

City of Kent

2005 Financial Report



A survey by the National League of Cities reports that for the first time in a decade, the majority of cities in the United States believe that their financial conditions are worse now than they were 4 years ago.



Losing ground.

Financial sustainability has been one of the defining issues of this decade for cities across the nation – and unfortunately Kent is no exception. Over the last 5 years the city's revenues have failed to keep pace with expense growth and despite expense management efforts the gap between revenues and expenses has increased each year.

One thing is clear: the era of robust revenue growth is over, and health care, energy, and transportation costs are at all time highs. The city has been able to delay the impacts of its financial imbalance by deferring projects, reducing head count, freezing vacancies and making efficiency improvements to minimize the stress on core services. But without an infusion of new revenue, or a cut in services, the structural deficit will force the city to dip into its reserve fund balance for the third straight year in order to balance the books.

On a short term basis using reserve funds to bridge-over temporary problems is a reasonable strategy – after all that's what reserve funds are for – but the problem is that the city can only go to the well so many times before we come up empty, and that day is now on the horizon – estimated at 2 ½ years from now. Two and one-half years may sound like it's off in the distance but we need to be talking about it and planning for it now so that we can come up with a thoughtful, reasonable fix rather waiting until 2008 and having to act in desperation at the last minute when our options will be very limited.

That's what this report is all about – preparing for tomorrow by tackling Kent's toughest problem today.

Report Objective

"To frame the city's financial challenges in a way that deepens our understanding of the problem, encourages strategic conversations based on data, challenges assumptions and promotes collaborative problem solving. "

A few thoughts on approach...

Staff is proposing a year long effort to review, discuss and deliberate on the development of a financial strategy for Kent. Using a diagnostic-based approach staff will seek to define where we are today, how we got here, and where we're heading in order to integrate Council's and the community's input on where we want to go and how to get there.

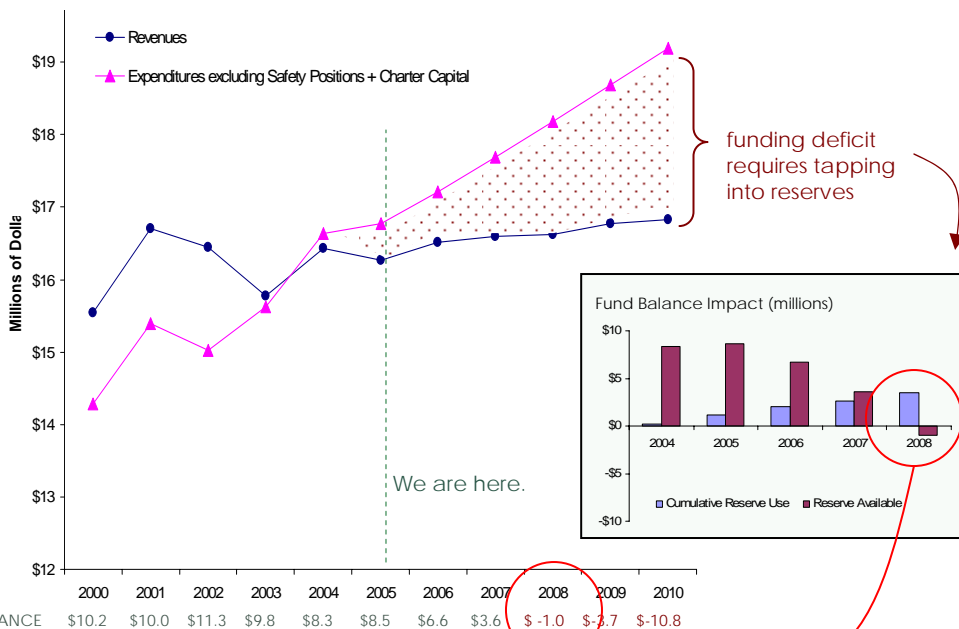
1. City Financial Position

The city's deficit problem comes as no surprise. The trend has been emerging over the last five years and the previous city administration warned of an impending fiscal crisis in the annual budget messages. The source of the problem remains the same as it was five years ago – sluggish revenues failing to fully fund basic city services – and to fill the gap the city has been forced to tap into its limited savings/reserve funds three years running.

"The most alarming factor in this budget is that the city will need to use over \$1 million dollars of the general fund balance to cover its anticipated expenses.... This challenge is becoming acute."

Lew Steinbrecher,
2004 Budget Message

Revenue Income vs. Expense & Capital Requirements



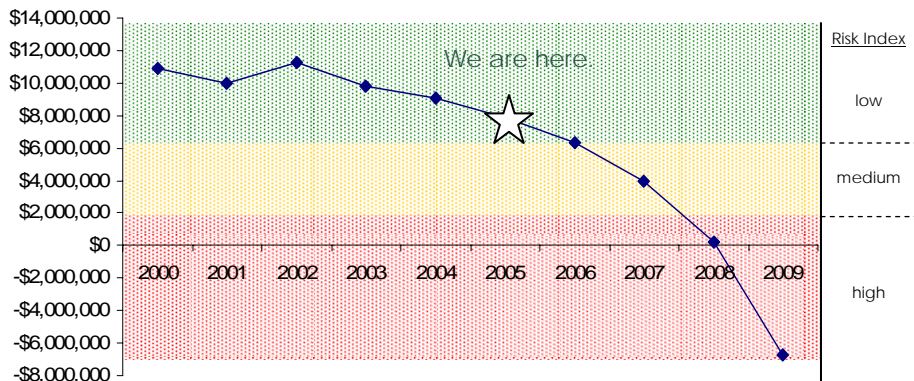
In the course of the last five years the revenue gap has continued to grow, the city's dependence on reserve funds is rising at a rate of 20% per year, and the window of opportunity to take preventive measures is closing.

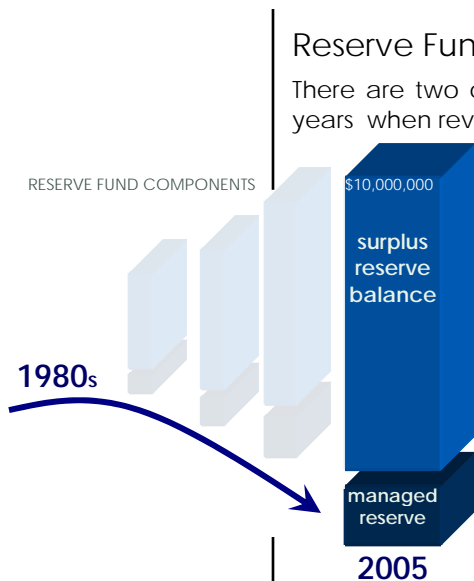
RESERVE FUND BALANCE

Through a combination of good fiscal management and increased borrowing practices the city has accumulated \$10 million in reserve over the last 10 years. Unfortunately, this balance is one-time cash savings so once it is spent, it is gone. As a result, the fund is ideal for one-time cash purchases, e.g. capital equipment or projects, but it is risky to rely on it to for recurring cash needs (e.g., payroll) for extended periods.

The city is now at a tipping point where revenue and expense decisions must either be made or the city must face the reality of draining the city's reserve fund balance within the next 2 ½ years.

The city's dependency on Reserve Funds to balance the budget is growing at a rate of 20% per year





Reserve Fund Components

There are two components to the city's reserve: 1) A cumulative surplus built from years when revenues exceeded expenses and; 2) A specially designated "managed reserve" fund, that was established by policy in the 1980s to ensure that the city always maintained a minimum amount of cash to uphold its fiduciary obligations, i.e., keep enough cash in reserve to pay its bills at any given time.

Once Council achieved its managed reserve target of \$1 million no further allocations have been made to the fund other than interest accrual (2005 balance = \$1.7 million). On the other hand, the surplus reserve fluctuates based on the net difference between revenues and expenses each year. The surplus reserve balance was built over the last decade to a high of \$11 million in 2002.

The surplus reserve is used for unanticipated fiscal needs and is also the source of cash for the city's "pay as you go" capital projects, including assessment projects where the city fronts cash that is paid back over time through assessments. The surplus fund is also the source of funding for correcting the budget deficit the last 3 years.

Balancing Risk



What is Council's financial risk quotient?

Risk Tolerance and Financial Decisions

Draining the reserve fund balance to fill the revenue gap is an action that increases the risk associated with the city's financial position. As the reserve balance drops the risk of financial shortfall increases. If you have a low tolerance for risk, then the declining balance could be alarming. If however you have a higher tolerance for risk, the use of reserve funds is perfectly acceptable.

Risk is inherent to every financial decision, the question is not how to avoid it, but how to manage it. The answer in part lies in keeping a "probabilistic" perspective that judges the odds of various outcomes and weighs them against the possible gains or losses associated with each outcome. The more Council can establish financial parameters for risk tolerance upfront the more effective staff can be in managing the risk and using it to drive asset allocation decisions.

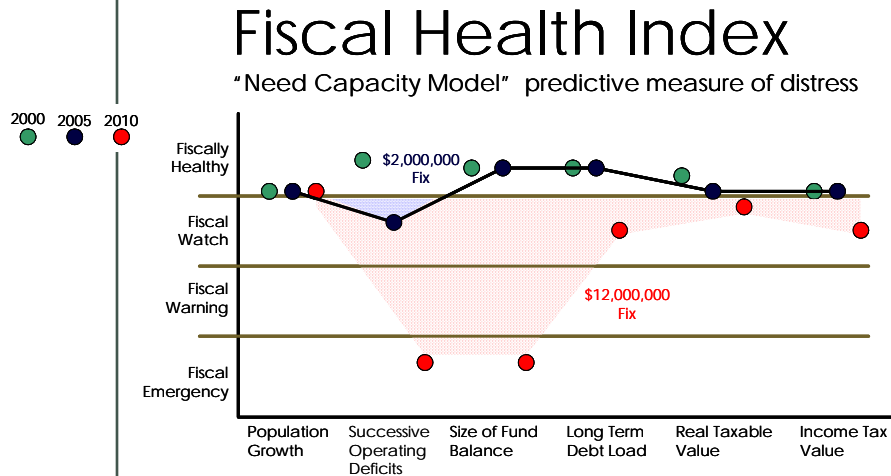
KENT'S STRUCTURAL DEFICIT

A deficit occurs whenever expenses exceed revenues. Sometimes those deficits are a result of unanticipated financial circumstances. Other times, the deficit is an intentional strategy where expenses are allowed to exceed revenues in order to bridge a funding gap. When the deficit is built into the budget, it is considered a structural deficit. Structural deficit budgets start the year with full anticipation of a revenue shortfall and they plan on using reserve funds to fill the gap.

After three successive years where expenses exceeded revenues, the City of Kent has used structural deficits as a strategy to bridge-over its revenue shortfalls. This strategy has enabled the city to avoid raising fees/taxes without reducing city services. Each of the last 2 city budgets were approved showing less revenues than expenses. This strategy helps manage through periods of temporary revenue corrections but it has to be balanced against increased financial risks of diminished reserve savings. Reserve funds are not unlimited so the continuation of this strategy needs to be based on some reasonable expectation of imminent revenue enhancement or expense savings, otherwise it contributes to further fiscal distress.

FISCAL DISTRESS

Just like physical health, the city's financial well-being is carefully monitored. The vital statistics for good fiscal health includes such things as a growing population base, increasing real property and income tax values, prudent long term debt load, and stable reserve fund balances. These criteria provide insight into the revenue capacity and financial sustainability of the city. When studied over time these indicators reveal important fiscal trends and provide a measure of fiscal distress in the community. For example, an assessment of these characteristics for Kent from 2000 thru 2010 reveals a steady decline from a fiscally healthy position to one of serious fiscal concern by 2010 if financial circumstances do not change.



With successive operating deficits the city has allowed a \$500,000 gap in 2003 to grow to a \$2,000,000 fix in 2005 that will in turn grow to \$12,000,000 by 2010 if the city does not change its financial course. As the city's fiscal position erodes the city's credit rating also declines and the cost of borrowing money increases due to higher interest charged by the lending agencies that consider the city a higher risk for default. For these reasons short term budget decisions must be weighed against long term fiscal health before making asset allocation decisions.

2. Financial Outlook

Forecasting isn't about predicting the future, it's about preparing for what the future may bring. The next section of this report reviews the historical revenue and expense data that led to current conditions. From this data we can seek to discern trends that provide insight into the city's most probable future conditions.

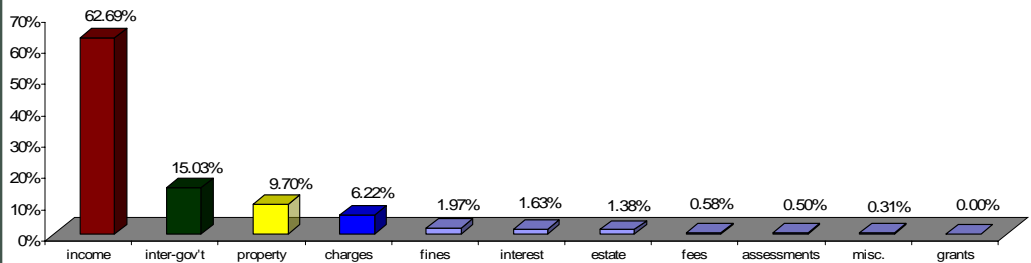
Revenues

A healthy revenue position is built on a diversity of revenue sources. The greater the spread of revenue sources, the lower the vulnerability to cyclic business fluctuations and recessionary periods. Likewise, the greater the concentration of revenues, the greater the risk of revenue instability when the primary source suffers setbacks.

CITY OF KENT REVENUE POSITION

The city has a number of revenue categories but in reality income taxes are the best indicator of the city's financial health as they contribute 4 times more than the next closest revenue source and 1 1/2 times more than all the other categories combined.

2004 Revenue Source Distribution

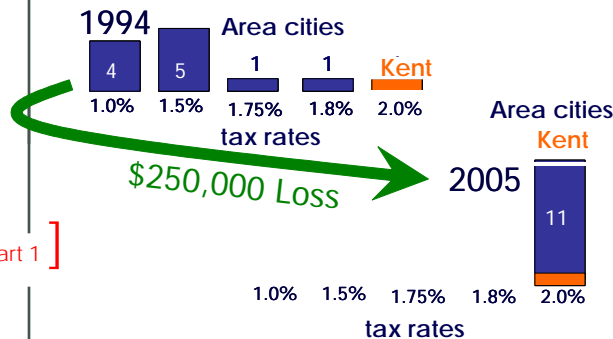


KENT INCOME TAX RATE

Kent adopted a 2% income tax rate in 1984 and it has not changed in the last 21 years. Of the surrounding cities with the largest number of Kent workers, Kent was the only city in 1984 and ten years later in 1994 to have a 2% rate. However, over the course of the last decade those cities have all caught up.

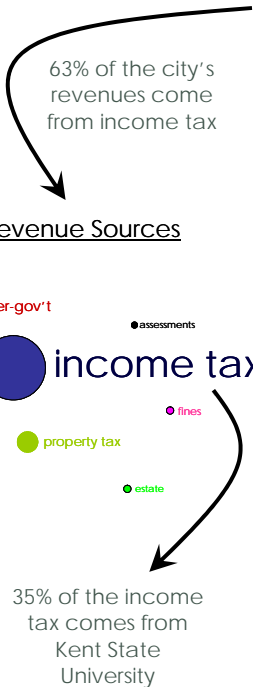
Income Tax Differential

Kent 2% since 1984

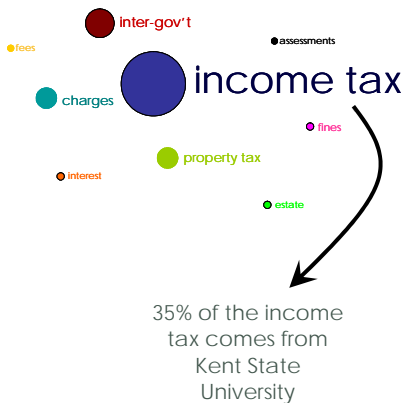


The closing of this gap is important because Kent collects the tax differential for people that live in Kent but work in another city with a lower rate. Residents in Kent get 100% credit for what they pay where they work, so if a person pays 1% where they work they only have to pay 1% to Kent to meet the city's 2% tax rate. Each time the other cities raise their rates closer to Kent's 2%, Kent loses its differential share of income tax.

With all 11 of the neighboring cities (where the largest numbers of Kent residents are employed) at 2% in 2005, Kent is no longer getting any income tax revenue from those workers, resulting in a net loss to the city of \$250,000 per year.



Relative Revenue Sources



[EROSION OF REVENUE BASE part 1]
- loss of tax differential

A Kent resident with a salary of \$50,000 pays \$1,000 a year in city income tax.

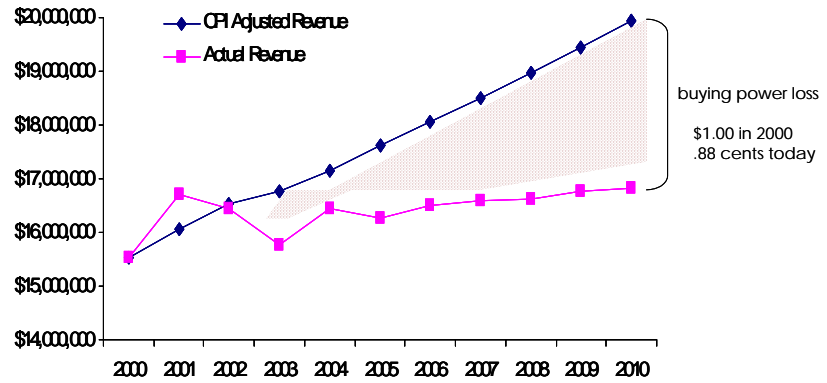
[EROSION OF REVENUE BASE part 2]

- loss of tax differential
- loss of buying power

WAGE EARNINGS

Wage earnings and new job growth have been relatively flat over the last 5 years in Kent with an average increase in income tax receipts of only 1.5% a year (pink line in comparative chart below).

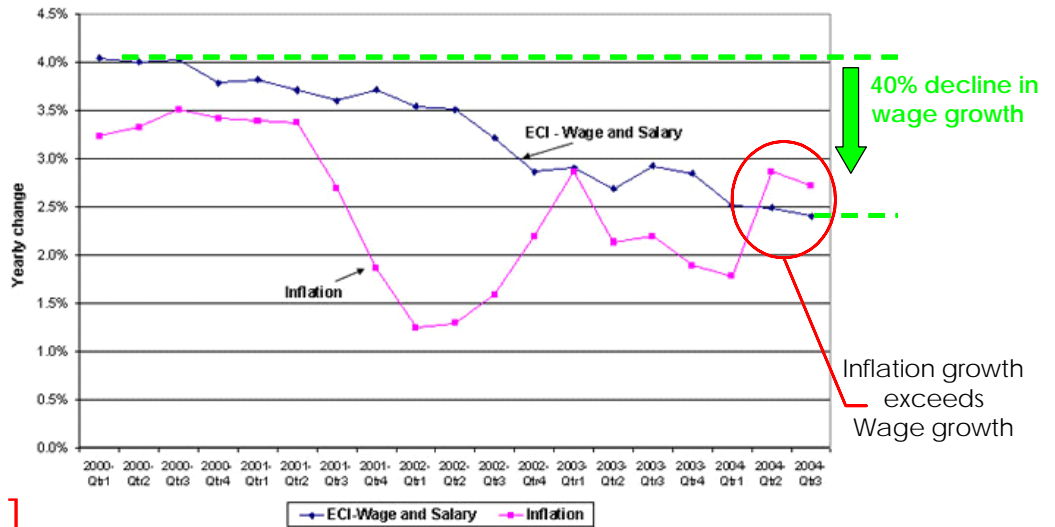
CPI Adjusted Revenue vs. Actual Revenue



With increases in the Consumer Price Index (CPI) for the same period averaging 3.3% per year the buying power of the city's base revenues declined by nearly 2% per year. The chart above compares the CPI adjusted revenue (blue line rising at the annual rate of inflation) against the actual revenue received (pink line) - thereby highlighting the loss of buying power of the city's income tax revenues.

In what has been coined the "jobless economic recovery" new jobs have not kept pace with the amount of lost jobs and although productivity reached all-time highs, wage and salary growth have actually declined by 40% in the last 4 years. For the first time inflation growth (pink line below) surpassed wage growth (blue line) in 2004.

Figure 2: Nominal wage growth compared to inflation, 2000-2004



[EROSION OF REVENUE BASE part 3]

- loss of tax differential
- loss of buying power
- wage growth decline

The declining trend in wage growth constrains the ability of income tax revenues to hold their ground against increasing rates of inflation, further contributing to the overall erosion of the city's revenue base.

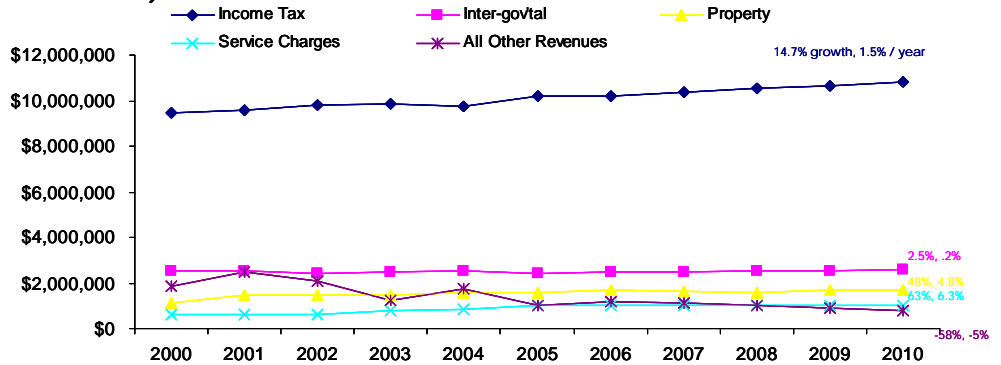
The Ohio Municipal League reports that income tax — which is the primary source of revenue for Ohio cities — is flat or going in a negative direction for a majority of its members.

REVENUE GROWTH

A review of the city's principle revenue sources indicates no-effective-net growth in any of the revenue categories (see chart below) from 2000 to 2005. In every category, revenue growth has failed to keep pace with inflation growth, resulting in a net loss of purchasing power.

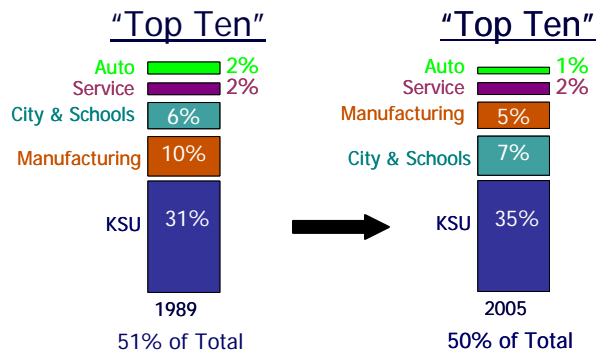
For projection purposes, current declining and flat line trends are extended out thru 2010 since there is nothing to indicate an imminent change in the performance of any of these categories.

Revenue Performance and Growth Forecast (2000 to 2010)



Another trend noted in the economic data observed from 1989 to 2005 is the further concentration of income tax receipts on employment at Kent State University. The narrowing distribution of income tax sources reflects the replacement of lost high paying manufacturing jobs in Kent with lower paying service jobs. As a result, private sector income tax contributions have continued to shrink and the public sector share of the base (including KSU) increased in proportional share from 37% to 42%.

Income Tax Contributions



[EROSION OF REVENUE BASE part 4]

- loss of tax differential
- loss of buying power
- wage growth decline
- "high paying" job loss

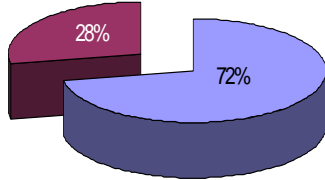
Expenses

The city has focused on expense management in order to drive higher performance in city operations while hoping to buy some time for a revenue turn-around that unfortunately has not yet materialized. Expense containment has been the principle financial strategy for the city over the past five years – but with so little truly “discretionary” expenses the city is constrained by its ability to cut costs without cutting into city services.

CITY COST CENTERS

The city’s expenses derive from two cost centers: 1) those non-discretionary costs such as workers compensation, retirement, etc. that are tied to personnel; and 2) those discretionary costs such as operating supplies and materials that support operations but fall within the control of management.

Discretionary
(materials, supplies, equipment)

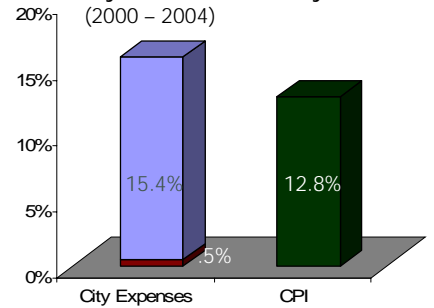


Non-discretionary
(positions, payroll, health care)

In comparing the cost histories for “discretionary” versus “non-discretionary” spending, the staff have held the discretionary costs to less than .5% growth total over the last 4 years as compared to 12.8% growth in the CPI – an equivalent savings of \$784,000.

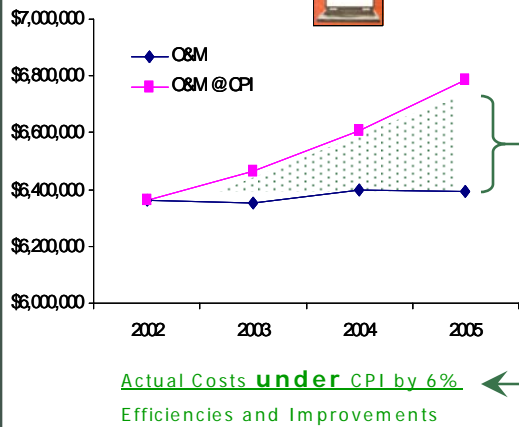
Yet at the same time the non-discretionary costs have risen 15.4%, exceeding the CPI by \$351,000.

Discretionary / Non-discretionary vs. CPI Growth
(2000 – 2004)

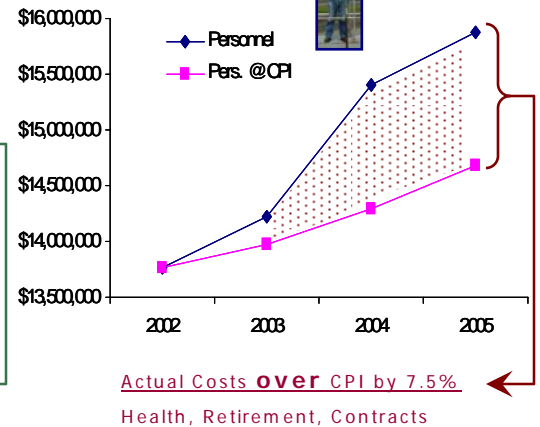


These trends are further illustrated in the charts below.

Discretionary



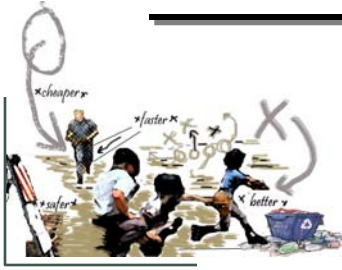
NonDiscretionary



The city cut 5% of the workforce since 1998 and has frozen an additional 5% in 2005 to contain costs.

Position Cuts and Personnel Savings

Planner to Part Time	\$ 37,750	Froze 3 firefighter positions	\$ 259,800
Reduced 3 police positions	\$247,500	Froze 2 police positions	\$ 165,000
Reduced 1 secretary	\$ 58,000	Froze 1 assignment spvr.	\$ 93,000
Reduced 2 systems analysts	\$154,000	Froze 1 wastewater oper.	\$ 68,800
Reduced 1 tax auditor	\$ 60,000		
Reduced 1 water specialist	\$ 92,000		
		TOTAL = \$ 1,235,800	



Doing more with less.

Blood Alcohol Testing	\$ 5,000
Sponsored Training	\$ 5,600
High Grass Transfer	\$ 1,500
One Stop Software	\$ 16,000
OSU Bicentennial Plan	\$ 100,000
In-House Design Work	\$ 16,000
Hook Lift Trucks	\$ 45,000
Vehicle Fuel Purchase	\$ 2,300
Oil Storage Room	\$ 1,900
Leaf Service Equipment	\$ 8,800
<u>Snow Plow Equipment</u>	<u>\$ 5,280</u>
SUBTOTAL	\$ 207,830
Phone Network Changes	\$ 15,700
Cell Phone Carrier	\$ 3,000
County-wide Rescue Team	\$ 52,000
Regional Haz Mat Team	\$ 23,000
Homeland Security Purchases	\$ 70,000
Smoke Trailer Elimination	\$ 6,000
Pager Contract Renegotiation	\$ 2,500
Digital Fingerprint Program	\$ 75,000
Deferred Vehicle Replacement	\$ 255,000
State Contract Purchases	\$ 30,000
Contract IT Services	\$ 35,000
<u>Firearms Qualifications</u>	<u>\$ 5,000</u>
SUBTOTAL	\$ 572,200
Road Salt Purchases	\$ 32,800
In-house Design of Area Q	\$ 12,450
Cuyahoga River Design Work	\$ 117,000
E. & W. Main Street Design	\$ 81,000
McKinney Blvd. Design	\$ 7,500
Glad Blvd. Re-Design	\$ 23,000
City Hall Parking Lot Design	\$ 6,000
Fish Creek Parking Lot	\$ 3,000
E. Main St. Ped Island Design	\$ 10,000
Liberty Garden Design	\$ 4,500
Middlebury Waterline	\$ 88,000
<u>Street Resurfacing</u>	<u>\$ 35,000</u>
SUBTOTAL	\$ 420,250
Uniform Contract Changes	\$ 19,000
Dissolved Floatation Savings	\$ 20,000
Clarifier Reductions	\$ 1,000
In-Sludge Presses	\$ 200,000
Electric Demand Meters	\$ 84,000
Risk Management Plans	\$ 6,500
In-House Training	\$ 8,000
Sludge Conveyor Bldg.	\$ 50,000
Plant Heating	\$ 10,000
Property Mtce. Contract	\$ 2,500
<u>Water Level Monitoring</u>	<u>\$ 3,000</u>
SUBTOTAL	\$ 404,000
TOTAL	\$ 1,600,000

CITY SERVICE PRODUCTIVITY IMPROVEMENTS

The combination of declining revenues and rising service expectations has required staff to look at eliminating waste and improving productivity wherever possible. Although these efforts have been decentralized, rather than coordinated as a formal citywide initiative, all of the departments have become more opportunistic in their purchasing and service delivery methods in order to stretch limited revenues. With resources being spread thinner staff has had to come up with new ways of meeting increasing service demands with funding that has remained essentially the same for the last 3 years. The list in the margin provides a snapshot of employee savings over the last couple of years.

CITY SERVICE IMPACTS

With rising health care costs, pension contributions, unfunded mandates and routine inflation increases, city resources have been stretched thin. On a short term basis city services can handle being stretched but the longer the operations are forced to run on over-drive the greater the toll it takes on equipment and personnel. Eventually the elevated pace of stop-gap measures wears resources so thin that staff capabilities become diminished whether intended or not.



Diminished service capabilities may be an unintended consequence but it has the same effect as a service reduction whether it is formally acknowledged as such or not. Service reduction is an option to consider in times of fiscal shortfalls but creating service reductions by capping expenses rather than through deliberative choices about what should be cut allows service reductions to be driven more by chance than by strategy.

As a result, rather than evaluating and prioritizing city services and making a collective decision about which service to reduce, service reductions have occurred indiscriminately. Often, the impacts of this approach are felt first where resource needs are the greatest to begin with, which may in fact be the last place cuts would be recommended through a priority analysis, e.g., public safety. In other words, service reduction is already happening by capping expenses that squeezes all services uniformly; the question is whether the city desires to be more effective and target service cuts to align with the city's goals and citizen expectations.

EXPENSES AS INVESTMENTS

The city's expenses are more than just costs; they are a measure of re-investment in the community's assets each year. And those assets are more than just physical infrastructure; they include city services and the opportunities created by city services that add value to Kent citizens and businesses. That sense of "shareholder" value is ultimately the city's economic engine that sustains and grows the city's revenue base.

Recognizing this relationship between the city's expenses - and the revenues that they produce - is important to understanding the risk of indiscriminate service cuts. The revenue generating capacity of the city is tied to its service capabilities and an extended period of indiscriminate cuts threatens to undermine the very services that keep Kent an "investment grade" community that is worthy of attracting the new investments that in turn bring new revenues. In other words, indiscriminate cuts avoid short term pain but they can chill future economic growth.

[EROSION OF REVENUE BASE part 5]

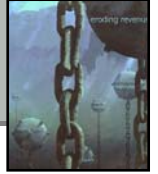
- loss of tax differential
- loss of buying power
- wage growth decline
- "high paying" job loss
- expense chilling effect

Expense management must always be a part of the city's business practices but from a return on investment perspective expense strategies can only do so much before they begin to erode revenue capacity as the city sacrifices market share (business and residential) to its neighbors who are increasing their annual re-investments in their communities.

3. Financial Strategies

Financial strategies are how we convert our financial assets into outcomes. They are the choices we make about what to do with our money, what not to do, and how to best allocate what we have for maximum effect. Strategies force us to be smarter, more disciplined, and more focused on what's important.

Financial strategies provide a path to get from where we are to where we want to be as a community. When done right, they help us navigate around the mines that dot the public sector landscape.



By trying to do everything for everyone we run the risk of doing nothing for anyone.

Strategy.



Picking the right tools for the right job.

INVESTMENT PERSPECTIVE

Time has a way of turning assets into liabilities and the City's service and physical assets lose value every day. Whether the tab is paid along the way or at the end of the trip, the meter is always running. The strategy question is how and when the bill gets paid.

How to pay the bill leads into a discussion of investment strategy questions like: How valuable are Kent's assets? How important is preservation of asset equity? What return on equity is expected? What is the risk tolerance for market loss? The answers to these questions help build an investment strategy that matches investor goals. Or in the case of the city, helps develop a financial strategy that aligns city service expectations with funding levels that are capable of fulfilling Kent's community goals.

START WITH THE END IN MIND

Strategies are tools that are available to use to achieve specific goals like economic development, environmental protection, historic preservation, quality of life and safe community. The tools are a means to an end; they are not an end in and of themselves. Yet when it comes to choosing financial tools for the city to use in the context of a budget, e.g., outsourcing, taxes, service cuts, fees for services, debt, etc., the tools debate often dominates the discussion and prevents the necessary dialogue about desired outcomes from happening first.

Like any construction job, we have to agree on what we want to build before we can discuss which tools will do the best job. A hammer is great for nailing but it's not very good with screws. The same logic applies with building community. Taxes, outsourcing, fees, and service cuts are all effective for certain purposes in certain conditions, the challenge is looking beyond the means to see what we are trying accomplish and then picking the tool most suited for the job. In other words, start with the end in mind.

DEFINING OUTCOMES

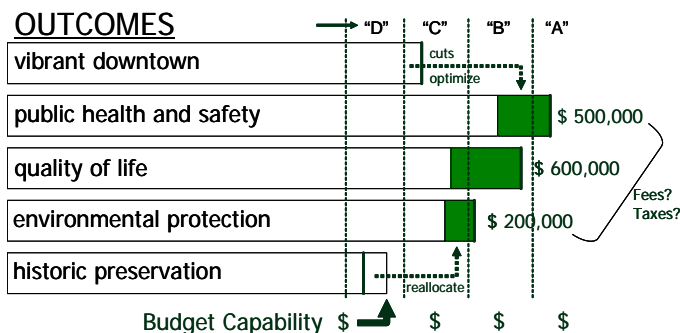
Strategies are judged by their ability to deliver outcomes so the first step is defining the outcomes desired. But defining the outcomes has to be more than listing broad vision statements. Good strategies are shorter on vision and longer on detail in order to be actionable.

In effect, the budget document and its use of financial strategies is where community goals get translated into daily services and operations. That translation requires a level of detail not typically expressed in broad community vision and mission statements, e.g., we want a safe community. For strategy purposes, safe community has to be refined into measurable objectives, e.g., # of patrol officers per capita, call response time, crime clearance rates, etc. When we do this we put ourselves in a position to compare where we are today with where we want to be – and more importantly what it will take to get there. "What it takes to get there" is the strategy tool discussion.

GAP ANALYSIS CONCEPT

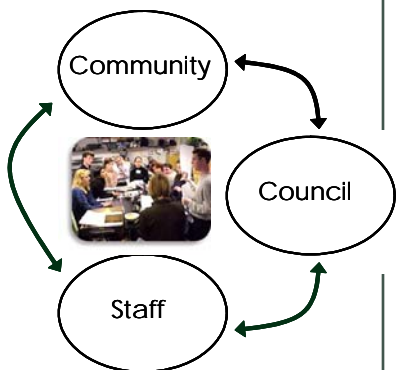
Gap analysis is a useful way to begin to narrow-in on what it will take to get to where we want to be. As an example, in the diagram below specific city outcomes are measured using a simple grading scale (D, C, B, A) with each letter representing a different level of service (D being low, A high).

Using this approach, service levels are loosely linked to funding levels which in turn makes it possible to assign an actual dollar value for what it would take to go for example from service level C to a service level A. That dollar value is driven by pre-defined service parameters, e.g., service level C may be equal to 10 officers per capita, 8 minute response time, 50% crime clearance rate, while service level A may be equal to 20 officers per capita, 6 minute response time, 75% crime clearance rate.



The linkage of funding levels to service levels is an inexact science but it is possible to provide rough enough correlations to support greater community dialogue about what we can afford and what it would cost to increase service levels or advance particular community outcomes. Identifying that gap then makes it possible to look through the strategy tool kit to see which tools are the best fit for the problem, e.g., service cuts, outsourcing, fees or tax increases.

Much like performance based budgeting, the gap approach introduces a price signal for levels of service that better defines what we get for our public dollars. Unfortunately the nature of tax based services and the traditional lump-sum tax bill has disconnected the cost for service from the service rendered and has contributed to misconceptions (and frustrations) over what people believe they get for their public dollar. Communities that have defined the connection between price for service have found it easier to explain possible service cuts or tax increases and garner public support for necessary change.



GAP ANALYSIS IMPLEMENTATION

To be effective the discussion of the affordability of community outcomes requires extended dialogue between citizens, staff and City Council. For the purposes of the 2006 budget, schedules will not permit that level of dialogue so staff will instead use a modified gap approach in preparation of the budget as a first step.

Rather than defining multiple increments of service levels (D, C, B, A), the budget will be based on fulfilling the city's "critical needs" (equivalent perhaps to levels D & C only). As a result the budget will be a status quo budget that seeks to sustain existing service levels for another year under severe fiscal limitations.

In the discussion of the "critical needs" budget, staff will also begin to introduce financial data outlining major funding gaps for core city services that have occurred due to the erosion of revenues over the last 5 years. Whereas the critical needs defines a "reality based budget," the gaps funding offers a "possibilities budget."

As the city leadership resumes its strategic planning discussions in early 2006 staff will continue to focus on "operationalizing" the community goals in a manner that supports the cost for service dialogue early-on in the development of the 2007 budget so that we can have the time needed to find the right tools and the best fit for Kent in 2007.

FINANCIAL FIT

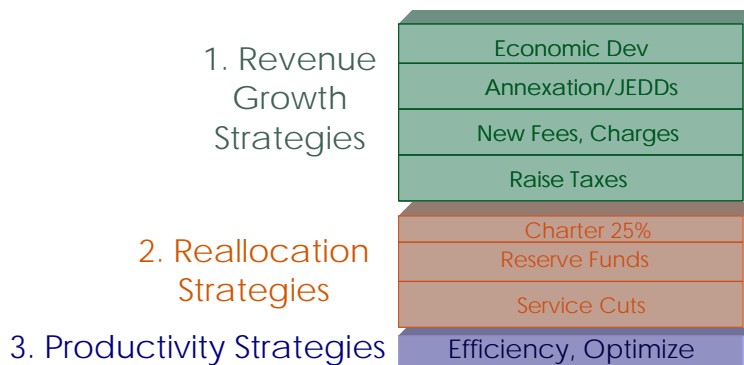
The tools available in the city’s financial tool kit each have their own strengths, weaknesses, pro’s and cons depending upon how and when they are used. The challenge is framing and defining the problem well enough to be able to recognize the most effective tool in a given circumstance – or in other words, finding the best fit.

From a financial perspective “best fit” has to do with how well the solution solves the problem (e.g., does it raise enough funds to fill the gap?); does the timeframe for the fix match the problem (e.g., will cash be available immediately or long term?); what’s the likely acceptability of the fix (e.g., is the problem clear enough to gain the necessary public support for the fix?); and what’s the risk that the fix won’t work (unintended consequences?).

In testing the city’s tools against the “best fit” criteria, it may be that more than one tool will be necessary to fully solve the problem.

STRATEGY CATEGORIES

There are three basic categories of financial strategies available in the city’s tool kit:



1. Revenue Growth Strategies

The first two options – economic development and annexation/JEDDs – are designed to grow the tax base in order to produce more tax receipts. The second two options – new fees and taxes – increase the contributions of existing tax payers to generate more revenues.

The following charts compare a few of the “fit” criteria for each category:

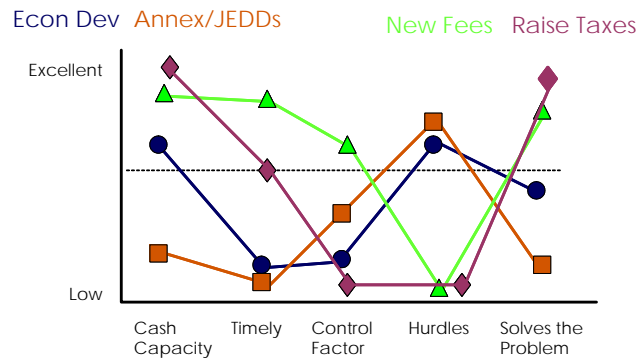
	Generating Capacity	Growth Potential	Limits	Rate of Return
Economic Development	Short term: Poor \$2,500 / yr. Mid term: Fair \$100,000 / yr. Long term: Good \$500,000 / yr.	Downtown underserved Manufacturing sites limited Vacant office space University spin-offs Hotel Conf. Center	Infrastructure investments Incentives Competitive Property accumulation Private dollars Speculative	Incremental Low margin Front-load investments
Forecast	- Short + Long	- Short + Long	- Short + Long	- Short + Long

	Generating Capacity	Growth Potential	Limits	Rate of Return
Annexation & JEDDs	Short term: Poor \$10,000 / yr. Mid term: Fair \$25,000 / yr. Long term: Good \$100,000 / yr.	Limited annexation options JEDD's built on 20 year schedule Active development in JEDD areas	Recruitment of businesses into JEDD's Long term timing	Incremental Low rates
Forecast	- Short + Long	- Short - Long	- Short - Long	- Short + Long

New Fees and Charges	Short term: Fair \$75,000 / yr. Mid term: Good \$250,000 / yr. Long term: Good \$500,000 / yr.	License Fees Permit Fees Ad / Sign Fees Rec Fees Health Fees Etc.	How much will the market bear? Chilling effects on usage Price sensitivity	Immediate
Forecast	+ Short + Long	+ Short + Long	- Short - Long	+ Short + Long

Tax Increases	Short term: Good \$1-3,000,000 / yr. Mid term: Good \$1-3,000,000 / yr. Long term: Good \$1-3,000,000 / yr.	Income tax to 2.5% Reduce income tax filing credit to 50% Increase property tax by 1-3 mils New Levy's Admission Tax Land Taxes	How much will the market bear? Chilling effects development Price sensitivity and ability to pay Voter approval	Immediate
Forecast	+ Short + Long	+ Short + Long	- Short - Long	+ Short + Long

Revenue Growth Summary – When the fit criteria for each of the revenue growth tools is plotted it becomes apparent that only the new fees and tax categories have the actual capability to provide immediate revenue relief but both face serious public acceptance hurdles.

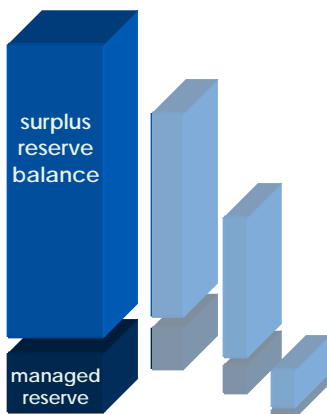
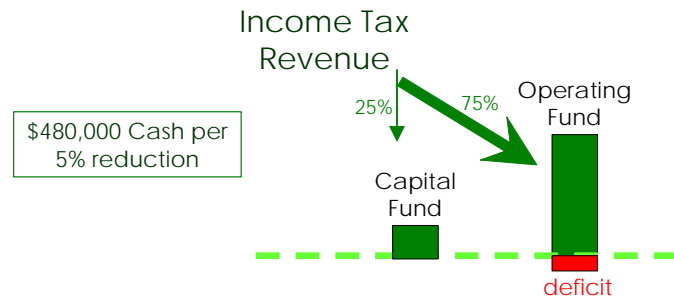


With the state tax code changes phasing-out portions of state taxes, Ohio residents will see decreases in their state tax payments. After years of unfunded state mandates squeezing the city's budget, it may be the right time to look at shifting the tax payments to make the city's budget whole.

2. Reallocation Strategies

Reallocation strategies redirect resources to fill gaps based on perceived priorities. The options include changing the charter 25% capital requirement in order to apply the funds to operating needs, using reserve funds, and making service cuts as part of a re-prioritization of city programs.

Charter Capital Requirement – The city charter requires 25% of city income tax receipts to be used each year on city capital projects. Although capital project needs are significant, it would be possible (with voter approval) to reduce the 25% allocation in order to free-up cash to fill the operating deficit. Each 5% reduction releases nearly \$500,000.



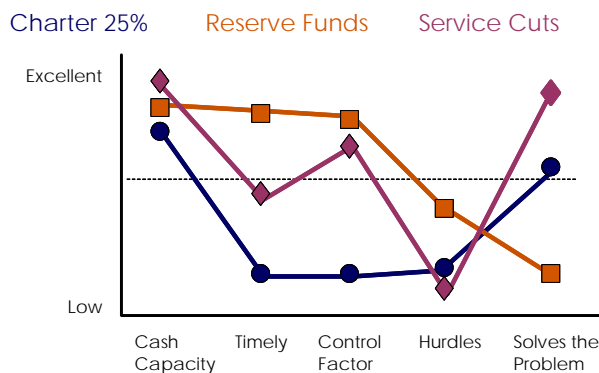
Reserve Funds – Undesignated or surplus reserve funds have been used for the last three years in a row to offset the operating deficit. As long as there is adequate reserve balance this strategy works but current projections indicate the likely depletion of the reserve fund in 2 ½ years so there is an upper limit on this tactic.

It may be possible to look at extending the life of the reserve fund through the sale of surplus city property. There may be some properties that no longer fit in any short or long term city plans that could be sold for cash purposes. Again, this is not a long term solution but it may buy more time for some of the long term options to get started.

Service Cuts – Rather than squeezing all the services uniformly, another approach would be to re-evaluate service priorities and cut or reduce funding to lower priority programs. Reallocating resources in this manner can ensure that the top priority services remain whole. The challenge is determining what to cut.



Reallocation Summary – When the fit criteria for each of the reallocation tools are plotted it becomes apparent that only the service cuts provides both an immediate and long term solution – presuming the public acceptance hurdles can be managed. The other two options have the capacity to fill the gaps in the short term but eventually the reserve funds will be gone and deferred capital needs will need to be addressed.

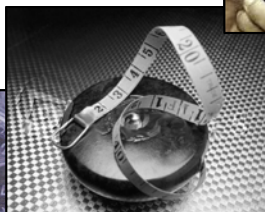


3. Productivity Strategies

Continuous improvement must become standard practice in all city operations. As documented earlier in this report, city staff have made significant strides towards being more productive and those efforts will have to continue if the city is to remain competitive. Unfortunately, efficiency improvements are typically incremental and take years to accrue so they are more of a long term solution rather than a short term fix.

Competitive Fitness of the Organization

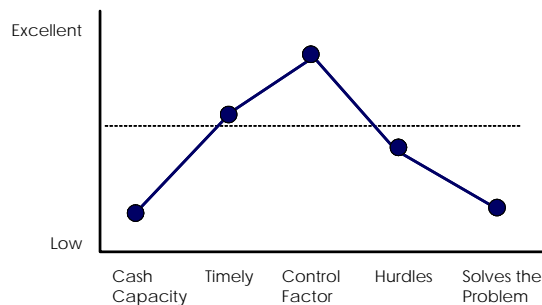
performance measures



benchmarks



Productivity



STRATEGIC COMBINATIONS

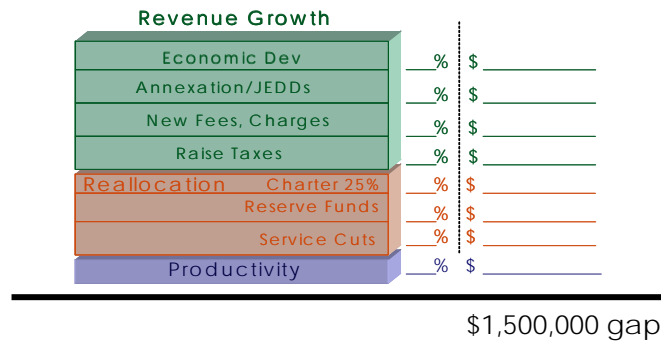
In even a cursory analysis it is apparent that there is no “perfect fit” for solving the city’s running deficit. This is a tough problem that will take some hard decisions to overcome. If it was easy, it would have been solved by now.

The tools that can generate enough funds to fix the problem today have some high hurdles to cross. With that in mind the most strategic decision may be a hybrid approach that combines the strengths of each. For example, it might make sense to combine some small service cuts with small fee or tax increases that support a planned schedule to phase out reserve fund use over enough time to allow some economic development projects that are in the pipeline to get on-line.

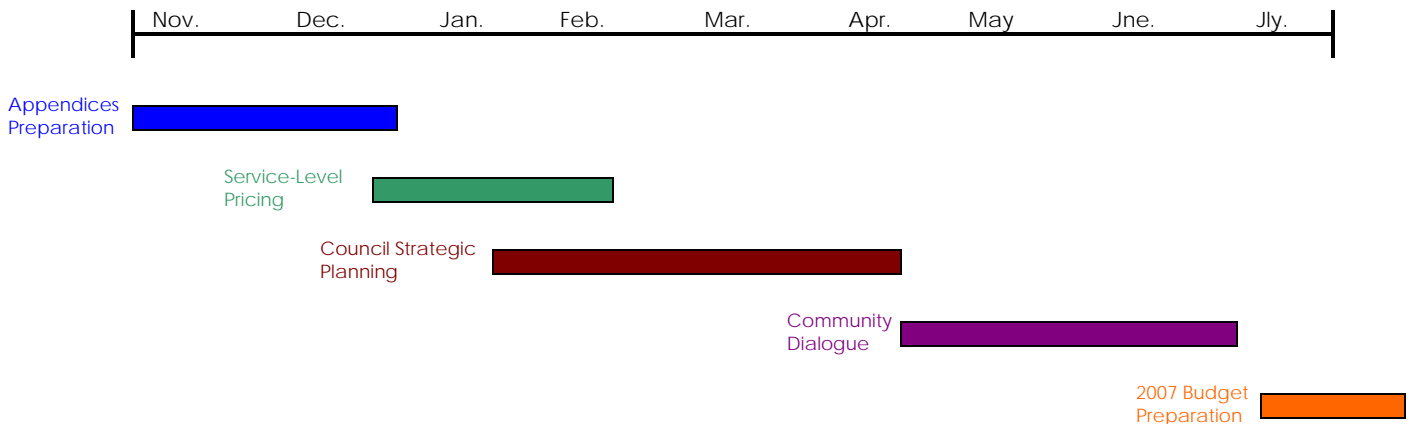
It will take more time and research to develop a more complex hybrid approach but it seems to hold the most promise for success.

Next Steps

Staff will continue to work on defining the revenue capabilities of each of the individual strategy tools so that Council can begin to look at how to bundle the options into a realistic hybrid solution. Using estimated data ranges, staff would like to move towards the development of a strategy worksheet (similar to the one shown below) that would allow for revenue targets (either percentage or actual dollars) to be set for each respective category. The objective of this exercise is to be more directed in preserving the city’s financial integrity and to keep the focus on financial performance.



To do this process right will require many months of work, so while the process is started in the 2006 budget cycle it is more likely to deliver results in the 2007 budget preparation. An outline of the general sequence and schedule of events is provided below.



Appendix

The appendix will provide summaries of relevant budgetary information.

- **Overtime usage trends**
- Major city budget gaps
- Economic development impact schedule
- Surplus city property list
- **Regional levies schedule**
- **Tax options, pro's and con's**
- Effective tax rate comparison
- City staffing levels
- **State tax law changes**
- Employee productivity initiatives
- Fee comparisons
- Service reduction impacts
- **City partners and contracts list**
- "Out of the Box" ideas

***bold** denotes available for 2006 budget discussion
