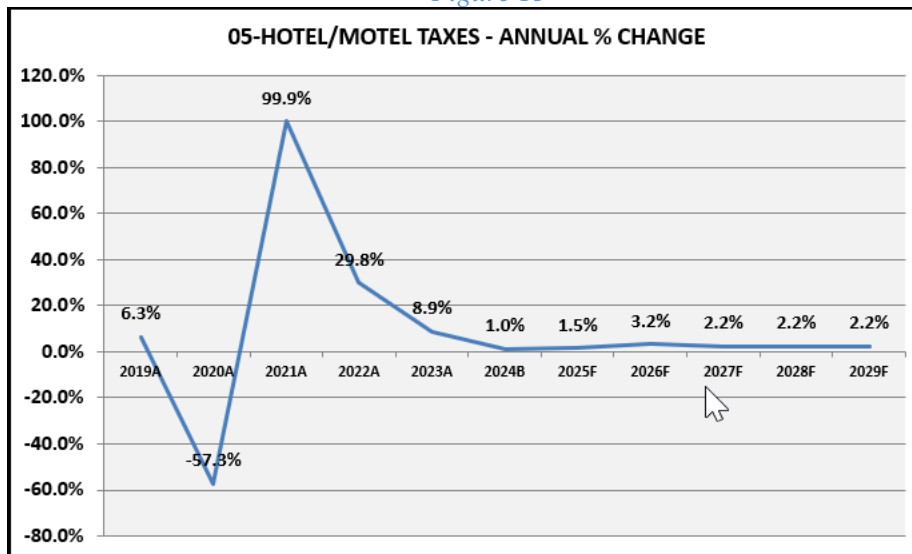
Building permit construction value is a predictor of subsequent years net new construction and the health of the local economy. Figure 14 depicts this activity since 1994. 2023 was below the historical average.

Figure 14



Only 30% of Hotel/Motel tax revenue increases go to the General Fund. 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 through 2023 putting us above pre-COVID revenue numbers; however that recovery appears to have waned and future years show much slower growth.

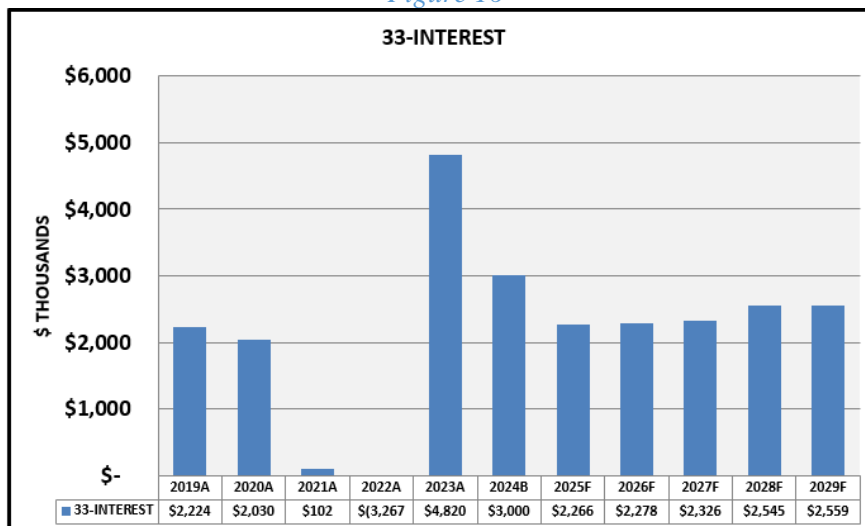
Figure 15



To combat inflation, the Federal Reserve has rapidly increased interest rates over the past 2 years. 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 occurred as shown below resulting in revenue levels not seen since prior to the Great Recession. However, we are projecting that the City will earn 25% less in 2025 due to

a 20% reduction in interest rates on its portfolio and a \$15 million reduction in the amount invested due to the ARPA spend down. This results in a general fund reduction of \$735,000 – a significant contributor to the 2025 budget gap.

Figure 16



Balancing the Forecast

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

TO BE PROVIDED AT A SUBSEQUENT MEETING

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 2025 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 in 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 2029 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.