

CITY OF KENT, OHIO
2018 RECOMMENDED BUDGET

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City Manager's Budget Message

2018 Proposed Operating Budget

November 8, 2017



To: Honorable Mayor and Members of City Council

The City Charter [Section 42. e] requires the development of an annual budget that provides a financial plan for all City funds and activities for the ensuing fiscal year, and I am pleased to fulfill that obligation with the submission of this draft 2018 Proposed Operating Budget for City Council's consideration.

Overview

The 2018 proposed City budget contains the budgetary line items that the staff recommends for sustaining the levels of services for our community in 2018. We submit this budget believing that it represents the best balance between what we can afford and what Kent residents and businesses expect from their City government.

In asking for your approval of the budget, we are seeking confirmation that the funding decisions contained in this budget are aligned with the goals and priorities of City Council and the Kent community.

The budget that you adopt will set the stage for what we are capable of achieving in 2018, as it governs the pace of progress towards our strategic priorities through the resource allocation decisions contained within it.

Across a range of economic indicators – including unemployment, private investment, new jobs, University spending, manufacturing production, corporate profit and retail sales – the Kent economy has demonstrated improved resiliency coming out of the recession.

However, as the pace of expansion has slowed so has City revenue growth, settling in at a 1-2% growth rate. With inflation hovering around 2-3%, we are anxious to find ways to reignite economic growth and keep pace, and preferably exceed inflation in the years to come.

Consequently, the 2018 budget remains tight but the combination of a little revenue growth and the cumulative impact of more than a decade of aggressive expense management, we have continued to make progress in chipping away at the gap between our resource availability and resource needs. We're still not where we'd like to be financially – but we're closer to where we need to be to sustain, improve, and in a few strategic areas expand City service capabilities in 2018.

The proposed 2018 Operating Budget not only fully funds our core City services, it continues the sidewalk snow clearing pilot program, and it recommends a number of position changes that we believe are important to meet longstanding staffing needs.

Last year, for the first time in more than a decade, Council authorized \$300,000 to go towards hiring 3 new firefighters and the City's first Information Technology Manager.

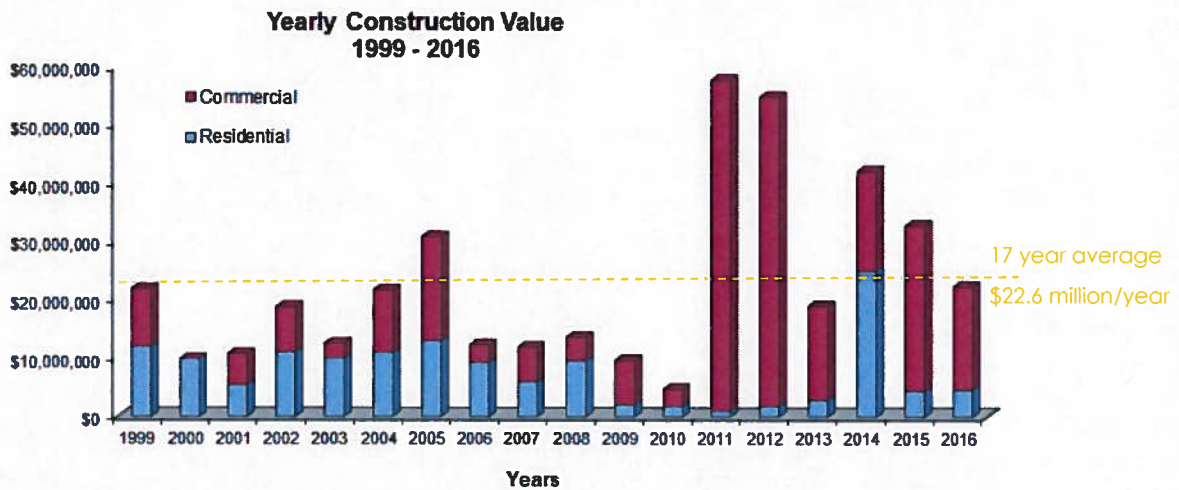
In 2018, we're asking Council's consideration for a smaller allocation (\$145,000) that would go towards more personnel changes that had previously been deferred but are considered critical to the success of City services.

Local Economic Conditions

The proposed 2018 budget reflects the strengths and weaknesses of the City's economy. The construction rebound that peaked in 2011 continued to show a gradual decline heading into 2016.

In the 11 years prior to the downtown redevelopment (1999 thru 2010) commercial construction investment in Kent averaged \$6.5 million a year. Coinciding with the downtown redevelopment in 2011 and 2012 commercial investment jumped to an average of \$55 million/year (an increase of 745%).

In 2016 commercial construction declined but coming in at \$17 million it was still more than double the pre-redevelopment pace -- and as illustrated in the chart below the combined investment in 2016 reached the 6th highest level in the last 20 years.



In 2016, Kent State University marked the 10th straight year of enrollment growth, adding 125 students to the previous hundred year enrollment record set in 2015. In 2016 Kent State University surpassed the highest retention rate in the history of the University at 82.2%. The Kent campus also welcomed the largest freshman class in its history – 4,335 new students.

In 2016, Kent State University continued an aggressive capital re-investment program with major renovations underway at Rockwell Hall, Lake and Olson Halls, MAC Center, Cunningham Hall, Smith All, Williams Hall and the Integrated Science Building. These investments have transformed the campus and the campus community connection, generating significant construction related jobs and tax revenues.

Elsewhere in Kent the construction values remained above the 10 year average. Single family residential construction continued to show signs of recovery with the new phases of single family homes selling well at the Lakes of Franklin Mills, the senior housing at Maplebrook II fully leased up, and new apartment occupancies overall averaging greater than 95% full.

Kent's older shopping plazas continued to generate new investment and show signs of recovery as vacant spaces were quickly filled with new tenants keeping Kent's retail vacancy rate one of the lowest in the region at 5%.

In late 2016 and early 2017, three historic Kent properties – the former County Courthouse building, the L.N. Gross building, and the downtown train depot – were all undergoing major reinvestment and restoration.

On Main Street, the Kent natural food co-op property began an expansion project, the former optometrist building was sold for conversion to a new bar/restaurant, and a new restaurant was announced for the former tattoo parlor at the corner of Water Street.

University Hospital also began a major investment project at the medical campus at Devon Place in Kent, adding 24 hour emergency and critical care services.

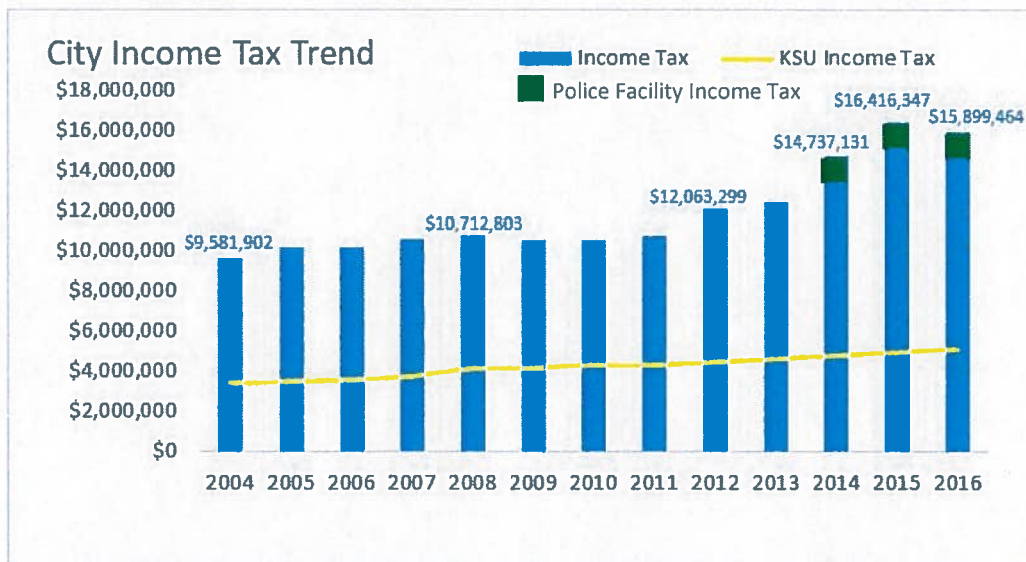
In 2016, the City and Kent State University completed Phase 1 of the \$18 million Summit Street Transportation Project. City planning and right of way work continued on the \$3 million SR 43 Signal Upgrade project and construction began on the new \$12 million City Police building with a projected completion date of November 2017.

Preliminary space planning and early design work also began on the new City Administrative building with bids for an architectural firm issued late in 2017.

As a result of aggressive grant efforts, the City was able to continue to reinvest in City bridges, streets and sidewalks at near record levels in 2016, allocating an extra \$1 million towards street repairs for the reconstruction of Woodward, Rockwell and Whittier Streets.

City Financial Profile

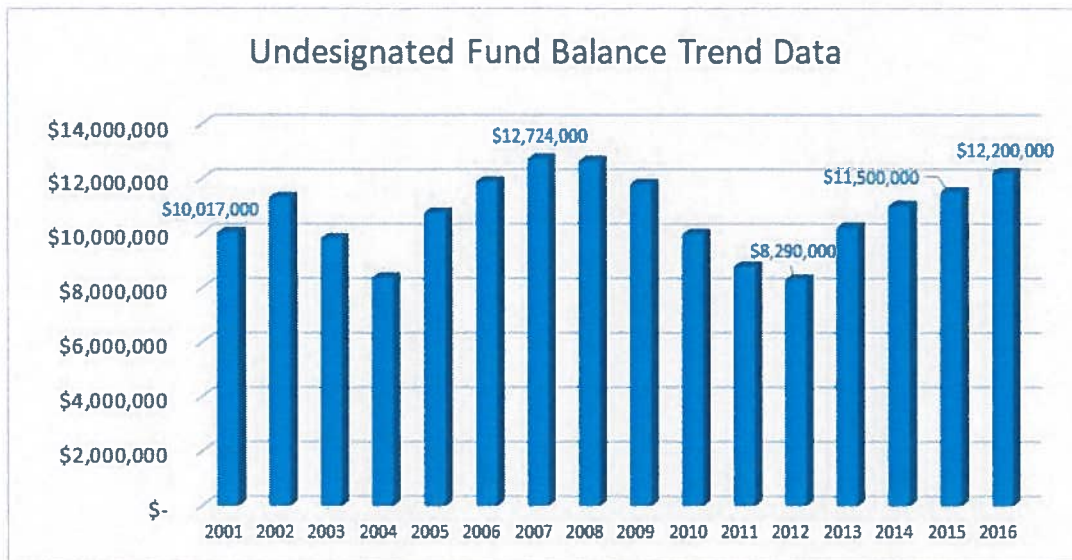
For year-end 2016, overall City income tax collections were down 3.15% percent (\$516,883) from 2015, while Kent State University's collections in 2016 were up 2.8 percent (\$139,559). The drop in private sector income taxes between 2015 and 2016 does not appear to be a trend but rather reflects a one-time business profit contribution that occurred in 2015, producing a bonus tax payment of \$739,957 in 2015 that was not repeated (and was not expected to be repeated) in 2016.



The City's financial condition is still heavily influenced by the University but private sector expansion is driving the majority of the City's income tax growth. In the last 12 years the total income taxes (excluding the Police Building taxes) increased by 47% -- with private sector increases responsible for 66% of that increase.

Kent State University remains the City's largest employer, but private sector job growth has resulted in Kent State University's income tax contributions dropping from a high of 40% in 2010 to 31.8% of total income tax revenues in 2016.

As the revenue vs. expense balance returned to a positive position, the City has been able to slowly replenish undesignated reserve balances to near pre-recessionary highs.



Income taxes from new construction are still likely to provide a slight revenue lift as construction will be underway on a number of University, City, and private developer projects in 2018 that should generate contractor income taxes.

The proposed 2018 does not build any temporary construction income gains into the base budget so it is reasonable to assume that income tax revenues may exceed the budget projections for 2018 – providing a small buffer for unanticipated needs or unfunded mandates. However, with construction values slowly declining from their record highs, this buffer is thinning as well.

Despite many favorable economic indicators, a few financial cautions remain.

Income taxes are the single most important factor to the City's financial well being and there appears to be a softening in income tax growth – to the point where the rate of growth in income taxes may fall below the rate of inflation for the first time in 7 years. That's a potential point of concern that must be monitored closely.

The City's Utility rate plans have significantly helped relieve the financial burden carried by the General Fund to bail them out but the General Fund remains somewhat at risk to projected deficits in the stormwater fund.

In 2016 Council authorized an increase of \$2/month in stormwater fees (from \$2.30 to \$4.30/month) which should allow the stormwater fund to remain solvent in 2018. That rate increase has provided adequate revenues to bridge the stormwater funding gap without a General Fund subsidy in 2017 or 2018 but 2019 is forecast to run a deficit, even with stormwater project deferrals – and the General Fund has traditionally been the source to cover those shortfalls.

The combination of less income tax revenues coming in to the General Fund, and potentially needing General Fund revenues to cover Stormwater Fund shortfalls is a matter that will have our attention throughout 2018.

2018 Budget Strategy

The challenge for our organization is to prepare a budget for 2018 that recognizes our financial limitations without negatively impacting the organization's ability to serve the public now and in the future. We believe we've accomplished that objective through the combination of a strategically aligned Operating budget and Capital Plan.

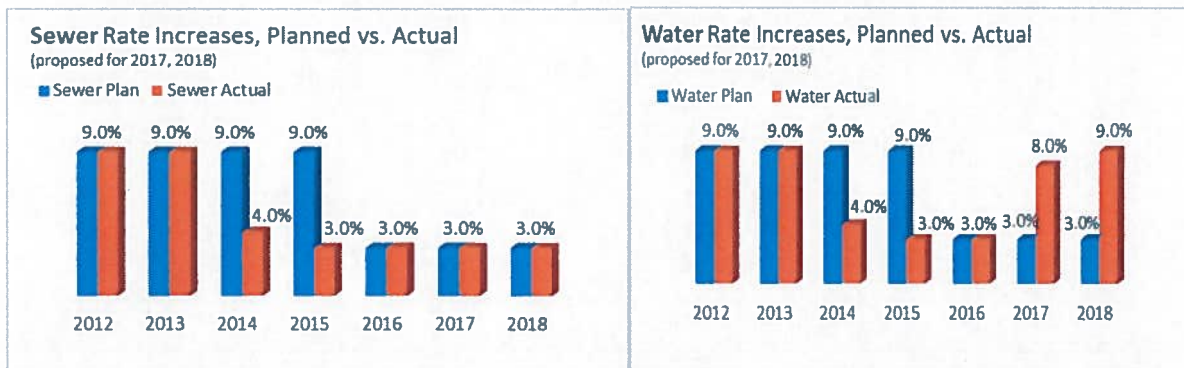
The staff success in securing grant funds over the last 7 years has created a degree of financial flexibility not otherwise available to us, which when combined with our cash balances in the undesignated fund, have enabled us to bridge operating budget gaps. We look to continue to leverage partnerships and grants in 2018.

Utility Rate Plans

Council approved the multi-year rate stabilization plans for the water and sewer funds in 2011. The approved rate plans included 4 years of 9% rate increases to "catch-up" with deferred maintenance and capital costs, followed by 3% rate increases in the out years of the plan to keep pace with inflation.

In the first 2 years (2012, 2013) of rate "catch up" the rates approved by Council matched the rate plans. However, in the subsequent following 2 years, the rates were less than half of what was originally projected in the plans. As a result, in 2017 Council authorized rate increases to make up a portion of the lost rates in 2017 (8%) and 2018 (9%) for the water fund only; the sewer fund is projected to be sustainable at the planned rate of 3%.

| | <u>2012</u> | <u>2013</u> | <u>2014</u> | <u>2015</u> | <u>2016</u> | <u>2017</u> | <u>2018</u> |
|---------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Sewer Plan | 9.0% | 9.0% | 9.0% | 9.0% | 3.0% | 3.0% | 3.0% |
| <u>Sewer Actual</u> | <u>9.0%</u> | <u>9.0%</u> | <u>4.0%</u> | <u>3.0%</u> | <u>3.0%</u> | <u>3.0%</u> | <u>3.0%</u> |
| Difference | 0.0% | 0.0% | 5.0% | 6.0% | 0.0% | 0.0% | 0.0% |
| Water Plan | 9.0% | 9.0% | 9.0% | 9.0% | 3.0% | 3.0% | 3.0% |
| <u>Water Actual</u> | <u>9.0%</u> | <u>9.0%</u> | <u>4.0%</u> | <u>3.0%</u> | <u>3.0%</u> | <u>8.0%</u> | <u>9.0%</u> |
| Difference | 0.0% | 0.0% | 5.0% | 6.0% | 0.0% | -5.0% | -6.0% |



Even with the rate recovery increases proposed for the water fund of 8% in 2017 and 9% in 2018, the City's utility customers will be paying an average of \$4.50 less per month, or around \$54 less per year, than what they would have been paying based on the original 2011 rate plan.

Although our dependency on undesignated reserves has diminished, we remain committed to improving our productivity and staying vigilant with our efficiency and effectiveness. We are committed to maintaining what we consider financial "best practices":

- We will track and forecast revenues and expenses utilizing historical and month-to-month trend analysis;
- We will monitor and work with our elected delegations to mitigate any legislative initiatives that could threaten our fiscal stability or impose more unfunded mandates on the City;
- We will research best practices in our industry and adopt productivity and cost savings measures wherever practical and affordable;
- We will collaborate and partner to lower our costs and take advantage of economies of scale;
- We will press for State and Federal funds for capital projects and available competitive grant processes.

Budgetary Assumptions

As noted, we have applied conservative budget principals to our draft 2018 Operating Budget. The most significant assumptions built into the budget include the following:

- Income Tax budget shows a slight (1.2%) increase; Local Government Funds show no net increase, and the Kent JEDDs show a leveling off in annual tax receipts (\$550,000) with no increase projected for 2018.
- All authorized positions have been budgeted at actual salary expenses as of October, 2017, plus adjustments of 3.25% for contracted increases scheduled for late 2017.
- Revenues in Water and Sewer Funds will be adequate to cover operating expenses and required capital needs for 2018 after implementing rate increases of 3% in sewer and 9% in water to stabilize fund reserves.
- Employer Medicare (FICA) expenses calculated at 1.45% of salary
- Workers' Compensation expenses calculated at 2.0% of salary
- Employer OPERS expenses calculated at 14.0% of salary
- Employer Police & Fire Pension expenses calculated at 19.5% and 24.0% respectively
- Employer Health Insurance expenses continue to be a concern, for 2018 this budget will increase from \$13,900 to \$14,700 per family for a total increase in City costs of \$160,000.
- Upgraded 1 position (Community Development Director from a II to IA), converted 2 part time positions to full time (Health Department Accreditation Coordinator, Engineering Aide I) and 1 new position is proposed to be added (Code Compliance Officer for rental registration) at a total Personnel cost of \$145,000 annually.
- Sellback expenses for sick and vacation time is based on prior two years activity.
- Overtime expense projections were provided by each department.
- The vacant Public Safety Director position is not budgeted to be replaced with the duties absorbed by the City Manager, preserving budget savings in excess of \$100,000 in salary and benefits.
- Recommended O&M costs for 2018 reflects a \$287,599 decrease (-3.3%) from the originally approved 2017 O&M budget (\$8,740,792 in 2017, \$8,453,193 in 2018); and a \$1,307,043 or 13.4% decrease below the most recent 2017 amended O&M budget (\$8,453,193 in 2018, \$9,760,236).
- Insurance/Bonding – we are not projecting increases in insurance overall, however there is some reallocation of expenses to cost centers that have added new insurable assets.

Budgetary Objectives

The principle role of City Council in the budget adoption process is to ensure that the City's policy commitments are in alignment with budgetary allocations. The question for Council is have we appropriated the funds necessary in our budget to achieve our community priorities?

To that end, the budget is our investment plan for progress toward the vision we share for our community and for which Kent is proud to be known. We will look to partner with our citizen advisory boards, commissions, peer governments, and of course, the public to fulfill our strategic goals as noted below:

- Financial Health and Economic Development
"to be a prosperous and livable city for all citizens"
- Natural Resources
"to protect and promote the City's natural resources"
- Quality of Life
"to enhance lifestyle choices through physical and social environment"
- Community Safety
"to be an exceptionally safe city"
- Communities within the City
"to strengthen the quality and enhance the value of neighborhoods"
- City / University Synergy
"to expand collaborative opportunities that enrich the community experience"
- Governmental Performance
"to provide the best services at the lowest possible cost"

2018 Budget Numbers

The proposed 2018 budget looks to ensure critical spending where it is most needed and maintain cost containment practices in everything we do. Where staff requested budget increases we asked them to look for cuts to offset those increases. The goal was to keep discretionary cost increases on par with inflation.

The staff exceeded that budget challenge and the recommended total for 2018 Operations and Maintenance compared to the 2017 Operating Budget reflects a 3% **decrease** -- \$8,453,193 in 2018 from \$8,740,792 in 2017.

As a service provider the City's largest cost relates to its investment in personnel. In total, it costs about \$70,000 per workday to perform City services – with 50% of those costs attributed to Fire and Police functions.

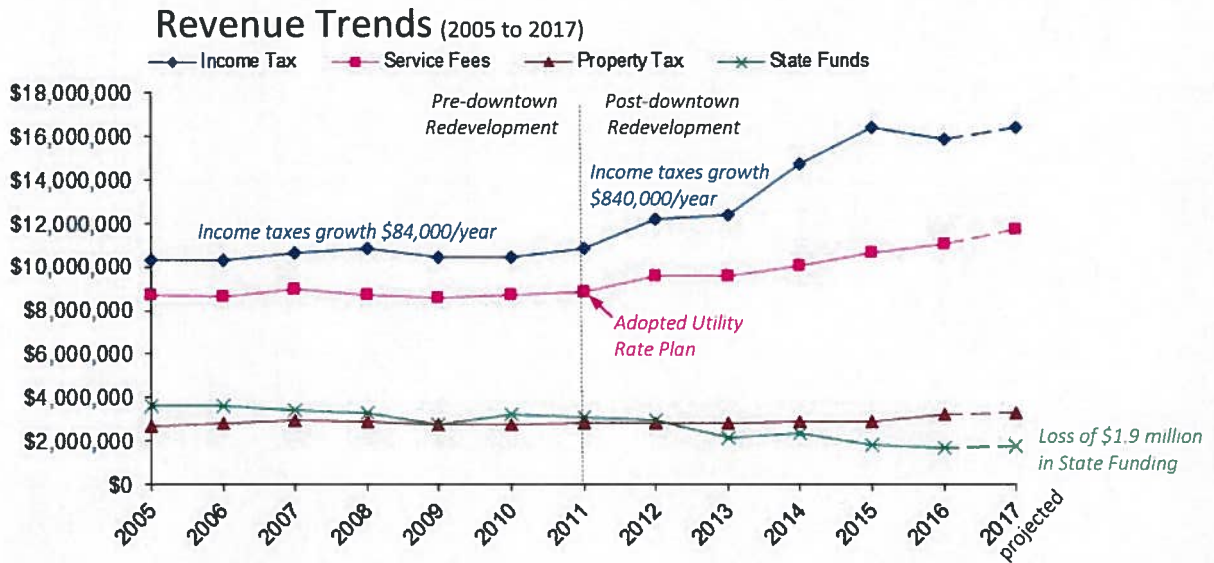
Most notably, the proposed 2018 Personnel budget includes the upgrade and reclassification of a couple of positions that staff felt are critical to the long term performance of the respective City operations. Those personnel changes will add \$145,000 annually to the City's operating costs.

It is important to note that the Personnel increases also reflect union contract agreements of a 3.25% pay increase in 2018 (followed by 3% in 2019, and 2.75% in 2020). With every 1% increase in wages, Personnel costs increase by approximately \$150,000 in increased pay.

Even with proposed personnel changes, and the contractual pay increases of 3.25% for 2018, the total Personnel Costs are projected to only go up \$225,230 or 1% above 2017.

Every City department still has legitimate new staffing needs, but we have had to prioritize and continue to defer those position needs until further revenue gains are achieved.

As noted, there has been a trend of recovery in select revenue categories so for 2018 the staff is projecting a modest range of operating revenue growth from 1% to 2% (excluding capital/grants/bond revenues/user charges).



In Closing

We recognize that the City government must find ways of doing more with less. We continually review priorities, make decisions about what we can afford and what we cannot afford, and seek out better, less expensive ways to deliver essential services. We have done all of those things in preparing this budget.

I am honored to work alongside our skilled City employees to implement our collective vision and I thank them for their hard work and dedication. I am particularly proud of the teamwork that Department Heads have exhibited with one another in charting new ways of going about our business.

I would also like to specifically acknowledge David Coffee, Director of Finance and Budget, Brian Huff, City Controller, and the entire Finance Department team for the many hours required to produce a spending plan of this complexity and scope.

As the end of another fiscal year looms, I am grateful to you, our Council Members, for your many hours of service and dedication to our community.

I submit this budget anticipating good results for Kent in 2018. While we might not have all the funds we need to support City services at the level we desire, we have invested well and we have seen steady progress – to the point where we are now recommending to finish a few more critical staffing needs for the second year in a row after more than 10 years of deferral.

Whatever next year may bring, I look forward to working with the City Council, our staff and the citizenry to keep Kent strong and its future bright for generations to come.

Respectfully submitted,

Dave Ruller, Kent City Manager