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MEMORANDUM

TO: HONORABLE MAYOR AND CITY COUNCIL
FROM: JOSHUA TETZLAFF, CITY ADMINISTRATOR
SUBJECT: 2024 TAX LEVY
DATE: NOVEMBER 29, 2023

On Monday (11/20) of last week, we briefly discussed the potential tax levy situation and then on Wednesday (11/22), I sent you an email updating you with information I had since learned. Now, as this memo is being finalized (Tuesday, 11/28), here is all of the information that I am aware of as the writing of this memo.

Back in September, the City Council approved a preliminary tax levy of \$5,114,295. This was roughly a 5% increase over the 2023 property tax levy. As requested by Scott County, staff filled out the form that accompanies the resolution we submit to the County. That form asks staff to report Gross Certified Net Tax Capacity Levy information (for General Revenue, Debt Service, and other Funds receiving levy), report the amount of LGA the City is receiving, and then deduct that LGA from the Gross number to report a Net levy. I have included the form that we submitted. As you can see, we reported the needed levy amounts in the first column, deducted the LGA amount, and ended with the amount the County used as our reporting number. That number is our exact levy amount, minus the LGA we are receiving. This means the proposed levy is \$1,183,527 less than we intended, or \$3,930,768. When documents were originally submitted, the correct levy amounts were stated in column A. The County reached out with a clarifying question about the resolution. After that conversation, we believed this form to be filled out in the manner requested by Scott County.

Staff became aware two weeks ago (week of 11/17) that the tax statements Scott County residents were receiving reported a number lower than intended when Councilmember Wolf reached out to me that he had received his tax statement and the number seemed low. I immediately reached out to Finance Director Robin Pikal to verify information on our end and then to City Attorney Scott Riggs about the situation to discuss possible remedies. Mr. Riggs started looking into state statutes and discovered two statutes that may apply. In Mr. Riggs opinion, pursuing a correction through the Minnesota Department of Revenue was likely our best option.

On Monday (11/20) of last week, City staff reached out to Scott County to discuss the situation. The County stated they didn't believe there was anything they could do to address the situation as they had reported the numbers to the State. The County did reach out to the Department of Revenue via email at that point (and CCed City staff) and eventually heard back on Tuesday (11/21) that the City should over-levy for 2025 to compensate for the lost revenue.

Also on Monday (11/20), City Attorney Scott Riggs stated that those in his office who would have the best knowledge of the situation were out of the office for the holiday but that he would continue working channels to get a plan formulated. That evening (11/20) at the City Council, I updated the Council regarding the situation that we were aware of, which was that residents on the Scott County side were receiving tax statements that

were artificially low due to an error in the amount the City proposed to levy. We had not heard from Le Sueur County at the point so I did not know what Le Sueur County residents would be receiving.

On Tuesday (11/21) of last week, I received my property tax statement and, looking at the proposed levy amount, saw that Le Sueur County was also reporting the same amount as Scott County. When speaking with Robin, this is because Scott County is the reporting county for New Prague and thus shares their information with Le Sueur County. We generally send Le Sueur County the resolution passed by the City Council (and did again this year) stating our intended proposed tax levy out of professional courtesy, but ultimately Le Sueur County uses the information sent to them by Scott County.

On Wednesday (11/22) of last week, Robin spoke with someone at the Minnesota Department of Revenue (DOR) to discuss the situation. Before Robin had explained why she was calling, the DOR employee stated that the State was aware of the situation and was not surprised to be receiving a phone call from New Prague. When the DOR received the preliminary notices from Scott County earlier in the fall, the DOR believed the 18% decrease by New Prague was odd and reached out to Scott County to confirm that New Prague did in fact want an 18% decrease from 2023. The County, according to this DOR employee, without confirming the oddity to New Prague staff, informed the DOR that New Prague did in fact want to decrease their levy by 18%. The DOR still believed it was odd, but hearing from the reporting County, recorded the proposed decrease. The DOR employee Robin spoke to stated that there was nothing he could do, but did mention that there may be avenues if we get our attorney involved, though he would not expound on what those avenues were. He then said this has happened to many other communities before all across the state (and will likely happen again) and that the recommendation made to communities is that they over-levy the next year to make up for the lost revenue (ultimately creating a neutral tax situation to property owners over two years).

On Monday (11/27) of this week, Mayor Jirik and I spoke to City Attorney Scott Riggs about the situation and asked for an update. During this discussion, Mr. Riggs shared that his office had been in contact with the DOR and had heard similar talking points that Scott County had heard the week prior. Within that conversation, the DOR staff member recommended the City leave the situation as it was and over-levy in 2025 to make up for the lost revenue. That, he said, is typically how cities handle the situation. The staff member also recommended not pursuing any additional legal action as it had never been done before to this employee's knowledge and would thus would not likely end in a manner that the City would be satisfied. After discussing the situation with Mayor Jirik, I asked Mr. Riggs to continue pursuing what would amount to a variance on the City's 2024 levy to see where the road may lead. Just because no one has pursued a variance to this extent does not mean it can't be done, or shouldn't be done; just that it hasn't been done. I also asked City Attorney Riggs to keep me updated with hours spent on this project so that we can continue to make the determination whether it is worth pursuing. Also in this time, Robin has spoken with Abdo about the situation and heard from them similar history on this issue...namely that it has happened to many communities (mostly involving an additional form required by some counties in similar fashion to ours).

While Kennedy & Graven continues to explore options for a variance from the posted preliminary tax levy, I believe it is important that the City prepare for the possibility of not be allowed to levy in 2024 what was intended through our budget discussions since August. Below, I discuss three primary options I believe the City has if the DOR does not agree with our case, and then a further breakdown of each option. I would first like to discuss the primary options and once the Council is able to narrow in on a primary option, we can then discuss the further breakdowns of those options. The three primary options the City would have if the DOR does not allow New Prague to levy at its intended rate are to:

- 1) borrow the required \$1,116,930 (the difference from the recorded preliminary levy and the proposed budget as of 10/24) from other funds or fund balance in 2024, and then repay itself over time by over-levying above what is needed until the funds are restored
- 2) borrow a portion of the funds, and then repay it over time. The remainder of the balance would use accumulated fund balance; or

- 3) reduce fund balances and delay purchases/projects totaling \$1,116,930.

Within all of these scenarios, I am expecting the budget to return to its assumed 2024 level, inflated by 5% for 2025, as a baseline. In each of the projections below, I am assuming standard spending will increase by 5%. I am not expecting any potential cuts in 2024 to be permanent. 5% is being used as a baseline because cities around New Prague are commonly seeing higher than 5% year-over-year the last few years but I know that the City Council’s commitment to keeping the levy increase low many times pushes New Prague’s levy increase lower than surrounding cities. In the coming years, debt service payments do begin to drop, though the City still has three bonds to come into payment, assuming it continues with the final two years of reconstruction projects (2024 and 2025). Because of those incoming projects, and because we have discussed reallocating those savings to the Equipment Fund, I have not shown any overall reduction in levy due to decreased debt service principal payments starting in 2029.

1) Borrow \$1,116,930 from the Sanitary Sewer Fund and repay over time by over-levying.

With this first option, the City would borrow \$1,116,930 (or whatever the final amount was at the end of 2024 to account for any savings staff was able to realize throughout the year) from the Sanitary Sewer Fund and then over-levy for that amount over a period of time to repay the Sanitary Sewer Fund. The Sanitary Sewer Fund would be able to support this interfund loan over a short-time period as its undesignated cash balance was \$7,787,342 at the end of fiscal year 2022. Speaking with the City auditors, this would generally require the Council to take a couple actions. First, the Council would approve the interfund loan between the Sanitary Sewer Fund and the General Fund. Second, the City Council would then decide the terms of the loan...what will the repayment look like and what interest rate would be involved. Because the City controls both funds, the City Council may determine both.

Should Option 1 be pursued, there would be a strong information campaign starting almost immediately explaining to residents the plan over the intended payback period. While this would not necessarily keep people from being upset at the sharp spike in their property taxes, I believe it would be the duty of the City to keep people informed of the plan so that they are able to plan ahead for increased levying to make up for the decrease in 2024.

Within Option 1, the City would not be affecting City employees’ wages/benefits and would continue progressing with projects as they are planned and discussed. All borrowing options assume a 0% interest rate on repayment of the Sanitary Sewer Fund.

a. Repay over a one-year repayment schedule

Under option 1a, the City is setting the repayment schedule at one year. Looking at the numbers, this means that the levy would be down 18.5% to \$3,930,768 in 2024 from 2023. Then, to recoup the cost, the levy would be up 63.3% (or \$2,486,245) to \$6,417,013 in 2025. Then down 13.3% in 2026 to \$5,565,087. I have outlined those numbers in the table below.

One Year Full Pay Back		
Levy Year	Levy Amount	Percent Change
2023	\$ 4,824,628	
2024	\$ 3,930,768	-18.5%
2025	\$ 6,417,013	63.3%
2026	\$ 5,565,087	-13.3%
2027	\$ 5,843,341	5.0%

Under Option 1a, City residents would realize drastic changes in their year-to-year levy amounts for three years but overall, the change would be estimated at 15.3% over a three-year span (or 4.6% in 2024, assumed 5% in 2025, and assumed 5% in 2026). The City would also be made whole the quickest in the revenue column.

b. Repay over a three-year repayment schedule

This option is very similar to Option 1a, but instead of a one-year repayment schedule, the repayment schedule is three years. Below is the estimated levy schedule.

Three Year Full Pay Back		
Levy Year	Levy Amount	Percent Change
2023	\$ 4,824,628	
2024	\$ 3,930,768	-18.5%
2025	\$ 5,672,393	44.3%
2026	\$ 5,937,397	4.7%
2027	\$ 6,215,651	4.7%
2028	\$ 6,135,508	-1.3%
2029	\$ 6,442,284	5.0%

As you can see below, the increase in 2025 is not nearly as great as in the one-year repayment option, which is because instead of paying back \$1,116,930 in a single year, the payments are being split in three payments of \$372,310 each year. By 2028, the funds are repaid and the levy returns to its standard amount. Of note, this will likely require a yearly reminder of increased levies to citizens, as well as Council remembering that levies will be artificially high for three years.

c. Repay over a five-year repayment schedule

As with Option 1a and Option 1b, Option 1c allows for normal budgeting year-over-year, but spreads the payments out even further, over five years.

Five Year Full Pay Back		
Levy Year	Levy Amount	Percent Change
2023	\$ 4,824,628	
2024	\$ 3,930,768	-18.5%
2025	\$ 5,523,469	40.5%
2026	\$ 5,788,473	4.8%
2027	\$ 6,066,727	4.8%
2028	\$ 6,358,894	4.8%
2029	\$ 6,665,670	4.8%
2030	\$ 6,764,398	1.5%
2031	\$ 7,102,618	5.0%

Option 1c further spreads the payments out, equaling \$223,386 per year over five years. This sub-option has the smallest increase of the three in 2025, though requires the discipline to continue payments for a five-year period.

2) Borrow ½ of the needed funds, or \$558,465, of the funds from the Sanitary Sewer Fund and make budget adjustments for the remainder.

With this second option, the City would borrow \$558,465 from the Sanitary Sewer Fund and then over-levy for that amount over a period of time to repay the Sanitary Sewer Fund. For the other half of the needed funds, the City would receive funds from a few places. First, the City would use realized interest from the City’s CD investments paid in 2024 that would have normally have gone towards future projects/equipment to reduce borrowing costs. Within the General Fund, the City is expecting to realize about \$125,000 in interest. For 2024 to this point, staff had been conservatively budgeting \$50,000 with the intent of the rest to go towards future projects/equipment, which means there is approximately \$75,000 of revenue to claim. Then, I would recommend reducing the 2024 golf transfer to \$0. That reduces expenditures by an additional \$97,016. For the remaining \$386,449, the City would use fund balance that it has accumulated. Currently, Robin and I have been able to identify about \$800,000 in fund balance that has been assigned to other uses, such as contingencies, future projects, and facility repairs.

As with Option 1, I would recommend immediately entering into an information campaign for the length of the repayment period to prepare property owners for an inflated levy.

As with Option 1, in Option 2 the City would not be affecting City employees’ wages/benefits. Future spending would likely be affected as the City would be reducing interest gained and fund balance by \$558,465. Future spending on facilities, equipment, and infrastructure would likely require either delaying purchases, increased borrowing, or both. There may also be a time period of having to increase levies to rebuild reserves that are looked at by creditors to offset the City’s debt load.

a. Repay borrowed funds over one year.

Within this option, like Option 1a, the City borrows funds from the Sanitary Sewer and pays them back over a one-year period. In option 2a, the City is only borrowing half of the needed amount though, which reduces this levy fluctuations in 2025. While it reduces levy fluctuations, it does use interest payments and fund balances that were previously assigned or intended for other purposes, such as aquatic center contingencies, future facilities, or park improvements. Below is what the payment schedule would look like, along with the used interest and fund balance amounts.

One Year Half Pay Back				
Levy Year	Levy Amount	Percent Change	Interest	Fund Balance
2023	\$ 4,824,628			
2024	\$ 3,930,768	-18.5%	\$ 75,668.00	\$ 385,781.00
2025	\$ 5,858,548	49.0%		
2026	\$ 5,565,087	-5.0%		
2027	\$ 5,843,341	5.0%		

b. *Repay borrowed funds over three years.*

Option 2b takes Option 2a and splits the payments up over a three-year time period to reduce the effect on year-to-year levy fluctuations. As with Options 1b, there is a commitment to three years of rectifying the lost revenue to return the City to whole.

Three Year Half Pay Back					
Levy Year	Levy Amount	Percent Change	Interest	Fund Balance	
2023	\$ 4,824,628				
2024	\$ 3,930,768	-18.5%	\$ 75,668.00	\$ 385,781.00	
2025	\$ 5,486,238	39.6%			
2026	\$ 5,751,242	4.8%			
2027	\$ 6,029,496	4.8%			
2028	\$ 6,135,508	1.8%			
2029	\$ 6,442,284	5.0%			

c. *Repay borrowed funds over five years.*

Under Option 2c, the repayment is again moved to a five-year time period. While reducing the levy fluctuations, it does require a longer commitment.

Five Year Half Pay Back					
Levy Year	Levy Amount	Percent Change	Interest	Fund Balance	
2023	\$ 4,824,628				
2024	\$ 3,930,768	-18.5%	\$ 75,668.00	\$ 385,781.00	
2025	\$ 5,411,776	37.7%			
2026	\$ 5,676,780	4.9%			
2027	\$ 5,955,034	4.9%			
2028	\$ 6,247,201	4.9%			
2029	\$ 6,553,977	4.9%			
2030	\$ 6,764,398	3.2%			
2031	\$ 7,102,618	5.0%			

3) Reduce fund balances and make budget adjustments to balance budget

Option 3 takes an approach of going after the budget for a single year but doing it through fund balance reduction and budget adjustments. This includes potentially increasing revenues and reducing expenditures to get the budget to balance with a \$3,930,768 tax levy. Unlike the first two options, this option may require affecting employees' wages/benefits.

As discussed, unbudgeted realized interest is able to increase revenues by about \$75,000. This reduces the need. I would also recommend reducing the Golf Transfer to \$0. With these two items, the need becomes \$944,914. At this point, a combination of fund balance and/or expenditure reductions is

possible. Using previously assigned funds (assigned but not committed), the City is able to account for roughly \$800,000. This reduces the need to \$144,914. When looking at expenditures, all of them are currently in the budget because I believe each of them are needed to continue moving the City forward. Each of them has their place and to cut any one of them is setting the City back at least a year from something it needs to continuing growing. The list includes:

- \$100,000 for City Hall Maintenance/Remodel
- \$150,000 for new Park Department Building Remodel
- \$130,000 for trail/sidewalk expansion (ARPA funds)
- \$40,000 for zoning code rewrite (half of the total needed)
- \$70,000 for Parks replacement equipment
- \$62,000 for new Squad car
- \$42,000 for IT equipment replacement
- \$38,000 for stump grinder
- \$25,000 for fire radios
- \$23,000 for crack sealing

With the need for each of these, recommending anyone over the other is tough.

And this is all without touching employee wages or benefits. To answer the question, the 4% COLA for General Fund employees is expected to cost the City about \$110,000. The steps for General Fund employees are expected to cost the City about \$40,000. These, along with health insurance contributions, I would absolutely recommend not touching. One, these numbers are for General Fund employees only. Would other employees paid by other funds receive increases or would they also be subject to this budget cut? In today’s world of easy movement, when other cities are giving record increases to retain and attract employees, we would likely lose employees. Potentially a lot of them. For health insurance, open enrollment has already taken place and employees have chosen whether to stay on our plan or move to a spouses health insurance based off the contributions that have been discussed. Changing contributions would not allow those employees to change their election. So I list employee costs so that you have the information, but I absolutely do not recommend proceeding with using them as cuts.

As with the other options, below is the table that should show levy changes year-to-year. As you all likely understand, the power of math means that reducing a larger number by an amount results in a lower percentage decrease than increasing a smaller number by the same amount. This is why a roughly \$1.2m reduction in a levy equals about 18% and the same increase the next year to return to normal levy (plus an assumed 5% increase) equals almost 35%. And that increase does not take into account any spending that needs to take place to make up for the lost year.

Budget Adjustments						
Levy Year	Levy Amount	Percent Change	Interest	Fund Balance	Budget Cuts/Delays	
2023	\$ 4,824,628					
2024	\$ 3,930,768	-18.5%	\$ 75,000.00	\$ 800,000.00	\$ 97,016.00	*
					\$ 144,914.00	**
2025	\$ 5,300,083	34.8%		* Golf Transfer		
2026	\$ 5,565,087	5.0%		** Remaining Balance		

As I noted, my professional opinion is that all of the costs listed above are either needed or highly recommended for New Prague as it continues to grow. They are costs that will likely need to be incurred and are unavoidable for a growing community. While they may be a cut for 2024, the cost will likely come back in the future with inflation.

Recommendation

It is at this point that I provide my recommendation for how to proceed, should the State not allow New Prague to levy as it intended since its first budget discussion began publicly in August. When I look at all of the options, I realize there are a number of things that must be considered. Things to consider include the financial impact of a decision on property owners, future growth and health of the City as an organization, the effect on current employees, and the potential financial implications for future borrowing, just to name a few. None of these items should be taken lightly because as with every decision that is made by the City, people's lives are affected. With all of that in mind, my recommendation would be to proceed with Option 1a, or Option 1b as a second choice.

Option 1a, in my mind, is likely the most difficult option on the table. It is an option that, while it would make the City finances whole in the shortest amount of time and is being recommended by the DOR based on what other communities have done in the past, is also the option that comes with the largest shock to property owners in terms of a drastic changes to the levy over a three-year time frame. That being said, it is also the option that, in my opinion, that allows New Prague to continue making advances that it very much needs as a growing exurb of the Twin Cities. And it allows this to happen while ripping the band-aid off and getting this whole ordeal behind us.

This option allows for discussions about a new police station to continue. This option allows for discussions on finishing the major street projects and looking at options for a city hall. It allows the recreation study to continue so that the City Council can respond to needs of area athletic organizations. It allows City equipment to be maintained and for staff to spend less time and resources keeping existing equipment running. It allows contingency funds to remain in place for the aquatic center and the fire pension. It allows for code rewrites to remain on schedule so that citizens and developers are be able to understand and build in a way that meets the City's needs and their own. It allows for the City to continue to push to be a leader in the far southwest area of the metro as other cities attempt to attract their own growth.

A big question would be what is the impact of this to property owners? The impact to property owners of Option 1a is less than the total change in the tax statement. The City tax burden only makes up roughly one-third of the total tax burden on residential property owners. So, while the City's levy may swing drastically, the residents will not feel the full effect of the swing. An 18% decrease on 1/3 of a tax bill equates to an average of 6% decrease on the total bill. Option 1a, which adds 65% to the total levy in 2025, would then see an average of 19% increase on the total bill, and then a 5% decrease on the total bill in 2026. This is the average but some property owners may see a different impact. Generally, commercial/industrial properties tend to carry about twice the tax burden of residential property owners so commercial/industrial property owners will see a larger swing than average while residential owners will see a small swing.

As I mentioned, I realize this recommendation does not come without pain. You will likely hear from citizens who complain about the property tax changes. Staff will hear the same complaints and likely field as many phone calls. But I believe it is the course of action that is needed to rectify the situation in front of us if the State is not willing to examine our situation and make the common sense decision to allow New Prague to levy for its intended amount.