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Memorandum

TO: City Council; Donald Gerrish, Acting City Manager
FROM: Gregory L'Heureux, Finance Director
DATE: February 3, 2017
RE: Budget Results 6-30-16 and Fund Balance Policy

Each year along with the presentation by the auditors, I provide the Council with a summary of the past years budget results and an analysis of how we stand financially. The analysis breaks things down in summary; both positives and, negatives. The second item discussed later in the memo is the fund balance policy and possible uses for amount in excess of the recommended balance.

The first thing I look at when I'm assessing the years results is looking at the Budget to Actual on pages 76-79 of the City's financial statements. Those pages highlight how revenues and expenditures compared to what was budgeted. I have prepared the following schedule which highlights the more significant of the variances and the resulted impact to unassigned fund balance.

Looking at revenues we had some significant deviations from estimated revenues. Fortunately, they were mostly all positive. Overall, the positive variances totaled \$2,979,355 for the City accounts. The following are the more significant variances:

- 1. For the second year in a row, property taxes saw a significant change in uncollectible taxes. This is reflected in the change in deferred tax revenues of \$199,000. The department did an excellent job working on delinquent tax accounts and our year-end tax collection rate improved to 99.01%, which is the highest in the past 15 years. This along with the fact the abatements were moderate for the year as compared to the overlay, the overall tax variance resulted in a positive variance of \$579,089.
2. Excise taxes have been very strong each of the past several years. The Finance Department has put together a strong team to handle fleet vehicles. This has resulted in a seamless process for multiple cars to be registered timely and efficiently. Some of these vehicles would otherwise be registered out-of-state or, in other communities. An example is a company having multi-state operations and they have the ability to register here in Maine or, possibly, in several other states. These fleets come with some measure of inconsistency and we have seen these vehicles swing hot and cold. For that reason we conservatively budget this revenue. We have gradually raised this estimated revenue as we felt more confident in the coming years' numbers. For FY17 we raised estimated

revenues by \$500,000 and \$300,000 in FY16. This past year, we had another spike in revenue from fleets, as well as an increase in residential new vehicle sales, resulting in an increase of \$861,100 and a favorable revenue variance of \$1,816,370.

3. State Revenue Sharing came in slightly better than the preliminary state estimate. We normally estimate based on the state provided number. The positive variance was \$100,328.
4. Building permits are a hard number to budget as larger development projects are somewhat inconsistent. We look at projects coming down the road and factor more of a rolling average on estimated revenues. Major swings occur for this account in good years and bad. This year, the City had one unusually large project (\$248,000) and in total had a positive variance of \$355,279.
5. The City's laddered investment strategy has had positive results even in periods of historically low rates of return. The City has seen slightly better yields from extending maturities for the longer term portions of the pool while maintaining a very safe and liquid balance to cover cash flow needs. The City had a positive variance of \$38,191 from investment earnings in the general fund.

Department expenditures variances came in very modestly with a few exceptions. Overall City expenditures were under budget by \$596,071, which equates to about 1.76%.

1. The employee benefits health insurance budget which, due to very good experience rate for the group, came in much lower than budgeted. The City's health insurance is on a calendar year so the rate for half the year is not known at time of construction of the budget. The overall health insurance budget had a positive variance to budget and in total the benefits came in \$183,208 under budget.
2. City Council had a surplus of \$19,932 due primarily from less seniors qualifying for the tax reimbursement program this past year (\$12,986 under budget). As the policy allows, this surplus was transferred to the Senior Property Tax Reserve, which you will note later in the Other Financings explanation below.
3. Public Works had a moderate winter season, along with rubbish cost declining due to a continuing increase in recycling, while it saw an increase in costs at the transfer station related to clean up for the transition to the new facility. Overall, the Public Works budget had a favorable unspent balance of \$92,325.
4. Overall Public Safety came in \$91,960 under budget, with Library \$34,444 under and Parks and Recreation \$96,748 under budget.

What are sometimes not noted, are the transactions below the expenditures. These fall into a category called Other Financing Sources and Uses. Over the course of the year, the Council will approve funding for certain transactions not part of the operating budget. Of note here are the following:

1. This past year the Council approved partial funding for the FY17 CIP budget through the use of unassigned fund balance of \$1,075,162.
2. The second item of note is the continued funding of the Clear Skies Legal Defense reserve with the Council approving \$500,000 for the funding of that lawsuit this year.
3. With the start of construction of the Municipal Services Facility, the council elected to reduce the amount bonded and separately fund other options totaling \$710,000 from the use of unassigned fund balance.
4. Another item that came out of last year's surplus discussion was the goal of lowering taxes. \$700,000 was set aside in the tax rate stabilization reserve, which will be allocated as revenues to future years' budget as tax relief.
5. Additionally, here you see the transfers to and from the reserves as a result of favorable and unfavorable budget events. Funds transferred to reserves were:
 - a. Senior Property Tax Relief Program \$12,986
 - b. Traffic Improvement Reserve \$10,000
 - c. Solid Waste Reserve \$30,000
 - d. Snow Reserve \$50,000

The attached schedule helps to better understand the changes of unassigned fund balance. Due to the very favorable variances on the revenue side this year, unassigned fund balance increased greater than we had anticipated. We have a fund balance policy in place that outlines the need for maintaining an appropriate level of unassigned fund balance. Under the policy the goal is to maintain a minimum unassigned fund balance of 9% of the City's general fund budgeted expenditures. The City's FY17 budgeted expenditures are \$82,787,929 which 9% would translate to \$7,450,914. Additionally, under the policy, when unassigned fund balance exceeds 12% (\$9,934,552), amounts in excess shall be used for capital improvements or other one-time expenditures as identified by the City Council. We feel the current fund balance policy is appropriate and are making a recommendation to Council for consideration for the following one time uses in the coming months:

1. At present the FY18 Capital Improvement Project budget is being developed. Historically the City has been able to avoid borrowing or require funding from property taxes, through the use of fund balance that exceeds the policy. For the coming year, administration is recommending somewhere around \$1.5 -1.6 million of fund balance be used to fund certain FY18 CIP budget items. Included in our preliminary numbers, is the need for an additional local contribution (not paid by grant funds) for the proposed addition at Redbank. Another large ticket item is the replacement of the Quint (a Quint is a fire service apparatus that serves the dual purpose of an engine pumper and a ladder truck). That vehicle has continually had "major" repair costs and presently has been taken out of service. The FY18 CIP has not been finalized and will be presented in more detail to Council later this spring but, we believe setting aside \$1,500,000 of fund balance for this would be appropriate.

2. Consider contributing an additional contribution to the tax rate stabilization reserve to increase the scheduled use of fund balance to lower the tax rate. At present the following amounts are funded in the present tax rate stabilization reserve:

FY17	\$500,000
FY18	\$400,000
FY19	\$300,000
FY20	\$200,000
FY21	\$100,000

We recommend contributing an additional \$500,000 such that FY18 thru FY22 would be funded as follows:

FY18	\$500,000
FY19	\$400,000
FY20	\$300,000
FY21	\$200,000
FY22	\$100,000

3. As you will note on the agenda for Monday night's council meeting, the Clear Skies Reserve needs additional funding. Consider at this time contributing an additional \$500,000 to the Clear Skies Ordinance Legal Defense Reserve. Future additional funding may also be necessary.
4. The City has participated over the past few years in the Municipal Street Light Group (MSLG) to allow municipalities the option of purchasing their street lights from CMP and retrofitting those lights with more efficient lights. This option would significantly save the City money over time. The exact cost of doing this would depend on several factors but would require a considerable investment upfront. The City has approved the investment grade audit and will be taking the results back to Council for further consideration. The financing for this would most likely be done through a lease financing over 10 years. We would ask the Council consider setting aside \$250,000 to partially finance this project. Any amounts funded initially would reduce the leasing requirement and result in savings sooner.
5. The City is bringing forth for approval a power purchase agreement later this month, which will construct a solar energy project array on the City's closed capped Highland Avenue landfill. As has been discussed, the City will have the option of purchasing this solar project any time after year six. An option, which I have proposed, is the City considering contributing to a Solar Reserve to set aside funds for a down payment for this buyout. Funding could be down over the next six years with annual contributions contingent upon available surplus.
6. There may be other smaller projects which could be added to this preliminary list.

Depending on the options the Council wishes to fund, the above recommendations would use some or all of the unassigned fund balance in excess of 12%. With the lawsuit unsettled, this should also be taken into serious consideration.

As these are only our recommendations, we would recommend Council workshop this discussion and, when necessary, take formal action by Council vote on those items the Council decides to approve.

The auditors and I would be happy to discuss these and any other issues the Council has in regards to the City's financial statements and overall financial condition.

City of South Portland
Unassigned Fund Balance Worksheet
Excludes School
6/30/2016

Unassigned Fund Balance 6/30/15

\$ 12,827,588

	<u>Budget</u>	<u>Actual</u>	<u>Surplus</u>	
Revenues (Non School):				
Property Taxes	20,680,043	21,259,132	579,089	
Excise Taxes	5,425,000	7,241,370	1,816,370	
State Revenue Sharing	1,185,000	1,285,328	100,328	
Homestead Reimbursement	485,000	484,938	(62)	
BETE Reimbursement	1,521,000	1,522,086	1,086	
Investment Income	390,000	428,191	38,191	
Code Enforcement (Building Permits)	415,000	770,279	355,279	
Fire (Rescue Billing)	837,000	875,444	38,444	
Bus Service	325,000	283,920	(41,080)	
Parks and Rec Charges	182,500	222,661	40,161	
Other	2,018,502	2,070,051	51,549	
(more detail found pages 76)	<u>33,464,045</u>	<u>36,443,400</u>		2,979,355

Expenditures (Non School)

General Government	3,051,133	2,976,064	75,069	
Citywide insurance and benefits	6,735,370	6,552,162	183,208	
Public Safety	10,699,751	10,607,791	91,960	
Public Works	4,576,965	4,484,640	92,325	
Parks & Recreation	2,511,301	2,414,553	96,748	
Other	5,823,957	5,767,196	56,761	
(more detail found pages 77& 78)	<u>33,398,477</u>	<u>32,802,406</u>		596,071

Other:

Capital Budget Appropriation FY17				(1,075,162)
Contribution to Legal Reserve (Clear Skies)				(500,000)
Contribution towards Municipal Services Facility				(710,000)
Contribution to Future Years Tax Stabilization				(700,000)
Contribution to Other Reserves				(102,986)
Other				5,718

Unassigned Balance 6/30/16

\$ 13,320,584

Unassigned as Percentage of Budgeted Expenditures FY16

16.09%