To: CITY COUNCIL MEMBERS, CITY ADMINISTRATOR, CITY CLERK

From: LEE RUNZHEIMER September 20, 2023

Subject: FINANCIAL RISK ANALYSIS OF THE PROPOSED 2024 PRELIMINARY BUDGET-URGENT

This document recognizes the many hours of staff time, especially the financial staff time, that have gone into developing the budget up to this point.

This document also incorporates by reference, my previous document titled "FINANCIAL RISK ANALYSIS OF THE PROPOSED NEW LIQUOR STORE". Those recommendations are still valid, and now even more urgent, as discussed below.

Where relevant, I will also include information from the final year-end 2022 Comprehensive Financial Report of the City of Northfield.

IMMEDIATE CONCERN--PROPERTY TAX LEVY RISKS:

The primary near-term concern is that we are heading into another double-digit tax levy increase, after benefiting from and adjusting for a $514,000 increase in LGA (Local Government Assistance) from the State of MN. Also, there will be the $291,000 benefit from ending/not renewing the Johnson Controls lease of the under-performing energy management system. This $805,000 benefit should be passed on to the taxpayers, and not absorbed by other undisclosed expense increases. This amount equals a 5 percentage point favorable impact, meaning that a stated 11.5% final levy rate increase is really a 16% increase in net budgeted expense.

To better understand EACH of the "Top 10" factors causing the projected 2024 expense increases, the Council should request of staff a more concise, dollarized spreadsheet of those reasons, that can be easily understood by the Council and the taxpayers as well.

Headcount increases of three full-time staff are included for the 2024 budget. The need for a budget analyst and systems tech are understandable. But expanded code compliance can be handled by rookie police officers issuing citations, without adding additional staff and benefits costs. During the last 10 years, the City population has increased by LESS THAN 5%, IN TOTAL! But City staff headcount has gone up from 89 to 114, a 28% increase! Can we find two other positions to cut, to avoid further increases-?

RECENT EXPENSE INCREASES:

In year 2022, vs. 2021, actual governmental expense increased 32% ($24.2 million vs.18.3 million)! Primary increases were in General Government (up 25%); Public Safety (up 59%) and Public Works (up 69%). This does not include the 9% increase in business-type activities. The Council needs to request further detail and analysis, to understand the SIGNIFICANT expense increases over the past TWO years, and make that analysis available to taxpayers.

For example, besides staff increases, what is the increase in outside consulting & professional fee expense related to the many new development-related projects? The Council needs to see the trend in consulting expense from 2021, 2022, 2023 forecast, and 2024 budget.

THE NEED FOR A PILOT PROGRAM IS URGENT!

The time has finally come to initiate a formal P.I.L.O.T. (Payment In Lieu Of Taxes) program with the two colleges. They have donated $80,000 annually to the City, which is a token amount compared to their fair share of costs incurred by the city each year to support these tax-exempt, but very profitable educational businesses, each one having SUBSTANTIAL investment portfolios. (Our largest taxpayer is Post Cereals/MOM which paid $468,000 in 2022 taxes.)

Many private colleges in the northeast and elsewhere make substantial PILOT payments to their host cities, to help fund the increasing municipal support cost structures. An amount north of $300,000 for each college, per year, would not seem unreasonable for PILOT payments to the City. This increased amount would help cover our recent LARGE expense increases for public safety and fire department services. (eg. the new $691,000 pumper truck, the police control van, the added police investigative staff, etc.).

FAILURE TO ADD INDUSTRIAL TAX BASE:

Unfortunately, the City has had only limited success in achieving our CRITICAL strategic plan goal of adding new employers, and expanding the industrial property tax base. PILOT payments will need to make up for some of that deficiency beginning in 2024. Other strategic plan initiatives have increased our cost structure AND ALSO UTILITY RATES, but have not increased our industrial/commercial tax base to pay for all our new project visions and desires. We are "putting many carts ahead of the small, tax-stressed horse".

Several valuable budget charts are the "Key Ratios-Peer Comparison" charts. Our tax rates based on total population may not seem out of line, at first sight. But we need to keep in mind that approximately 30% of our population is composed of tax-exempt college students, and residents of tax-exempt senior housing. And we do not have the industrial/commercial tax base that other cities in the peer group have, to help make up that deficit. PILOT IS URGENTLY NEEDED FOR 2024!

SECOND KEY CONCERN--RISKS OF FALLING INTO A DEBT TRAP, THAT IS NOW BEING SET:

The above issues tie directly to the second key concern with the 2023 budget. With all the special development projects being considered for the next several years, in addition to needed maintenance-type projects, the projected debt level for 2025 and the following 20 years is FAR IN EXCESS of the legal or financially responsible debt level that would be required to fund them! Our AA debt rating could be at risk, which would result in our interest rates being increased.

The City's actual debt at the end of 2022 was $27 million. Per the year-end 2022 independent audit, our city debt limit is $50 million. At the August 8, 2023 Council meeting, the Council approved an additional $17 million of new revenue bonds for the wastewater plant and system, plus other projects.

The other additional, multi-million dollar projects under consideration include: Bridge Square, riverfront, numerous bike trails, streets, Wall Road, ice arena, new liquor store, 5th & Water St., 5th & Washington St., Babcock & Sechler Parks, NCRC, new water treatment plant (25%), Wastewater projects, flood control, city hall maintenance/upgrades, Ames Mill dam removal, and other smaller projects in the CIP.

Combined with a municipal bond interest rate that has increased significantly from the low point two years ago, we are looking at a cumulative debt financing impact in excess of $100 MILLION from new project investments! Numerous consultants have produced beautiful presentations and documents, but with LITTLE or NO data re. financial justification/return on investment analysis and due diligence, and how we fund them with our already stressed commercial and residential tax base, and low growth rates. Longer-term financial projections, risk analyses, and Council due diligence have not yet been completed. This needs to be given URGENT PRIORITY before proceeding further with the 2024 budget process.

Voter approval and state legislative approval of a sales tax to help fund the projects is less than certain, and would apparently not be possible before 2026.

We need to avoid this impending DEBT TRAP, and a descent into a self-fulfilling, non-affordability quagmire. About 15 years ago, the city of Vadnais Heights MN got into such a debt trap from building a new ice arena/rec center. Fortunately, Ramsay County bailed them out, and took over the project, to avoid municipal insolvency.

PROPOSED NEW ICE ARENA:

A new arena is estimated to cost $18 million. In some respects, this arena is a business operation, not a park, and some of the comments on the new liquor store apply to the ice arena. For example, a complete financial model needs to be generated, showing the details of all projected revenue and expenses. I believe the current arena runs an annual deficit in excess of $400,000 per year. It is fully depreciated and debt free, so a NEW facility will incur an even larger deficit, when depreciation and interest expense at current municipal bond rates are included. Maintenance would likely be less, but utilities and depreciation would be more.

On a slide presented at the September 5th Council budget work session, it shows the $250,000 per year lease of space to ISD#659 as an offset to the initial bonding, described as “pay as you go funding”. But this actually should be considered annual revenue, to cover arena utilities, operating expense and bond interest, lowering the annual arena deficit. The ISD is NOT paying in advance, so the City would still need to borrow the full construction amount in advance.

Running a complete arena financial model, for a 20-year time frame, would likely show that financial viability is a significant risk, due to low utilization and low revenue. Without the previous support from St. Olaf College teams, there are only about 300 active skaters from Northfield and the ISD. This works out to about $60,000 of investment PER SKATER, to provide an $18 million arena! This is also a low growth student market, and family expense to support each active hockey player has become substantial.

The only solution may be to partner in a shared arena with Faribault, Farmington or Lakeville, to reach a regional minimum economy of scale, and higher utilization rates, to cover the high fixed annual overhead cost of a new arena. The mayor suggested this approach at the end of the September 5 work session.

Quoting from the NF News arena article of June 28, 2023: “In order to pay off the 20-year bonds, the city would have to hike taxes on its residents by more than $1 million annually, representing a 7.7% levy increase. That figure could be even higher if not for the $250,000 in annual lease revenue from Northfield Public Schools."

(Comparatively speaking, $18 million would fund 72 new affordable housing units at $250,000 each.)

OTHER ISSUES TO CONSIDER:

As Councilor Holmes pointed out at the end of the September 5 work session, the City also needs to remember that the city taxpayers also need to fund the school district, which has completed significant upgrades to the pre-school, elementary and middle school facilities, but still needs to do the same for the high school. This will likely be a 2024 voter referendum item. The high quality of our school district is a critical growth driver for our residential tax base.

RECOMMENDATION TO THE COUNCIL:

With all of the above unresolved issues and financial risks involved, it is recommended that the Council implement an immediate two-month hold on all consultant and promotional activities involved in the numerous development projects that are in process. Focus the next month on completing all analyses of the financial justification, debt service increase, residential & commercial property tax increase, and utility cost increases ASAP.

Then prioritize the "must do" list, from the "nice to do" list, and reduce the list to what fits the taxpayer ability to fund, and which limits the projected total city debt increase to a $50 million maximum.

This will demonstrate that only about a fourth of the remaining total projects list will be affordable by the taxpayers, at reasonable commercial and residential tax levy rates.

If the new water treatment plant (25%), street repair, city hall projects, and other required maintenance are higher priorities, there will likely be NO funds left for a new liquor store, new ice arena, 5th & Washington, Bridge Square, Ames Mill dam or Wall Road projects.

Shelving a number of these development projects as not being financially viable, will allow us to eliminate from the 2024 budget the premature and wasted consulting/professional fee expense.

That appears to be the brutal reality for levy, utilities rate and debt increases, until we FIRST expand the industrial tax base, and promptly begin negotiations to implement the college PILOT program for 2024.

Respectfully submitted,

Lee Runzheimer   lrunzheimer@msn.com

1308 Prairie St., Northfield