April 17, 2018s

A Special Budget Work Session of the Danville City Council convened on April 17, 2018 at 5:32 p.m. in the Conference Room located on the Fourth Floor of the Municipal Building. Council Members present were: James B. Buckner, L. G. "Larry" Campbell Jr., Mayor John B. Gilstrap, Vice Mayor Alonzo L. Jones, Dr. Gary P. Miller, Sherman M. Saunders, Fred O. Shanks, III J. Lee Vogler, Jr., and Madison J.R. Whittle (9). *Rev. Campbell entered the meeting at 5:38 p.m.*

Staff Members present were: City Manager Ken Larking, Deputy City Manager Earl B. Reynolds, City Attorney W. Clarke Whitfield Jr., and City Clerk Susan M. DeMasi.

Mayor Gilstrap presided.

<u>WORK SESSION ITEMS</u>

<u>PRESENTATION BY NATIONAL RESOURCE NETWORK</u>

City Manager Ken Larking noted David Eichenthal from the National Resource Network will be doing the presentation by conference call and will be discussing the presentation off the power point *City of Danville Multi-Year Financial Planning, April 17, 2018 City Council Meeting.* Mr. Larking noted everything being presented tonight is based on information that was provided by the staff; the Finance Department, Michael Adkins, made sure the information they received was accurate. Cynthia Thomasson and others have reviewed the information, it has been fully vetted and staff is highly confident in the projections that will be presented.

David Eichenthal noted this presentation is a follow up to the joint meeting with the School Board several weeks ago. One of the things they were asked about was the interplay between the Multi-Year Financial Plan and the process the City is going through with Fiscal Year 2019 Proposed Budget.

Mr. Eichenthal explained they have started and have now largely completed the part of the work around the multi-year plan for the diagnosis/prognosis component of the work. It is the beginning, to figure out what the baseline looks like for the City of Danville over a five year period of time in terms of revenues and expenditures. What would happen if the City budget went on automatic pilot, making reasonable assumptions about growth rates, in terms of revenue and expenditures, based on historic performance, what they know going forward over the next five years, what happens to the City's budget. Typically, spending is growing at a faster rate than expenditures, and you wind up in a situation of a structural deficit. In determining their baseline approach to the five years, they essentially took the City Manager's Proposed Budget for FY2019 as a starting point. Assuming that it were to go forward as proposed, the baseline budget incorporates a number of key components that affect spending and revenues, including the increase in the meals tax rate from 6% to 7%, the reduction in annual capital spending by about $1.1M and the changes that have been discussed related to public safety retirement benefits. They also noted the proposed new riverfront park, understanding that does not have a direct 2019 impact on the City's General Fund because of other sources from a legal settlement and the hope to raise some of that money privately.

Using the 2019 proposed budget as a starting point and looking back over the last couple of years, the development of the structural deficit that was discussed at the last presentation is seen. In 2014, 2015 and 2016, Danville actually closed each of those years with surplus ranging from a little under a million to a little over $5M. If the proposed 2019 budget were adopted, it would be the third year in a row that Danville was dipping into fund balance and actually running a deficit.

Basically, the decisions around capital spending and operating spending over a three year period of time would essentially take $15M from fund balance in a three year period.

There are some uses of fund balance that are more appropriate than others, spending one time revenues or making a one time expenditure of non-recurring revenue for non-recurring activities. Capital spending can be seen that way and in both 2017 and 2018, the City has used its Unrestricted General Fund balance mostly for the support of capital and also for economic development and blight removal initiatives. Those initiatives actually speak to the important part to the approach of looking at the City's finances over a five year period of time.

Mr. Eichenthal discussed how this structural deficit emerged noting Danville has gone through a period of time with relatively slow growth in tax revenues, particularly property tax revenue. At the same time, the cost of the existing base of employees has been growing, and they are projected to grow going forward over a five year period of time because of the decision to grow at about 2% per year for pay for performance. That affects other expenditures like retirement contributions and FICA, and there is expected to be growth in both health insurance and retirement funds in the 2019 budget over the course of the five year plan.

In response to Mayor Gilstrap, Mr. Eichenthal explained growth in the property tax is projected, based on recent history of .35% per year for the full five year period. If a significant source of revenue is growing rather slowly and the biggest part of expenditures which are related to personnel costs are growing at 2%, which seems fairly modest in terms of the wage component, it is about six times of the rate of growth of one of the City's principal tax sources. That is the very definition of how a city or any local government gets into a structural deficit problem. If the City just tries to cut their way out of the problem, it risks an imbalance of what was discussed last time; there will be a balanced budget but nobody actually lives in a city or opens a business in a city just because they have a balanced budget. Ultimately, what they hope they are going to be able to help Danville with in the five year plan, is how to keep out of the deep end in terms of fiscal challenges while still making strategic decisions to grow the economy, so over the long run the tax base grows at a faster rate and the City can afford more. The short play is making sure that the City is not driving its deficit to the point where it runs out of money.

Mr. Eichenthal explained they took the baseline budget that is built off the 2019 proposed budget, taking reasonable assumptions and the baseline, where does that get Danville. By 2023 Danville will have reduced their Fund Balance to just under $1M; the three years of consecutive deficit would continue in FY2020 – 2023 as well, which is essentially how the City winds up with next to no fund balance by 2023. It goes from about a $3.7M deficit in 2019 up to a high of about $6.5M in 2022. It goes down a little bit in 2023 largely because part of the baseline assumption limits the amount of debt the City would undertake; as a result of retirement of debt, the number goes down a little bit. Danville adopted a policy that Unassigned Fund Balances should be no less than 20% of operating revenues. That is a policy independent rating agencies, like the GFOA, look at with considerable approval and makes its less costly for the City to borrow. The chart shows that as the fund balance goes down, the City goes from being within that policy, being at about 23.3% for FY19 to dropping below the policy immediately next year. As the fund balance goes away, the City is far out of compliance with policy, which has real ramifications particularly to the extent that Danville does want to tap into debt as a way to fund some of the capital coming forward.

Mr. Eichenthal noted there are a handful of decisions they discussed with the City staff and others that are on the table in terms of the 2019 budget. The model helps elected and administrative leadership see the ramifications of those choices over a period of time. When Danville gets the final model in the final plan, part of the value of it is, it is like a light switch. There are different initiatives and different assumptions that can be looked at and very quickly see what happens just on a basis of that change and assumptions. They have been through the assumptions with the City staff, and with their team, they are consistent with their approach in multi-year planning and they are appropriately conservative for the development of the baseline projection.

Mr. Eichenthal stated they understand that there are alternatives that are under discussion, and looking at a slide titled Alternative Scenario A, which would be proceeding with the retirement changes and in this case a multiplier of 2.4 instead of the 2.2 in the baseline, and no increase in the prepared meals tax rate. Basically increased retirement benefits but no commensurate increase in revenue, but everything else in the proposed budget remaining the same. If the City is increasing costs without increasing revenue to offset it, it increases the cumulative deficit to $36.1M over the course of the five years.

Scenario B notes everything in the baseline, but the City freezes wages over a period of time. If the City pushes down the cost curve at the same time they allow for an increase in revenue from the meals tax, the cumulative deficit goes down, and by 2023 the City still has $12M in the bank. With a wage freeze, Mr. Eichenthal stated Danville will have a fund balance by 2023, but would be out of compliance with financial policies.

Scenario C looks at what happens if Danville grew wage growth at only 1% and didn't change any of the retirement benefits. Even that 1% wage growth that is built in on annual basis doesn't fully offset not going forward with the retirement changes. There is a cumulative deficit of $20.9M with $7.3M in fund balance.

Scenario D has the retirement changes and no meals tax increase, and would result in a negative general fund balance of $5.4M in 2023 and a cumulative deficit of $33.6M.

Scenario E is the baseline without any of the proposed FY19 changes; Danville runs a negative fund balance by 2023 of $6.4M and has cumulative deficits of $34.6M.

Mr. Eichenthal explained they are talking about a handful of decision points that are part of the FY2019 budget, and depending on how those decisions points play out, if Danville continues down that path over a five year period of time, they are looking at a cumulative deficit that could range over five years from $11.6M to as high was $41.9M. The main thing is, the decisions Council is making related to these four or five different issues in the context of the FY19 budget have an obvious impact. Part of the problem is that Danville had this structural gap over the last few years to begin with, are starting in a bit of a hole and to the extent they take action on revenue and expenditure side, the City is not starting from zero; it is cumulative in that respect. It is obviously a lot easier to close a cumulative deficit over five years of $12M than it is to close a gap of close to $42M. The baseline scenario doesn't make any additional investments in things like the School's budget and other types of investments.

Mr. Eichenthal noted there are specific things they are looking at in Danville, and they are at a point where they want to spend the next month to month and half in great detail with the department heads to share some of the specific things they are thinking about and have them vet them. They want to hear if the department heads have specific concerns they have operationally that NRN hasn't considered, begin to cost them, and really understand what the specific fiscal impact is. It is going to take time, effort, and hard work on the part of the City's administrators to get these done. In the short term, they are going to come back with recommendations or a series of strategies to close that structural gap that are reliant on limiting spending to what local government can afford. That will include things like service reductions, potential recommendations around staffing, what Danville spends its budget on and what they have seen elsewhere. There are opportunities to see whether there are things that City employees do that can be done more efficiently and sometimes better by the private sector as opposed to just looking at outsourcing certain things. Shared Services and consolidations are areas they are looking at to see if there are areas within the City government itself where there is overlap or duplication in terms of activities and consolidation with increased efficiency, to exponentially reduce some of the costs and some of the head count for doing this. Mr. Eichenthal noted they are looking at whether there are opportunities for an increase in revenue, but doing it in a context of overall economic competitiveness. Mr. Eichenthal noted in the long term, it is hard to see how Danville cuts its way out of the gap over the next five years. If it were to extend this over a ten year period of time, a lot of the investments that the City has made and proposes to continue to make in things around community development and economic development are part of the long term strategy to build the tax base.

Dr. Miller stated the School Board proposal this year is for them to retain a $2M excess they have to give an across the board raise to all teachers. There is no such money next year, has that been factored in on how much more money the City is going to have to give the school board, year by year. Mr. Eichenthal noted for the purposes of the baseline proposals, it adopts the proposed budget for 2019 and keeps it flat over the next five years. What Danville is required to do under state law is even more limited than what it is doing right now. There are all sorts of additional and new needs that have been identified that they are going through that they are going to offer up as initiatives that may cost additional money over time as well.

Dr. Miller questioned civilianization, and Mr. Larking explained that is taking a sworn position and making it a civilian position. Mr. Eichenthal noted it is a common thing they will look at in the police and fire departments, because there are things that they have seen in other police and fire departments that have been successful at in terms of shifting responsibilities away from sworn personnel to civilian personnel. Dr. Miller questioned span of control and Mr. Larking explained span of control changes the way the organization is structured to put more focus on provision of services rather than supervision of services.

Mr. Larking noted looking at the five year projection, there is an order of magnitude that isn't going to be solved by coming up with minor fixes around the edges. They are going to be looking at significant changes to service levels and significant changes to the way the City does things which will require a certain amount of time to implement and see the benefit of that cost reduction. With regard to the initiatives to save money going forward through this process, it may not have immediate savings to this upcoming budget but it will have a long term savings to the five year projection; it will take time to implement it. If Council is looking at reducing the cost of the General Fund in any significant way, it will require a reduction in services and reduction of personnel. Because Danville is in a situation where it has a decent fund balance and are not in the fifth year of a situation where they are out of money, they can go into that through attrition or some other manner.

Mr. Shanks noted if the City raises the meals tax this year they still have a tremendous structural problem next year. To do the meals tax and try not to do the right thing for public safety, those are hard issues, issues that need to be undertaken. In the end they may end up doing the meals tax, but Mr. Shanks noted he can't see going to the public every time the City has a structural problem and asking them to carry it through. Council needs structural ideas this year to help it before they decide on any other new ones.

In response to Mayor Gilstrap, Mr. Larking noted the proposed budget was balanced and there is a way to deal with the areas staff missed to make it balance. There is a balanced budget that can be achieved and meet the legal requirements by the dates that are set. Council can implement some initiatives this year to help, likely they are going to be doing the majority in the next year.

Mr. Vogler noted his agreement with Mr. Shanks, the frustrating part is that Council is being asked to present a balanced budget before the end of this month. They don't have that information in front of them now and are being asked to make some pretty big decisions just to get to a balanced budget that they then may entirely undo some of it or decide to make drastic changes to. That desire for sooner rather than later is because of the big decisions in front of Council this year in terms of the budget.

Mr. Saunders noted watching the presentation gives a whole new perspective on what the City Manager was saying; if the City continues to spend $6M a year for five years it is going to be broke. With regards to the future, the first thing that comes to mind is a flat budget for the next five years, nothing new. Maybe some cuts, personnel costs and in his view not continue to raise fees and taxes if the City isn't growing. His concern is, looking at that five year projection, how to still invest in the City so after the five years there are going to have more revenues to improve the City. Mr. Larking noted that was a good point and that is why they are doing this exercise; it sounds like a lot of doom and gloom, the reality is that most cities that try to tackle an issue like this wait until they are out of money to do it. Danville is not in that situation, they are trying to prevent that. They are going to make decisions now so that not only can they continue to provide government services that people expect, but can also make key investments that will lead ideally to a growing tax base so that they don't have to continue to worry about cutting or raising taxes in order to just provide government services. The reason why they invest in things like economic development, parks and recreation and quality of life initiatives is to make Danville a desirable place to live. It is the three focus areas that Council came up with, to reduce crime, improve education and grow the City. All of them are intertwined, they all relate to each other and they have to work on all three to make people want to live in Danville. In Danville's situation they are not a suburb of a metro area that is growing exponentially and Danville benefitting from all that growth. Danville is an isolated, former industrial city that has to build its own momentum for growth. The history has been that Danville has been growing its tax base at less than 1% and expenditures are at 3%, it is not sustainable. It could never be sustainable unless services are cut or raise taxes; those are the two choices, there is no other choice beyond that. Mr. Larking stated his belief is that if they want to be a successful city in the future, they have to continue investing in the city to make it an attractive place to live so that there can be growth, a sustainable revenue source and a growing tax base.

Mr. Saunders questioned with regard to Danville, based on this five year projection, what will this do to the bond rating. Mr. Larking noted if the city violates its fund balance policy in year two, it will be detrimental to the bond rating and the cost of borrowing will go up. Mr. Eichenthal noted to remember, this is the baseline, this is basically a sort of diagnosis; the diagnosis is based on doing nothing. Council has done very tough things fiscally and have been prudent fiscally in prior years. Other cities face some of the same economic challenges that Danville has faced and continue to face, have not been. But part of the reason they have brought so much in terms of federal support for the network and the Arnold Foundation support for the Network to Danville is because what they have identified is the desire to turn this around. Rating agencies look at multiyear financial planning and even forecasting like this as a credit positive as long as there is a continued willingness to act upon it. By supporting this sort of effort and by the willingness to make tough choices, Danville stands out as a place where there is great promise going forward.

Vice Mayor Jones questioned if the City Manager could have something for Council for this year's budget, some suggestions on how to close the gap to help with the five year plan. Mr. Eichenthal noted they are trying to do that, trying to figure out if there are specific things where they could move ahead at looking at fiscal impacts more quickly. If Council is asking is it possible between now and May 1st, he thinks that would be very hard. If they are asking is it possible between now and mid or late June, he thinks that is very doable.

Mr. Vogler noted they see the growth in the River District, the symbols of growth and prosperity, but looking at the stats, the revenues are not keeping up with that level of enthusiasm in the growth. He is not suggesting the City stop what they have been doing but it might be time they temper their enthusiasm a little and be a little bit more realistic about where the City actually is right now and where it is going. Mr. Larking noted staff hasn't really measured that either, it could be that some of these efforts have kept the City flat instead of negative; there could be metrics that would support the efforts. There have been some, the $30M public investment in the River District with $130M in private investment, that is actual tax base. If the City didn't have $130M in new tax base in the River District, they would actually be going down in tax base. Mr. Vogler noted just raising taxes alone is not going to solve the problem, the City is going to have to cut back on spending and Mr. Larking stated that was correct.

Dr. Miller noted the public is more concerned about the crime problem than economic development, and number two is schools. The City has to do things that retain and recruit police and teachers and doesn't think Council can drop the incentives for teachers and police officers. Council's priority is fixing the crime and fixing the schools. Mr. Shanks noted Council needs to address recurring expenses and should take a pause on excessive economic development funds, and excessive spending of blight funds. It has done a lot of good but there is an opportunity for a pause in the funding and let the market catch up with what the City has spent. That should be part of the equation when Council gets recommendations from the consultant.

Mayor Gilstrap stated it is not all doom and gloom, there are some bright spots in the City and four times the amount of money the City invested in the River District is a bright spot; it is true the City hasn't seen return on all of its investments. It still has time to get that return in and he is still hopeful that is going to pay off big dividends for the City; they have to have more than 1% growth. Mayor Gilstrap noted he didn't think the City is going to reset by cutting back, the City has a budget problem and there may be areas Council may need to look at. It may be services that can be reduced and it might be things that it can contract out and save money.

Mr. Larking noted he appreciated all the department heads being here to listen, he asked that they all be here so everyone hears the same information.

Council Members thanked Mr. Eichenthal for his presentation.

MEETING ADJOURNED AT 6:44 P.M.

MAYOR

CITY CLERK