



COVID-19 Pandemic Financial Response Plan

Developed by: City of Cadillac

- **Office of the City Manager**
- **Financial Services Department**

**Provided to Cadillac City Council
Special Meeting
May 28, 2020**

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THE PROBLEM

The COVID-19 pandemic has created significant financial turbulence that has negatively affected the economies of countries around the globe and did not spare the United States or Michigan. Recent revenue estimates place the loss of revenues for the State of Michigan's general fund at approximately \$2 billion for the current fiscal year, with additional decreases anticipated for the State's upcoming two fiscal years as well. The impact to Michigan's economy will inevitably affect the local economy and the revenues that Cadillac receives.

This is a time of economic uncertainty, while at the same time the City needs to pass a budget for the fiscal year beginning July 1, 2020. In an effort to exemplify the City's ongoing conservative fiscal approach during this time of unknown impacts to important revenue sources, this Pandemic Financial Response Plan was developed. This Plan showcases financial planning diligence by identifying potential projects to temporarily pause until financial indicator(s) are available, such as receipts from future tax collections and new projections from the State.

LOCAL IMPACT

This report focuses on four primary funds of the City: General Fund, Major Street Fund, Local Street Fund, and Water and Sewer Fund. Collectively these funds comprise a majority of the City's overall budget and contain the revenue sources that will face the most significant and actionable impacts from the pandemic.

Within the four funds mentioned above, several specific sources of revenue are most at risk of being impacted by an economic crisis. These sources of revenue will be the primary focus of this economic analysis. These sources include:

- Property Taxes (*General Fund only*)
- State Shared Revenue (Constitutional and Statutory) (*General Fund only*)
- Act 51 Road Funds (*Major and Local Street Funds*)
- Water and Sewer User Charges (*Water and Sewer Fund*)
- Interest Income (*General Fund; Water and Sewer Fund*)

Following the analysis of the impacts that the current economic crisis will have on the City's primary revenue sources, this report details the financial response to the potential revenue reductions.

REVENUE IMPACTS

Property Taxes

Property tax revenues are expected to provide \$3,977,000 to the General Fund, or 56% of total fund revenues. Based on the property tax calendar each year, values for the next tax roll are established as of December 31 each year. This means that the tax roll that will provide revenue for the FY2021 budget was established at December 31, 2019, prior to the start of the economic crisis. In addition, most outstanding tax balances are transferred to Wexford County for delinquent collection as of March 1 each year. This means that except for a small portion of the delinquent taxes due, the City will collect 100% of the current levy during the fiscal year. If any balances remain unpaid three years after they are due, then the tax foreclosure process begins.

Additionally, one of the impacts of the Headlee amendment is that the taxable value of property changes differently than assessed value. In theory, assessed value reflects 50% of the actual

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market value of a particular property and can change from year to year based on market conditions. Growth in taxable value, though, is restricted to the twelve-month change in the consumer price index as of September 30 each year. This means there is typically a gap between assessed value and a lower taxable value. In fact, this gap for the current tax roll for City parcels has grown to \$54,158,255 which is just over 20% of total assessed value for real property in the City.

The gap cushions the City in times of shrinking property values from experiencing dramatic year to year losses in property tax revenues. In fact, taxable values could increase based on inflation even in years when assessed value drops. Charts 1 and 2 illustrate the City’s assessed and taxable values since 2008, the tax year prior to the Great Recession, in terms of both dollars and percentage change year to year. It’s important to note that the housing market was one of the significant contributing factors to the 2008 recession, which is very different than the factors creating the economic crisis caused by the pandemic.

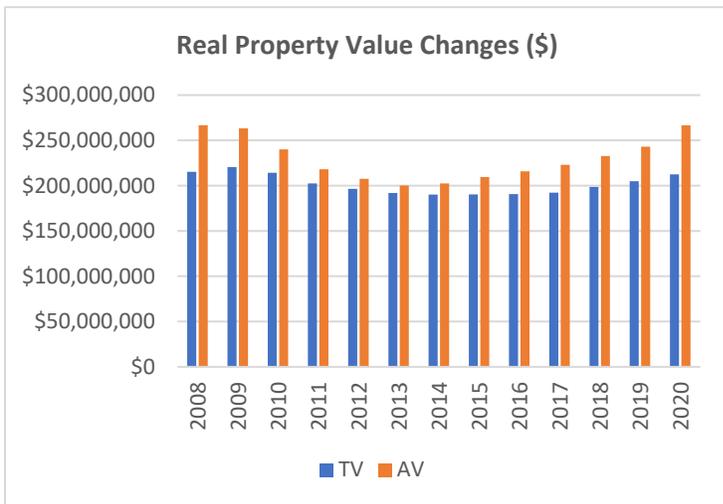


Chart 1

Assessed Value (AV) peaked in 2008, then dropped \$66.5 million (25%) over the next five years before recovering to nearly the same value in 2020.

Taxable value (TV) peaked in 2009, then dropped \$30.4 million (14%) over the next five years and is still over \$8 million less than pre-recession levels. So, while TV still dropped, the impact was far less than the actual loss in property value, and the subsequent growth has been slower than AV.

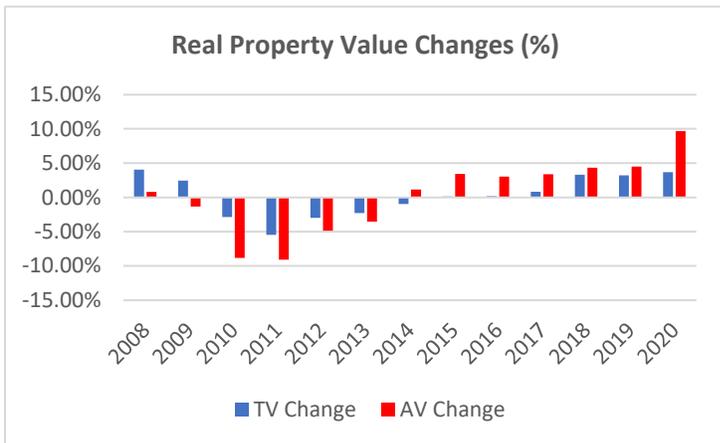


Chart 2

This chart illustrates the year to year change in both TV and AV. It highlights the fact that the assessed value is subject to more significant changes both in times of increasing values, and in times of decreasing values, while TV changes at a far smaller rate.

Property Taxes - Summary of Impact on FY2021 Budget

Essentially, this means that this important source of revenue should not be impacted for the FY2021 budget, but will need to be monitored for future years, even though future years’ potential losses will be cushioned by the protectionary gap between Assessed Value and Taxable value.

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State Shared Revenue

The second most significant source of revenue for the General Fund is State Shared Revenue. There are two components of State Shared Revenue. The first and most significant is a constitutional component that passes down by formula amounts that are collected from sales tax revenues. The second portion is based on the State of Michigan’s City, Village and Township Revenue Sharing (CVTRS) program and is based on an annual appropriation in the State budget.

The City had conservatively planned for total revenue of \$1,120,000 from State Shared Revenue. This was based on estimates provided by the State of Michigan prior to the pandemic and was initially \$26,000 below these projections. Of the total amount of expected revenue, \$915,000 was Constitutional, while \$205,000 was the Statutory portion based on the CVTRS appropriation.

It is important to remember that State Shared Revenue has fallen woefully short of the amount that should have been provided by the State of Michigan. As Chart 3 illustrates, the amount of revenue now expected for FY2021 is approximately the same dollar amount received 25 years ago in FY1995! A strong effort to inform the public about this issue can be researched at www.savemycity.org.

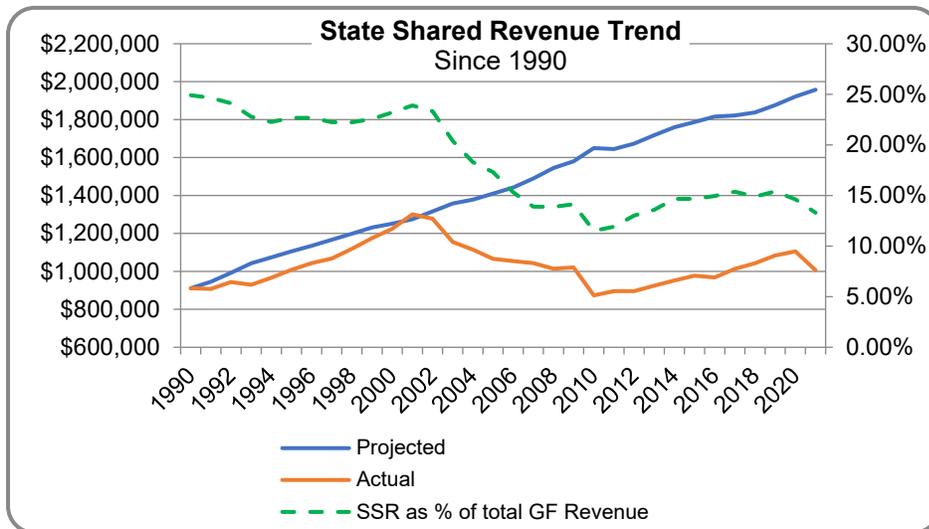


Chart 3
Latest estimates from the State of Michigan put the total anticipated state shared revenues at the same level as 1995. The dotted green line highlights that this revenue source is providing a decreasing share of General Fund revenue.

State Shared Revenue – Summary of Impact on FY2021 Budget

Estimates provided by the State after the May 15, 2020 revenue estimating conference project that the City’s combined State Shared Revenue will be \$1,005,969, as compared to an initial budgeted amount of \$1,120,000. This results in a decrease of \$114,031.

The CVTRS portion of revenue, the non-Constitutional component, is currently projected at \$206,679 compared to the City’s proposed budget of \$205,000. There are no indications at this point what additional action the State may take regarding this component of the appropriation, and currently it is stable. However, should the State make a 10% cut to the non-Constitutional CVTRS portion of revenues, that would result in a \$20,000 reduction to the City.

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Act 51 Road Funds

Act 51 road funds are passed down from the State of Michigan through the allocation of gas taxes and motor vehicle registration fees. These local allocations have risen over the last several years based on an increase in state gas taxes from \$0.19 per gallon to \$0.263 per gallon in 2017 and increases in registration fees in the same time period. The pandemic will clearly have a short-term impact on these revenues, though it remains to be seen what the final impact will be. The City has a total projected budget of \$1,370,000 combined in the Major and Local Street Funds from this revenue source.

Act 51 Road Funds – Summary of Impact on FY2021 Budget

The Michigan Department of Transportation updated projections of payments to local road agencies on April 29, 2020. Based on these estimates and combined with the City's conservative approach to budgeting for potential increases, the most recent State projections still provide 100% of the amount budgeted for FY2021. Earlier projections had estimated that the City would receive \$1,441,775 in FY2021, but the City had budgeted just \$1,370,000. The newest projections estimate \$1,372,679 in revenues for Cadillac which is nearly identical to the budgeted amount. Therefore, the City's FY2021 budget will be mostly unaffected, barring further reductions to the State's estimates.

Water and Sewer User Charges

Nearly all of the \$4.4 million budget in the Water and Sewer Fund is funded through user charges. This is typical of an Enterprise Fund that accounts for the operations of municipal systems like water supply and wastewater treatment. The majority of connections to the City's water and sewer systems are residential customers or residential-size meters, with 3,251 of 3,574 customers – over 90% - in this category. Usage in this category is not expected to be significantly impacted by current conditions. However, actual billing for this class of customers only provides on average about 40% of system revenues. The reopening and recovery of local commercial customers and industries will be very important to the system's finances. Cadillac is in one of the two regions allowed to reopen in late May 2020 with reduced restrictions. As a result, this area will inevitably see more commercial activity through the reopening of many businesses. The system's largest customers, industries, were allowed to reopen earlier in May, and it is anticipated that this too will positively affect the system's finances.

Water and Sewer User Charges – Summary of Impact on FY2021 Budget

It is difficult to predict the short- and intermediate-term impact that the pandemic may have on the trend of user charges in the water and sewer systems. As the country and State reopens this should re-stimulate the local economy, and it is expected that usage could quickly return to pre-pandemic levels. However, because there was an impact on April and May volumes, the City has already reduced spending in the fund and is closely watching volumes to determine future actions that may be necessary to maintain the financial stability of these systems.

Separate from the pandemic, local industries and residents have been making incremental gains in installing higher efficiency fixtures and systems, which has put downward pressure on usage trends. This is illustrated in Chart 4, as it shows the conservation impacts to both systems since 2005.

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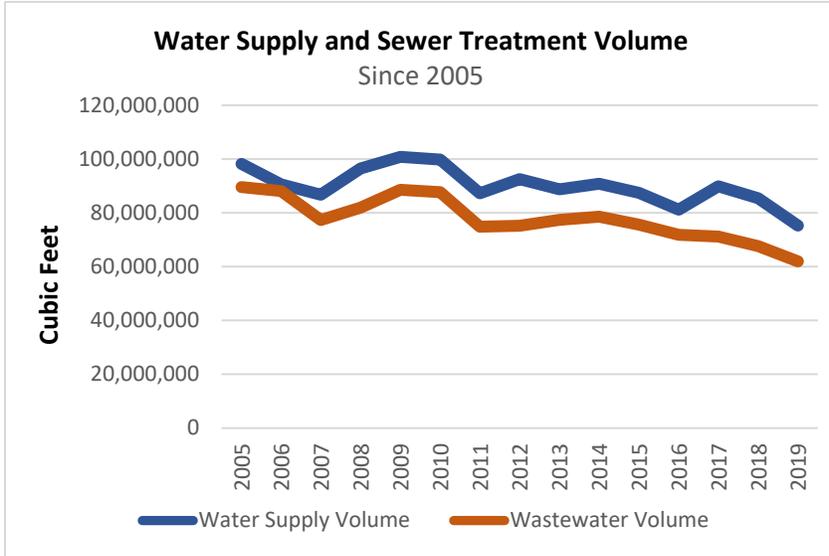


Chart 4
 Volume trends have been on a general downward trend since 2010. This is the result of residents and businesses implementing new, higher efficiency technology, equipment, and procedures. Unfortunately, there is not a direct, 1:1 correlation in the drop in volume and the cost of providing water and treating wastewater.

Interest Income

Because the Federal Reserve System took quick and significant action to help protect the economy by lowering the federal funds rate, this will have an impact on the amount that the City earns on the investment of surplus funds. The rate has been reduced to 0-0.25% as compared to 2.5% just one year ago. Typically, the City’s weighted average return benchmark is the 3-year treasury yield. This yield has dropped from 2.17% on May 20, 2019 to 0.22% as of May 19, 2020. The City’s average return as of 4/30/2019 was 2.04% but is on a downward trend and was 1.76% as of 4/30/2020. Average returns will continue to decline as short-term investments mature and are reinvested at lower rates, but rates will eventually increase again.

Interest Income – Summary of Impact on FY2021 Budget

The City’s four primary funds currently have about \$7 million in reserves invested in various short-term, conservative investments. A potential loss of 50 basis points, or 0.5% in average returns, would reduce investment earnings by approximately \$35,000 across these four funds. A potential loss of 100 basis points would equate to a reduction of approximately \$70,000 across these funds.

Summary of Revenue Losses on FY2021 Budget

In summary, the impact of the current pandemic on the primary revenue sources of the City’s four major funds may be as follows:

Table 1 – Summary of Potential Revenue Losses

Source	Primary Fund(s) Impacted	Total Initial Budgeted Revenue	Potential Loss
Property Taxes	General Fund	\$3,977,000	\$0
State Shared Revenue	General Fund	\$1,120,000	(\$115,000)
Act 51 Road Funds	Major/Local Street	\$1,370,000	\$0
Interest Income	All	\$102,000	(\$35,000 - \$70,000)

SPENDING AND APPROPRIATION ADJUSTMENTS

With any economic crisis comes the necessity to closely analyze spending in order to respond to the crisis in a thoughtful and prudent way that enables the City to maintain services while also ensuring current and future financial stability. With this in mind, the City’s Response Plan offers the following analysis:

Strong Reserves

It is critical to note that the City has entered the current crisis with very strong reserves, which is one of the most significant advantages that will enable Cadillac to have a “soft landing” as the economy continues to adjust and revenues may further dip before rising. As of the last audited financial statements of the City dated June 30, 2019, the City had the following reserves in the four primary funds:

Table 2 – Summary of Reserves on Hand

Fund	Available Reserves	As % of Total Expenditures	Benchmark
General Fund	\$2,466,312	35.31%	15%
Major Street Fund	\$754,447	60.34%	N/A
Local Street Fund	\$393,325	50.49%	N/A
Water and Sewer Fund	\$1,597,596	35.66%	3-6 Mos, or 25-50%

Strong reserves allow continued investment in critical and important community services even (or especially) during local crises.

General Fund

Anticipating that the General Fund could face the loss of \$130,000 - \$150,000 (1.8 – 2.0%) in total revenues for FY2021, this Response Plan identifies the following items that may be temporarily deferred:

Table 3 – General Fund Financial Response Recommendations

Current Budget	Pandemic Response Plan	Increase (Decrease)
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GENERAL FUND

Department: Revenue	\$7,159,600	\$7,019,600	(\$140,000)
Amended Line Items Detail			
Sales & Use Tax - Constitutional	915,000	800,000	(115,000)
Sales & Use Tax - Statutory	205,000	195,000	(10,000)
Interest Income	50,000	35,000	(15,000)

***Purpose:** Reduce revenue lines due to COVID-19 pandemic impact on State and local revenue sources.*

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Department: City Complex	\$356,400	\$279,400	(\$77,000)
Amended Line Items Detail			
Capital Outlay	77,000	0	(77,000)

***Purpose:** Freeze funding for Staff Car (\$27,000) and Backup Generator Replacement (\$50,000).*

Department: Parks	\$256,300	\$231,300	(\$25,000)
Amended Line Items Detail			
Capital Outlay	25,000	0	(25,000)

***Purpose:** Freeze funding for three planned capital projects: Lakefront Lighting (\$10,000), Shoreline Stabilization (\$7,500), Riding Mower (\$7,500).*

Department: Various - all departments			
Amended Line Items Detail			
Travel and Education	65,300	49,000	(16,300)

***Purpose:** Freeze funding for 25% of all Travel and Education budgets in the General Fund.*

General Fund Summary	Prior Proposed	Amended
Revenues	7,159,600	7,019,600
Expenditures	7,158,200	7,039,900
Revenues Over (Under) Expenditures	\$1,400	(\$20,300)

The deferment of these line items represents \$118,300 of postponed spending. The Response Plan maintains Police and Fire related projects, because deferring these purchases could negatively impact the City’s ability to respond to public safety emergencies with the most up-to-date tools available. These public safety items are the only capital purchases that would remain authorized in the General Fund. This Plan also would anticipate the use of \$20,300 in reserves on-hand, an amount that would not impact the City’s ongoing compliance with fund balance policies.

In addition to the plan above for the FY2021 budget, the City has also delayed a current year project (Rotary Pavilion Sign Upgrade), that saves \$20,000 in the current budget and results in a total of \$138,300 of deferred spending.

Note - Personal Property Tax Reimbursement Update

As reported in prior years, the personal property tax reimbursement provided by the State of Michigan has exceeded projections since its inception in FY2017. This was the reimbursement tool passed into law when eligible manufacturing personal property (EMPP) was removed from property tax rolls. On May 26, 2020, the City received the second portion of this payment for FY2020. Similar to prior years, this revenue source, originally budgeted at \$500,000 for FY2020, will be well in excess of projections, with nearly \$350,000 more than budget received. This unexpected additional revenue will provide funds to help maintain service delivery and support capital projects.

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Major and Local Street Funds

Because the updated projections from MDOT staff indicate that the City should still receive full budgeted revenues for FY2021, no changes to the initial proposed appropriations are recommended for the Major and Local Street Funds. If the impact of the crisis becomes greater than projected and future revenues fall further below current State projections, there are sufficient reserves in both funds to help mitigate the immediate impact of the reduction while further decisions are made. Funds will still be appropriated for Chestnut Street, Evert Street, and Stimson Street as originally planned and approved in the 6-Year Capital Improvement Program.

Water and Sewer Fund

Based on the challenge of projecting usage once the economy is reopened, City staff will be closely monitoring monthly usage trends and will look to respond accordingly to financial challenges in the system as necessary. As part of this effort, this Response Plan identifies the following items that may be temporarily deferred:

Table 5 – Water and Sewer Fund Financial Response Recommendations

	Current Budget	Pandemic Response Plan	Increase (Decrease)
WATER AND SEWER FUND			
Department: Revenue	\$4,447,000	\$4,447,000	\$0
Amended Line Items Detail			
* No specific reductions recommended at this time	0	0	0
 <i>Purpose: No specific recommendations are being made to reduce projected revenues at this time. Instead, certain expenses and capital purchases will be essentially frozen until further Council action depending on actual impact to revenue throughout the year.</i>			
Department: Capital	\$10,037,000	\$9,615,000	(\$422,000)
Amended Capital Investment Detail			
Capital Investment	10,037,000	9,615,000	(422,000)
Projects Deferred:			
Service Truck	28,000		
LIMS/WIMS Software	75,000		
Revolution Blower	200,000		
Ultraviolet Bulbs	34,000	(Need to buy \$6,000)	
Manhole Rehabilitation	25,000		
Storage Barn	35,000		
Water Well Inspection	25,000		
Total Projects Deferred:	422,000		

***Purpose:** Freeze funding for projects referenced above. Purchases/projects are still recommended but will be readdressed as the year progresses.*

In addition to the project deferrals referenced above, the Utilities Department is analyzing scheduling and staffing options to provide further cost reductions if needed.

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SUMMARY OF CHANGES

In summary, the City will respond to the impacts that the crisis may have on the FY2021 budget in a thoughtful and flexible way. In the City’s largest funds, this response is summarized as follows:

	Current Budget	Pandemic Response Plan	Increase (Decrease)
General Fund			
Capital Expenditures	157,000	55,000	(102,000)
Travel and Education	65,300	49,000	<u>(16,300)</u>
			(118,300)
Water and Sewer Fund			
Capital Projects	10,037,000	9,615,000	<u>(422,000)</u>
		Total	(\$658,600)

RECOMMENDED CITY COUNCIL ACTION

In accordance with the information and guidelines outlined in this Response Plan, it is recommended that City Council consider approval by resolution the proposed Cadillac Pandemic Financial Response Plan that freezes spending for the items detailed in the ‘SPENDING AND APPROPRIATION ADJUSTMENTS’ section.

Based on the information and guidelines outlined in this Pandemic Financial Response Plan, it is also recommended that City Council adopt by ordinance the General Appropriations Act as originally presented with the inclusion of the Downtown Infrastructure Project Fund as described in Addendum A.

FUTURE OUTLOOK

It is anticipated that throughout the upcoming fiscal year updated action may be necessary as is typical in most years. However, due to the pandemic, this upcoming fiscal year certainly may be unique.

The spending adjustments identified in this Response Plan can be readdressed during the year should the pandemic ease and the economy and revenues begin to stabilize. Indicators such as stable or “normal” tax receipts, water/sewer revenues and shared revenue income could indicate a stronger level of comfort in restoring appropriations. These projects otherwise would not be able to be implemented until subsequent action is taken by the City Council to restore their appropriation. Council will be provided with financial status updates in order to stay abreast of current financial conditions.

This will be a unique budget year! However, this is a resilient organization that will continue its proud tradition of being fiscally conservative while also providing high quality services and doing whatever possible to provide an environment where Cadillac will continue to thrive and prosper.

ADDENDUM A

May 28, 2020

Council Communication

Re: Changes to proposed FY2021 General Appropriations Act

In order to address the upcoming downtown infrastructure project and to appropriate funds to cover debt service on the upcoming bond issuance, the following changes are recommended to the FY2021 General Appropriations Act:

	Current Budget	Amended Budget	Increase (Decrease)
BROWNFIELD REDEVELOPMENT FUND			
Department: Revenue	\$34,500	\$75,500	\$41,000
Amended Line Items Detail			
Property Taxes	34,000	75,000	41,000
<i>Purpose: To recognize additional taxes captured from Lofts project.</i>			
Department: Expenditures	\$34,500	\$75,500	\$41,000
Amended Line Items Detail			
Contractual Services	16,100	57,100	41,000
<i>Purpose: To appropriate funds to transfer taxes captured from Lofts project to cover debt service on capital improvement bonds.</i>			
DOWNTOWN INFRASTRUCTURE PROJECT FUND (NEW!)			
Department: Revenue	\$0	\$1,000,000	\$1,000,000
Amended Line Items Detail			
Bond Proceeds	0	1,000,000	1,000,000
<i>Purpose: To appropriate funds for bond proceeds that will be utilized to fund the public infrastructure in the downtown area adjacent to the Lofts project. Bond proceeds will be repaid with captured taxes from incremental growths in the taxable value within the project area.</i>			
Department: Construction	\$0	\$1,000,000	\$1,000,000
Amended Line Items Detail			
Construction	0	1,000,000	1,000,000
<i>Purpose: To appropriate funds to fund the public infrastructure in the downtown area adjacent to the Lofts project.</i>			

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2020 CAPITAL IMPROVEMENT BONDS DEBT SERVICE FUND (NEW!)

Department: Revenue	\$0	\$325,000	\$325,000
Amended Line Items Detail			
Transfer In - Major Street Fund	0	142,000	142,000
Transfer In - Local Street Fund	0	142,000	142,000
Taxes	0	41,000	41,000

***Purpose:** To recognize revenue transferred in to pay debt service on new capital improvement bonds.*

Department: Administration	\$0	\$325,000	\$325,000
Amended Line Items Detail			
Principle	0	215,000	215,000
Interest	0	110,000	110,000

***Purpose:** To appropriate funds to pay debt service on new capital improvement bonds.*

MAJOR STREET FUND

Department: Administration	\$395,500	\$537,500	\$142,000
Amended Line Items Detail			
Transfer Out - 2020 Debt Service Fund	0	142,000	142,000

***Purpose:** To appropriate funds to transfer to debt service fund to pay debt service on new capital improvement bonds.*

LOCAL STREET FUND

Department: Administration	\$156,500	\$298,500	\$142,000
Amended Line Items Detail			
Transfer Out - 2020 Debt Service Fund	0	142,000	142,000

***Purpose:** To appropriate funds to transfer to debt service fund to pay debt service on new capital improvement bonds.*

Recommended Action

It is recommended that the General Appropriations Act ordinance be adopted as originally presented with the modifications above incorporated into the ordinance.