



To the Honorable Mayor and City Council,

Pursuant to the Escanaba City Charter and relevant state laws, I hereby submit to the City Council and community, the FY 2023-2024 recommended budget. A copy of this document has been placed on file with the City Clerk and at the Escanaba Public Library, where the public may review it during normal hours of operation. An electronic version is also available on the City of Escanaba website: www.escanaba.org. The presented budget is guided by the City of Escanaba mission statement, “Enhancing the enjoyment and livability of our community by providing quality municipal services to our citizens.”

The City of Escanaba operates in the fiscal year beginning July 1 and ending June 30. The city operates in several segments. The budget is comprised of a large number of major and non-major funds. For major funds, the General Fund serves as the primary operations fund for general governmental functions. Major Enterprise Funds represent the utilities of Electric, Water, and Wastewater.

A Brief Review: Budget Trends and June 30, 2022 Financials

Recent General Fund budget numbers are presented in the table below:

	<u>GENERAL FUND</u>		
Budget Period	2021-2022	2022-2023	2023-2024
Recommended	(478,489)	(1,022,241)	137,405
Adopted	(550,641)	(366,800)	TBD
Actual	(247,235)	TBD	TBD

The 2021-2022 and 2022-2023 adopted budgets featured budget deficits. The 2022-2023 recommended budget included a General Fund deficit of approximately \$1 million, and the adopted budget reduced the deficit to \$366,800. This was accomplished by making \$267,000 in budget cuts, increasing the millage rate by 0.442 to generate \$143,000 of added tax revenue, and a receipt of \$273,000 in one-time federal revenue. The 2023-2024 recommended budget includes a \$137,405 surplus with no increase to the millage rate.

As of June 30, 2022, the General Fund carried an unassigned fund balance of \$5,436,857, equal to 60% of annual expenditures and transfers out. A fund balance greater than six months of annual expenditures provides the city financial strength. It is critical that financial strength be maintained for the mitigation of revenue shortfalls and unexpected expenditures, the provision of working capital, and to bolster to the city bond rating,



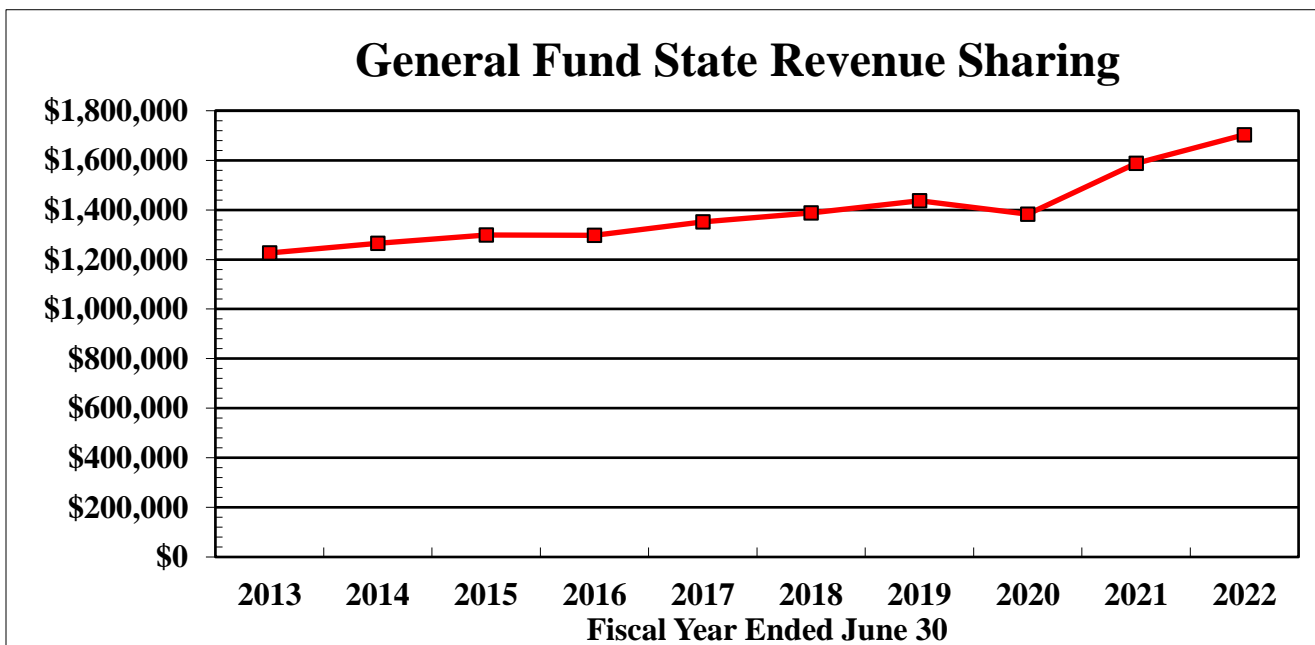
Property Taxes

Property tax revenue provides approximately 50% of revenue for all governmental activities. While a stable source of revenue, growth in property tax revenue is restricted. Proposal A limits the growth of existing taxable values to the lesser of inflation or 5%, plus new construction. Also, taxable values cannot be higher than the assessed value. As a result, episodes of real estate decline, such as the Great Recession, reduce both assessed and taxable values. While market values may recover at a pace higher than inflation, taxable values remain impaired by slow growth.

The City of Escanaba has experienced reductions in taxable value because of the Dark Store Theory and various property tax exemptions. In addition to property tax loss, legal fees for the related to commercial appeals have exceeded \$1 million since 2012.

State Revenue Sharing

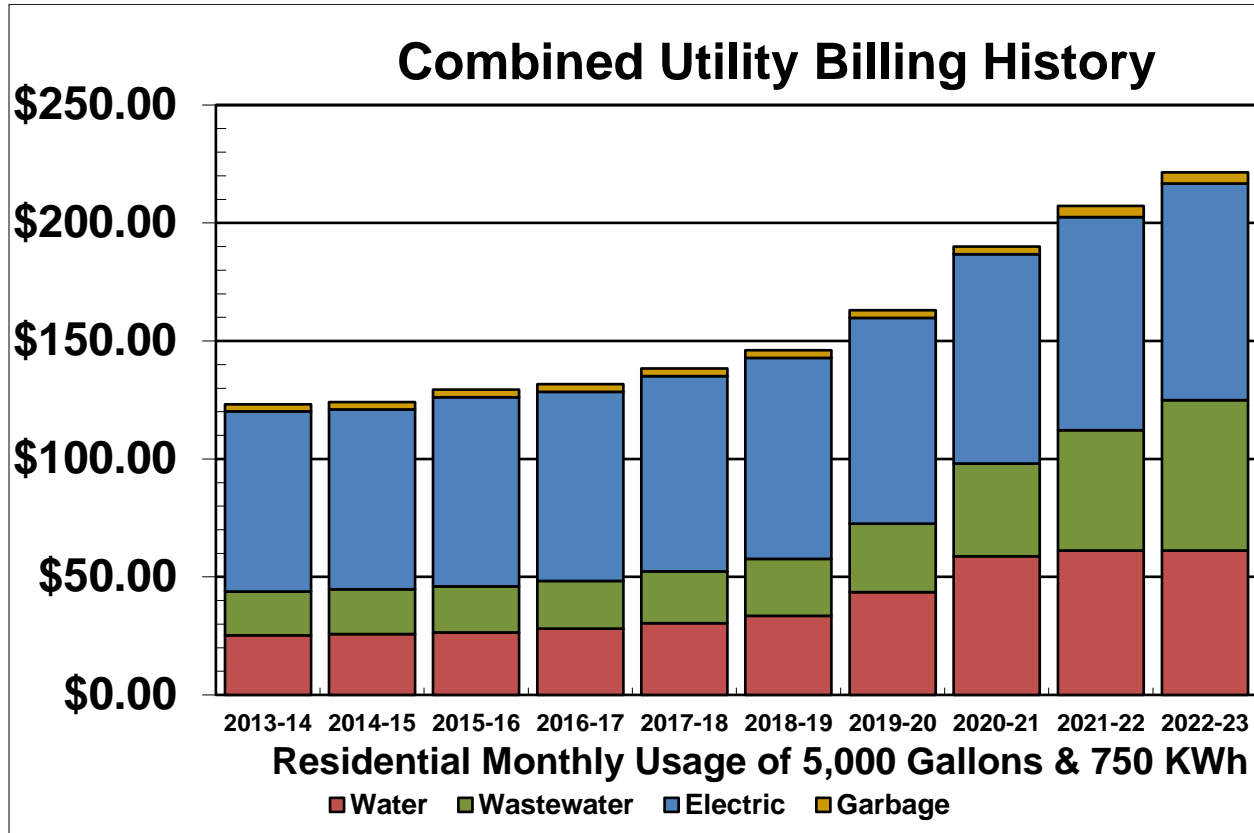
State revenue is temporarily improving. The decade beginning in 2001-2002 saw revenue sharing decline from \$1.8 million to \$1.2 million. Revenue sharing has been mostly flat since 2012 and indicated sign of weakness in 2020. There was an acceleration in 2021 and 2022 from two nonrecurring extra payments. This may be a situation to monitor as it is correlated to the strength of the economy.





Utility Rates

City of Escanaba utility customers have experienced utility rate increases as a result of mandatory investment in infrastructure. This situation is not unique to Escanaba, and Escanaba utility rates remain competitive. Utility rate comparisons can be viewed online in the City of Escanaba EVIP report.



Financials

City of Escanaba audited financials are available online: <https://www.escanaba.org/controller/page/annual-city-comprehensive-audits>

A summary of government-wide net position and change in net position is provided on the next page. Net position displays the residual of assets and liabilities, and long-term net position trends are indicative of the direction of the financial health of the city.



NET POSITION

	GOVERNMENTAL ACTIVITIES		BUSINESS TYPE ACTIVITIES		TOTAL	
	2022	2021	2022	2021	2022	2021
ASSETS						
Current and other assets	18,401,279	20,254,840	22,683,388	19,586,911	41,084,667	39,841,751
Capital assets, net	24,313,122	24,133,938	46,880,123	41,765,685	71,193,245	65,899,623
	42,714,401	44,388,778	69,563,511	61,352,596	112,277,912	105,741,374
Deferred outflows of resources	3,133,211	760,207	437,094	390,069	3,570,305	1,150,276
LIABILITIES						
Long-term debt	813,705	935,116	17,368,872	13,393,354	18,182,577	14,328,470
Current and other liabilities	14,030,699	9,636,683	7,902,208	8,858,788	21,932,907	18,495,471
	14,844,404	10,571,799	25,271,080	22,252,142	40,115,484	32,823,941
Deferred inflows of resources	1,276,496	5,019,515	1,001,058	424,022	2,277,554	5,443,537
NET POSITION						
Net investment in capital assets	24,343,122	24,133,938	28,690,847	28,511,361	53,033,969	52,645,299
Restricted	7,623,176	7,750,725	377,291	455,743	8,000,467	8,206,468
Unrestricted (deficit)	(2,209,586)	(2,326,992)	14,660,329	10,369,397	12,450,743	8,042,405
TOTAL NET POSITION	29,756,712	29,557,671	43,728,467	39,336,501	73,485,179	68,894,172

CHANGE IN NET POSITION

	GOVERNMENTAL ACTIVITIES		BUSINESS TYPE ACTIVITIES		TOTAL	
	2022	2021	2022	2021	2022	2021
PROGRAM REVENUES						
Charges for services	1,127,329	1,443,017	22,926,098	21,117,215	24,053,427	22,560,232
Operating grants and contributions	2,049,858	2,649,672	(677,806)	-	1,372,052	2,649,672
Capital grants and contributions	939,988	61,540	670,867	50,366	1,610,855	111,906
GENERAL REVENUES						
Property taxes	5,704,331	5,895,765			5,704,331	5,895,765
State shared revenue	1,703,115	1,588,283			1,703,115	1,588,283
Unrestricted grants and contributions	192,492	204,082			192,492	204,082
Unrestricted investment earnings	(438,997)	186,231		72,524	(438,997)	258,755
Gain on sale of capital assets	6,200			14,119	6,200	14,119
TOTAL REVENUES	11,284,316	12,028,590	22,919,159	21,254,224	34,203,475	33,282,814
EXPENSES						
General government	850,643	1,157,051			850,643	1,157,051
Public safety	5,193,483	3,872,348			5,193,483	3,872,348
Highways, streets, and public works	2,672,821	2,507,540			2,672,821	2,507,540
Sanitation	821,101	810,214			821,101	810,214
community services	120,554	94,550			120,554	94,550
Recreation and culture	1,717,055	1,625,408			1,717,055	1,625,408
Community and economic development	456,699	540,345			456,699	540,345
Other functions	6,024	3,937			6,024	3,937
Interest on long-term debt	11,685	15,317			11,685	15,317
Electric utility			13,004,786	12,953,865	13,004,786	12,953,865
Waste water utility			1,961,099	1,886,091	1,961,099	1,886,091
Water utility			2,511,644	2,616,808	2,511,644	2,616,808
Marina			284,874	235,195	284,874	235,195
TOTAL EXPENSES	11,850,065	10,626,710	17,762,403	17,691,959	29,612,468	28,318,669
Change in net position before transfers	(565,749)	1,401,880	5,156,756	3,562,265	4,591,007	4,964,145
Transfers	764,790	765,790	(764,790)	(765,790)	-	-
CHANGE IN NET POSITION	199,041	2,167,670	4,391,966	2,796,475	4,591,007	4,964,145
NET POSITION BEGINNING OF YEAR	29,557,671	27,390,001	39,336,501	36,540,026	68,894,172	63,930,027
NET POSITION END OF YEAR	29,756,712	29,557,671	43,728,467	39,336,501	73,485,179	68,894,172



The Recommended Budget and Administration Discussion

Triage, Reform, Caution, Opportunity

Municipalities across Michigan are facing similar budgetary challenges. As shown in the figures above, large forces continue to stress several funds. City Administration, through this budget, presents immediate budget actions.

Budget actions can be financially analyzed in terms of their effect on the size, timing, and riskiness of cash flows. Additional considerations of budget actions are the impacts to services today and in the future. Our goal is to provide reliable services at the best value today and for generations to come.

General Fund

The recommended budget provides substantial general fund relief for the 2023-2024 fiscal year and the next several years. While the city budget focuses on one operating year, budget actions are being proposed that provide optimal conditions for multiple periods.

2023-2024 General Fund Surplus: \$137,405.

The General Fund has many necessary expenditures. Personnel has been reduced over many years, and substantial further reductions would inhibit the ability to provide services, especially when the demand for services continues to increase in multiple segments.

Notable actions and considerations for the General Fund budget:

- No change in the tax levy
- Combination of Manager and Assessor positions
- Attrition of one Public Safety Officer and the change of Detective/Lt. to Detective
- Changes to library funding and hours
- Pension – Application of surplus division and additional contribution
- The impact of pending union contracts is not finalized

The Escanaba Public Library is a heavily utilized city service. However, it has faced budget challenges for several years. Continuing operations unchanged would result in a library budget deficit of approximately \$56,000, bringing the library fund balance to a \$52,000 deficit. This budget introduces a tiered user fee for non-city residents based on the desired level of service. The primary source of funding for the library comes from the library millage and general fund transfer, both which are impositions on city taxpayers only. In addition to increased revenue, it is recommended the library reduce hours of operation to a more efficient schedule.

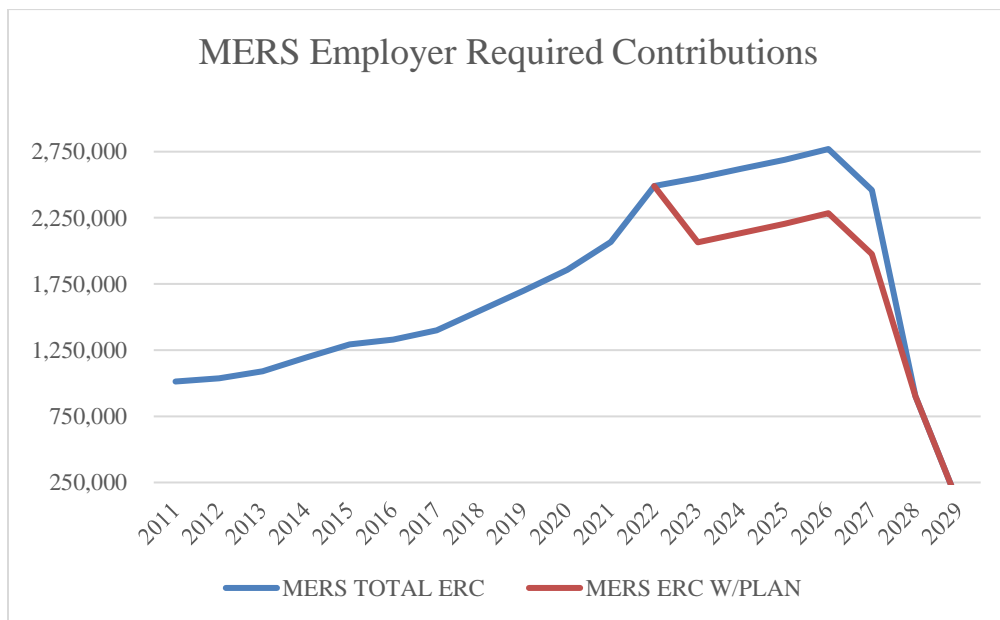
General Fund Capital Spending

The General Fund makes several capital investments. This includes the replacement of generators at Public Safety and the Civic Center, Public Safety garage doors and body cameras, and several old computer replacements. City parks are showing signs of age, and City Administration is planning steps to make regular targeted improvements. This budget presents a \$100,000 match for grants at Royce Park. The matching funds come from restricted funds that can be used for new recreational opportunities.

Pension

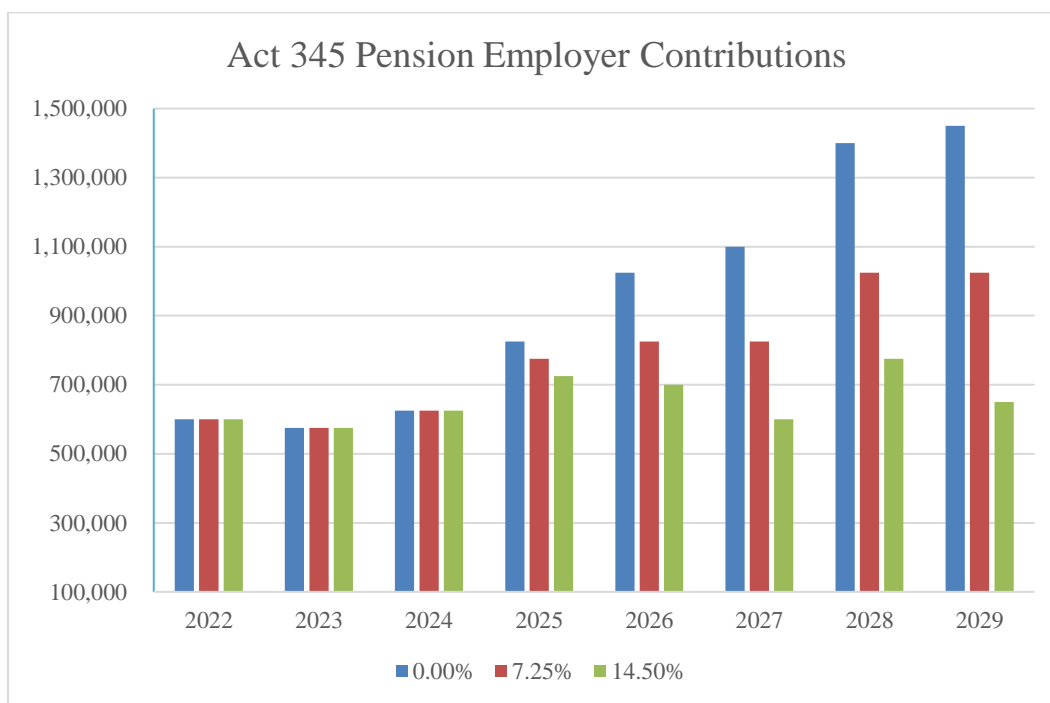
As the charts display below, pension costs continue to escalate. Annual employer required contributions in the MERS administered pension have doubled since 2011 and are projected to reach a peak by 2027. Despite making the required contributions, the funded ratio has made little improvement, at just 68% as of 12/31/2021. Reasons for this lack of progress include returns consistently being lower than the assumptions, a long amortization period, and the use of 10-year smoothing in the wake of the recession in 2008. This delayed contribution increases. Of the 160 plan members, 17 are active employees.

It is important to City Administration that pensions be funded to minimize the burden on future budgets. In 2018, the city made a \$2,500,000 lump sum contribution to a pension surplus fund. The proposed budget recommends an additional transfer of approximately \$500,000. This bolstered surplus fund would be deployed over four years to level the period of peak contributions. These maneuvers will provide current savings and provide greater budget stability for the next several years while simultaneously staying the pension funding course and avoiding emaciating budget cuts.



The Act 345 pension also is poised to stress the general fund. While it is better funded, at 91.4% as of June 30, 2022, contributions are still expected to increase from \$600,000 to \$1,000,000 by 2028. The chart below emphasizes the sensitivity of changes to market returns.

While both pension plans are on a path to 100% funding, the dramatic sensitivity to market returns is a sign of caution.



Economy

The economic environment and financial conditions must be considered when preparing our city budget. During this process, we assess the local and macroeconomy as it relates to city revenues, expenditures, and demand for services.

Our country is experiencing an inflationary episode as a result of the COVID-19 response. The M2 measure of the money supply increased 40.2% from February 2020 to February 2022. Inflation in goods increased due to supply chain disruptions by shutdowns while aggregate demand was fueled by stimulus. Inflation became embedded and continues to remain elevated, especially on the services side. History suggests the actions required to restore price stability also result in a recession, and recessions impair city revenues with immediate and lasting effects.



As a result of inflation, city revenues and expenditures increase. Property tax revenues are increasing with the combination of large gains in the residential real estate market. We have seen the first 5% inflation rate multiplier since the onset of Proposal A. It is possible that revenue sharing could increase with higher prices as long as consumer spending remains strong. Lastly, there are increased grant opportunities as a result of stimulus. City Administration continues to monitor and apply for grant funding opportunities.

Expenditures continue to face extreme inflationary pressure, especially related to materials and labor. The impact of higher interest rates will be a consideration for future borrowing.

Water and Wastewater

The proposed budgets include 4% and 3% rate increases to water and wastewater respectively.

The city is currently in the middle of a \$10+ million upgrade to the water plant, and recently completed a \$14 million upgrade to the wastewater treatment plant. The completion of these projects ensures the reliable production and treatment of water for the City of Escanaba for years to come.

As mandated by the State of Michigan, the city is pursuing the replacements of lead impacted services. Currently, there are approximately 4,000 lead impacted services that require replacement. EGLE mandates that these services be replaced within a 20-year period. Since 2020, the City has replaced 359 of the impacted services. The estimated cost for lead service line replacements could exceed \$50 million. Another \$50 million is needed for replacement of old and undersized watermain.

The city wastewater collection system experiences high levels of inflow and infiltration. We are obligated to make repairs that will bring the system into compliance, a cost of tens of millions.

Since 2017, water and wastewater has spent over \$50 million on projects and project planning, \$30 million of which has been grant funded and almost \$20 million of which has been financed with State Revolving Loan Funds.

The city continues to aggressively apply for grant and loan opportunities, including the State of Michigan DWSRF/CWSRF. We are hopeful that this opportunity remains available as it will reduce the size of future water rate increases.

Electric

The proposed budget includes a 1.75% increase to electric rates. The City has managed stable electric rates for several years, and this trend is expected to continue. This budget includes regular upgrades such as the replacement of electric poles, streetlights, and the replacement of meters with advanced metering infrastructure. Major distribution system improvements include the replacement of underground cable, additional substation cross connections, improvements to



the west side substation, and an improved SCADA system.

Motor Vehicle Fund

As of June 30, 2022, the Motor Vehicle Fund had net working capital of \$173,499. It is estimated that over \$5 million in vehicles and equipment needs to be replaced immediately, and \$10 million over the next 5 years. City Administration is actively working through long-term reform of this segment. In year one, this includes the purchase of two police patrol vehicles, a street sweeper, one tandem deicing truck, a paint grinder, and one pickup truck. City Administration has confirmed restricted funds may be used for certain MVF purchases, indicated by a \$1.3 million transfer into the MVF. The city continues to phase in higher rental rates to establish positive operating cash flow. In an effort to produce a sustainable operation in the intermediate and long-term, City Administration will continue the development of a new model for vehicle replacement.

Closing

A Case for Optimism

The city has no shortage of challenges. The combination of sluggish economic growth and legacy costs have resulted in a difficult budget today. However, this budget presents a step toward a bright future. We are seeing generational investments in our community from both the public and private sectors. At a scale not seen in decades, the thoughtful planning, financing, and execution of city infrastructure investments will provide stability for existing residents and fertile ground for new opportunities. Escanaba is poised to benefit from the \$1 billion investment into the mill, the transformation of our north shore, and continued investment into the commercial corridor.

In addition to economic growth, conservative budget management will position the city with a future of budgetary flexibility. We must be able to weather potential storms and capitalize when opportunity arrives. Conservative management also allows for better access to capital markets, enabling the city to finance large projects by maintaining a strong bond rating, and provides resources for future services and facilities.

I am grateful to serve our city and work with a dedicated team. The preparation of the budget is a large group effort. The office of the City Controller deserves special mention for the continuous support to the city budget process. We look forward to presenting this budget and another year of service to our residents and customers.

Respectfully submitted,

James R. McNeil
City Manager