MEMORANDUM OF THE FINANCIAL STRATEGY RESOURCE TEAM'S RECOMMENDATIONS
AUGUST 20, 2006

This memorandum is the initial draft of the Financial Strategy Resource Team's (the "Committee") recommendations.

<u>BACKGROUND –</u>

The City of Kent (the "City") expects to incur a structural deficit of $1.5 million in FY 2006. The structural deficit is projected to be over $2.0 million in FY 2007. The City has cash reserves of approximately $8.0 million as of the date of this report. At the current deficit spending rate, the City will deplete its cash reserves by 2009. There are no foreseen circumstances or events that will alleviate the structural deficit.

The deficit is caused by an increase in labor and benefits costs for the City, an increase in households and a decrease in the City's non-City employed workforce. Any operation, including the City, which is labor intensive, has faced employee health care costs rising at three to four times the general rate of inflation. Labor constitutes 52.9% of the City's non-capital budgeted expenditures, up from 49.8% as recently as 2003. The number of households in the City has increased from 8,800 in 1990 to 10,100 in 2005, a 15% increase and thus significantly increased the need for City services. While during the same period employment in the City has declined by 15%, decreasing the City's ability to pay for the services. The City's demographics continue to look more like a Cleveland suburb. This trend forecloses the possibility of growing out of the fiscal problem in the short-term. Thus, the City must increase recurring revenues from the current base of workers, residents and properties and decrease costs to balance the City's budget.

The residents and businesses of the City demand the current level of services as evidenced by the City Council Resource Preferences poll. Any significant decrease in services could hamper economic development and depress property values. The City provided the Committee with certain service cost data and benchmarks with comparable cities. Based on this information, the services are provided at a reasonable cost. If the current level of services are to continue and given the fact that the services are being provided in a cost effective manner based on comparable city data, the only solution to the deficit is to increase revenues. Otherwise services would need to be reduced counter to the desire of the City's citizens.

Economic development and sustainable wage growth is the only panacea for maintaining a high level of services without constantly increasing the tax burden on the workforce and the citizens of the City. Constantly increasing taxes or decreasing services will only stunt the City's ability to sustain economic development. The primary goal of economic development should be to add high paying jobs without adding substantial operating costs. The City must make sustainable economic development its number one priority. The Committee believes that there is no cohesive strategic economic development plan.

REVENUES AND COSTS –

Increasing the City's revenues is the primary method recommended to reduce or eliminate the structural deficit. The Committee believes that the cost of the revenue increase needs to be borne by all of the City's constituents, although not evenly, including residents, workers and end-users of services. The Committee believes the residents should bear a greater share of the burden because the residents are the primary beneficiaries of the City's services. In addition, any substantial increase on the burden to the workforce and end-users would hamper economic development. The following is a table of the Committee's recommended revenue changes and the estimated annual revenue impact. In the table we present two alternatives for the credit for taxes paid and the tax rate. Our intent is that the City Council should choose a combination of those two items. No matter what combination is chosen, the total revenue should be in the range shown:

Source of Funds	Alternative 1	Alternative 2	Revenue Impact	Alternative Impact
Credit for taxes paid	1.5%	1.80%	$1,000,000	$400,000
Tax rate	2.1%	2.20%	680,000	1,360,000
Property taxes	Increase 1 mil		320,000	320,000
License fee	Increase by $5.00		125,000	125,000
Fully-cost enterprise activities			200,000	200,000
Other fees			200,000	200,000
Total increase in revenues			$2,525,000	$2,605,000

The benefit of reducing the credit is that it does not hinder economic development by increasing the tax rate of new employer's workers and sends a strong message to potential employers that the CITIZENS of Kent are behind the economic development initiatives. The benefit of increasing the tax rate is that it more evenly spreads out the burden of the increased revenues.

City revenue per capita would increase to $815 from $732. This amount is still less than the median for our local peer communities. The City's cost burden per capita including school taxes would increase to $3,304 from $3,221. This amount would put the City effectively equal to Aurora, significantly lower than Hudson and slightly less than Stow.

The effective local tax rate (including the increase in the tax rate, decrease in the tax credit and increase in service fees) would increase by 11.9%. This local effective tax rate increase is less than the 21% reduction in the state income tax rate that gradually goes into effect this year and is fully implemented by 2009. The State of Ohio has funded the decreased state tax rate by shifting costs to local governments in the form of unfunded mandates and reduced intergovernmental transfers from the state to local governments. Thus, it only makes sense to transfer some portion of the costs to the local taxpayer.

Although the Committee has certain cost cutting ideas outlined below, we do not have the knowledge to make detailed cost cutting recommendations. The Committee recommends that the City's administration identify and implement $200,000 to $300,000 of cost savings without affecting primary service levels.

The increase in available funds from the revenues and cost savings totals approximately $2.7 million. The Committee recommends that $1.6 million of the increase in available funds be allocated to the annual operating budget. The remaining $1.1 million should be used for tangible economic development.

SUNSET PROVISION –

Higher tax revenues should be realized in the future if the City's economic development potential is properly implemented and is as great as the Committee and the community believes. The Committee believes that seven years is an adequate time period for the citizens to properly evaluate the tax scheme and the results of the economic development experiment. Therefore, the Committee recommends that the income tax increase and the reduction in the tax credit have a sunset provision of seven years.

COST SAVINGS IDEAS –

The Committee does not have the detailed knowledge to recommend specific cost savings. Through our observations, presentations by City administrators, reading and discussion with the community, we believe there are several concepts that should be evaluated. Those concepts include:

- Combination of positions through attrition, technology and redesign of tasks
- Redirect administrative positions to frontline positions (a priority of the City Council)

- Share services with other cities
- Reduce labor requirements through effective use of technology
- Reevaluate the City's current short-term financing strategy given the flat yield curve. Note that the current financial situation may make long term financing more expensive due to the higher risk.

ECONOMIC DEVELOPMENT –

The Committee believes that economic development and job growth are the keys to a stable revenue source and sustainable services for the City. To the best of the Committee's knowledge, these recommendations, if implemented, are the first source of substantial operating funds for economic development. The City Manager must devote substantially more time to economic development than is currently being devoted and the City Council must allow the City Manager the authority to implement policy. City Council should set policy and approve significant investments. The City Manager must develop a detailed strategic economic development plan and timetable, approved by City Council for presentation to the citizens in conjunction with the request for the tax increase. The economic development plan should, at a minimum, address:

- Creation and funding of a non-profit development corporation that includes the City, Kent State University, the Downtown Development Corp., the Chamber of Commerce and other community interest groups. Consider funding full-time planning and implementation staff such as modeled by Campus Partners in Columbus, Ohio or the Main Street Ohio Program.
- Foreclosing on the old hotel and razing the hotel to make the property ready for development. This is not only an economic advantage to the City, but also a symbol of a new era of economic development.
- Increasing code enforcement to reduce the impact of boarding houses on single-family houses and lifestyles.
- Creating a destination event in the mode of the Shaw Festival in Niagara-on-the-Lake or the Shakespeare Festival in Ashland, Oregon. The event should

take advantage of the local resources such as Blossom, Kent Stage, the University, the Porthouse Theater, the Stump Theater and the Wright-Curtis Theater.

- Direct subsidy of an incubator.
- Tax abatements.
- Infrastructure improvements.
- Economic development funds or debt funds for land bank acquisitions.
- Downtown renovation funds.
- Marketing the benefits of doing business in the City and the City as a destination venue.
- The development of a conference center, hotel and the retail project in partnership with the University. The City should use its power of eminent domain when appropriate.

OTHER –

Several other items came to the attention of the Committee during the course of its study, including:

- The City should consider spending more funds for tax collections.
- Perform a complete and realistic evaluation of what properties are truly needed by the City. Any surplus properties should be sold.
- Proper control over permit issuance may need to be implemented.
- The City needs to take a position in future collective bargaining negotiations to ensure that total personnel costs do not grow faster than the City's tax revenue base.
- Consider implementation of street light violation and school zone speeding cameras.