MEMORANDUM

TO: MAYOR AND CITY COUNCIL

FROM: VICTOR CARDENAS, CITY MANAGER
CARL JOHNSON, CHIEF FINANCIAL OFFICER

SUBJECT: BUDGET SESSION 2.0/BUDGET QUESTIONS 3.0

DATE: APRIL 10, 2024

During the first budget session for fiscal year 2024/25, the administration was directed by City Council to provide recommendations for increasing the General Fund fund balance to an amount exceeding the target percentage approved by Council resolution a few years ago (22%-25%). The discussion generally contemplated that the increase would come from reducing expenditures by approximately $2 million for fiscal 24/25 and an additional $1 million annually for 25/26 and 26/27, increasing fund balance to the 30%+ range. The specific request was to identify various capital and/or operating reductions that could be made to meet the desired fund balance levels.

The proposed budget for FY 24/25 had revenues equal to expenditures —with the notable exception of one specific proposed use of fund balance for a new salt dome at the DPW. The recommendations that follow propose

1. funding the salt dome from other funds (i.e., no longer the General Fund), and
2. reducing operating/capital costs to achieve revenues more than expenditures of $1 million annually for each of the next three years.

The salt dome realistically has to be built this year, but other expenditures can be put off or abandoned to meet the target percentage.

SALT DOME ($928,810)

The reconstruction of the salt dome storage is a significant project, and staff strongly recommends proceeding as scheduled. This project has continually been "kicked down the road" going back to 2016. Planned as part of the reconstruction of the DPW facility in 2019, it was removed from the project as a cost savings but was kept in the Capital Improvement (CIP) Fund. During the discussions leading up to the approval of the FY 2023/24 budget, members of City Council on the CIP Committee recommended the salt dome project be removed from the CIP and be a planned use of General Fund fund balance. This project has been in the works for months (the dome has been emptied and readied for demo) and is ready to begin in July 2024.

It is the administration's first recommendation to use a combination of CIP, drain and possibly road funds to cover the General Fund's portion of this projectIf the use of the

CIP fund is not desired, the City could use a combination of municipal road funds (which will be freed up if the Council moves forward with the $20 million in road bonding discussed during the budget study session) and drain funds.

General Fund Operating and Capital Reductions

Approximately 76% of the City's annual budget is salaries and fringe benefits, which include the significant pension contributions driving that percentage slightly above the industry average of 70-75%. To reach the significant level of expenditure reductions requested, personnel must be included. The following are some of the key items involving capital projects, operating costs, and personnel noted in the attached plan:

Fiscal 2024/25

- Do not fill the vacant Plan Examiner position. (Annual savings of approximately **$110,000**.)
- Eliminate Accreditation Assistant (Annual savings of **$78,900**)
- Do not fill the vacant Economic Development Manager (formerly the Director role) position. (Annual savings of **$138,000**.)
- The City is currently on a five-year replacement cycle in replacing fleet vehicles to reduce repair costs and maximize trade-in values. The City would skip a year in this cycle and not purchase the scheduled six (6) vehicles. (Savings of approximately **$215,000**.)
- The City is currently on a seven-year replacement cycle in replacing fleet truck vehicles to reduce repair costs and maximize trade-in values. The City would skip a year in this cycle and not purchase the scheduled two (2) vehicles. (Savings of approximately **$158,000**.)
- Eliminate the **$25,000** transfer from the General Fund to the EDC for the next three years, as the EDC has no plans for the use of these funds and has a healthy fund balance to cover events.

The above-recommended savings (including moving the salt dome out of the General Fund but still building it) represent a reduction in General Fund expenditures of approximately $1.6 million, bringing the fund balance to a projected $12.1 million, which represents 29% of FY 24/25 expenditures. To obtain an additional $773,000 in reductions, additional cuts could be made:

- Do not make the annual purchase of the large plow truck CIP #94 (two-year build on these vehicles). (Savings of **$332,000**.)
- Push generator replacement at Civic Center off from FY 24/25 to FY 27/28. (Savings of **$441,000**).

Fiscal 2025/26 and 2026/2027

In addition to the above positions not being filled and the EDC transfer not being made, the administration proposes the following:

- Remove the proposed two (2) new positions for training officers. (Annual savings of **$220,680**.)

- Remove the proposed two (2) new positions for fire training assistant and fire inspector. (Annual savings of **$223,820**.)
- Annual department savings (across the board), which the council previously directed to put toward capital rather than pension, would go directly to the fund balance, totaling **$150,000**.

The above-recommended savings represent an expenditure reduction of approximately $956,639 and $980,087 for FY 25/26 and FY 26/27, bringing the fund balance to a projected 31%, or $14 million, by 6/30/27. If the plow truck and generator are not spent, fund balance would be 33% or $15 million.

Additional Resources

All of the above actions to meet the 30%-plus fund balance discussed are reductions in expenditures (including through the use of different funds for the salt dome). It should also be noted that other resources at the City Council's disposal can be leveraged for needed projects or expenditures at any given time. The CIP Fund, specifically, is available for any capital-related projects as outlined in the specific ballot language (except for roads).[1] The projected remaining funds available in the CIP Fund on 6/30/24 is $2.1 million, including the recent property purchases.

[1] In August 2016, voters approved (3,330 to 3,243) a 1-mill Capital Improvement millage for 10 years. The purpose of the millage was to cover a gap in the city's budget where most tax dollars went to pay day-to-day operations, leaving little left over to fund long-term capital needs. Year to date the millage has raised $26,959,000 (FY's 2018-2024).

BUDGET QUESTIONS 3.0

1. **Please provide the official Fund Balance policy and advise when it was approved?**

A. Current Policy. From the City's Annual Audit document
The City follows the City Council's adopted, by resolution, fund balance/reserve policy. The policy establishes a reserve to pay for expenditures, states the City will attempt to obtain additional revenue sources to ensure a balanced budget and aggressively collect revenue, establishes user charges and fees at a level to take into account the cost of providing the service, maintain a level of reserves to comply with terms and conditions of debt instruments, and review fund balance/reserves annually during the budget process. In addition, in the event the level of expenditures exceeds the estimated appropriations, the City will create a plan to replenish fund balance/reserves within three years by controlling operating expenditures, adjusting operations and/or dedicating excess or specific revenue sources. The policy establishes a minimum reserve as a percentage of budgeted expenditures of 22-25% in the General Fund, 10-20% individually and collectively amongst the three road funds, 12-22% for Parks and Recreation, and varying reserves for the remaining special revenue funds dependent on the funds yearly activity and capital needs

B. City moved from 14-18% to 18-22% in 2011

https://cityofnovi.org/Novi/Minutes/Council/2011/110124.htm

C. Amendment in September of 2011 to encompass other funds

https://cityofnovi.org/Novi/Minutes/Council/2011/110912/2-AmendCitysFundBalance-ReservepolicytoincludecertainSpecialRevenueFunds.pdf

D. Change to current 22-25%

https://cityofnovi.org/media/dfzn1rum/452017_170405.pdf

CM 17-04-050 Moved by Staudt, seconded by Wrobel; MOTION CARRIED: 5-2

To change the City Council Fund Balance Policy for the General Fund to increase the range from 18%-22% to 22%-25% effective with this budget.

Member Wrobel wondered if this passes how this would be looked at by the financial institutions. Finance Director Johnson said they have been able to increase the rating from S & P, when he talked to Moody's we got a bump up to the second highest rating. One of the items they recommended was Fund Balance and their target is 43%-45%, so any increase looks well to the rating agencies. Mayor Gatt said he learned from the best, Mr. Brooks Patterson. Mayor Gatt insisted on a 3 year budget when he became

Mayor and was told it couldn't be done. Mr. Patterson has had an AAA Bond Rating for years and his Fund Balance is about 40%. Special Meeting of the Council of the City of Novi Wednesday, April 5, 2017 Page 11 Roll call vote on CM 17-04-050 Yeas: Wrobel, Gatt, Staudt, Burke, Mutch, Nays: Casey, Markham

2. Please provide a history of the Fund Balance amount going back to 2000?

	Fund Balance		Expenditures		FB%	
Fiscal Year	Budgeted	Actual	Budgeted	Actual	Budgeted	Actual
24/25	10,209,830		44,100,000		23%	
23/24	12,161,923		42,024,747		29%	
22/23	11,660,827	14,445,394	39,995,555	41,374,300	29%	35%
21/22	11,564,043	16,409,153	37,036,890	37,657,226	31%	44%
20/21	9,968,668	13,675,202	35,342,824	37,145,329	28%	37%
19/20	10,347,085	10,596,128	35,622,849	35,742,115	29%	30%
18/19	11,155,123	11,297,109	34,815,376	35,242,582	32%	32%
17/18	10,590,619	11,819,066	33,484,730	33,627,514	32%	35%
16/17	11,189,911	12,905,841	33,288,909	32,855,622	34%	39%
15/16	8,621,500	13,745,202	31,249,612	31,858,979	28%	43%
14/15	7,743,968	12,357,647	30,423,995	29,038,582	25%	43%
13/14	6,228,792	9,490,017	29,878,687	29,308,072	21%	32%
12/13	7,008,191	8,811,564	29,786,566	30,084,543	24%	29%
11/12	6,175,704	9,564,600	28,484,075	28,159,739	22%	34%
10/11	6,471,892	11,417,075	28,148,605	28,041,078	23%	41%
09/10	5,323,185	9,710,402	30,095,493	28,248,221	18%	34%
08/09	5,940,449	10,314,220	33,039,201	32,083,184	18%	32%
07/08	5,737,330	12,413,039	33,973,972	31,347,750	17%	40%
06/07	5,015,930	11,614,777	32,648,670	30,697,031	15%	38%
05/06	3,795,852	10,513,370	27,113,892	26,198,303	14%	40%
04/05	3,697,380	7,204,337	24,862,196	24,480,845	15%	29%
03/04	3,445,501	5,133,307	23,966,235	23,941,919	14%	21%
02/03	2,295,668	5,293,046	22,956,682	22,142,897	10%	24%
01/02	1,906,289	4,700,855	21,251,828	21,405,614	9%	22%
00/01	1,411,348	4,404,123	20,391,854	18,942,254	7%	23%

3. Why was the $900k transferred in from Muni Street Fund during Amendment #1? My guess is that it was to keep minimum fund balance at $1.2M (10%) per the policy. Which (again) begs the question, if we transferred in $900k to plug the hole, and then we had underruns, shouldn't the motion sheet clearly call this out so that council can understand that instead of reversing a portion of the transfer, you are

recommending we fund a project not originally contemplated in the budget (or any version of amended budget) with said underruns?

In general, both the major and local street funds are kept at their fund balance minimum of 10% as we spend every dime of these funds, and additional funds are transferred from the Municipal Street Fund as needed. Because of that, any increase or decrease in revenue or expenses results in an increase or decrease in the funds transferred from the Municipal Street Fund. Amendment #1, referred to in the question, is the rollover amendment that was mentioned the other night, which had a total of $4,521,140 of contract balances remaining as of 6/30/23; the remaining subsidy related to them from prior years from the Municipal Street Fund specifically was the $900,000.

4. **Why was the Industrial Rehab Project increased by $900k in Amendment #1, and now is coming back in at original budgeted amount? (Coincidentally, driving the need to transfer in $900k).** The increase was the exact balance remaining in the budget at 6/30/23 that was a rolled over. As stated above, the $900k transfer in was the amount of the rollovers covered by the Municipal Street Fund.

5. **It appears you are double counting the Fountain Walk project in your 2023/2024 estimated budget.** The amendment to move the savings between the lines in the Major Street Fund was originally posted in error twice and then reversed once we saw that. Unfortunately, it looks like the information you have was before the reversal. At this point, there is no net impact on the overall fund as it was again just moving amounts between the capital outlay line items.

6. **Please provide fund balance policies for General Funds in our comparable communities.**

Rochester Hills
Page 60 of the 2022 Annual Comprehensive Financial Report has a section related to Fund Balance Policies, including that "At a minimum, the fund balance of General Fund and Special Revenue Funds will be maintained at twenty percent of operating revenues". Additionally, their 2024 Adopted Budget Plan Book (pg 44 - 45) goes into further detail on their Fund Balance/Reserve Policy that was initially adopted on June 4, 2018. I have attached both the agenda summary and the proposed Policy from the 2018 meeting.

Troy
2023/2024 Adopted Budget Page 23 indicates: "RESERVE POLICIES The City accounts for reserves in accordance with Governmental Accounting Standards Board (GASB) No. 54. City policy calls for a range of General Fund unassigned fund balance between 20% to 30%. A financial plan is required should the General Fund unassigned fund balance fall outside of this range". Earlier adopted budgets reference the same percentage rate as having been adopted by City Council as a General Fund Balance Policy in 2014 wherein "*The policy states the General*

Fund must maintain a minimum unassigned fund balance at a level of 20% to 30% of annual expenditures. This Fund Balance policy is used to guide City administration in future fiscal situations while providing stability and flexibility to respond to unexpected opportunities or economic adversity. Fund Balance is used to cover costs of one time, capital expenditures." (2015-2016 Budget pages 4-5)

Auburn Hills

Page 43 of the 2022 Annual Financial Report states *"The City's fund balance policy proscribes the minimum unrestricted fund balance as 20 percent of operating expenditures in the General Fund. This is deemed to be the prudent amount to maintain the City's ability to meet obligations as they come due throughout the year."*

Canton

Page 12 of the 2022 Annual Comprehensive Financial Report offers that, as part of long-term Financial Planning *"The Board maintains a fund balance policy which requires a minimum of fifteen percent (15%) of total expenditures for the four major funds: General, Roads, Fire and Police. Unassigned fund balance in the General Fund (as reported to be in compliance with GASB Statement No. 54) amounted to 17.11% of total General Fund expenditures."*

Farmington Hills

Page 32 of the Adopted FY23-24 Budget lays out Financial Policies and includes "*The City will strive to establish and maintain an unassigned fund balance of 15-25% of the General Fund expenditures for the subsequent year to pay expenditures caused by unforeseen emergencies, cash shortfalls caused by revenue declines or delays and mitigate the need for short term borrowing."*