MEMORANDUM

TO: Mayor Lewis and City Council Members

FROM: Gregg Guetschow, City Manager

SUBJECT: Motor Vehicle Pool Fund

DATE: May 19, 2016

During the May 9, City Council meeting, Council Member Bahmer proposed reducing the equipment rental rate charged by the Motor Vehicle Pool fund. He subsequently contacted the City Clerk and asked for a ten-year projection of equipment replacements in the fund. The purpose of this memorandum is to determine whether the potential exists to reduce rental rates.

The Motor Vehicle Pool fund (MVP) is an internal service fund that operates like a business. It owns pieces of equipment used by the Department of Public Works for its various tasks. It “rents” this equipment, charging an hourly rate that is accounted for as “equipment rental” in the financial statements of the activity or department in which it is used. This rental rate covers all the costs associated with the ownership of the equipment: parts, fuel and oil, replacement, insurance, labor, etc. The rates used by the City are developed by the Department of Transportation based on surveys of costs incurred by County road commissions for their equipment.

Assets of the MVP include dozens of pieces of mobile equipment and small tools that are listed on the equipment schedule that will be found elsewhere in the agenda packet. This equipment was purchased at various times at a cost of nearly $2.2 million. The assets also include the former Armory property purchased at a cost of $237,000.

DPW Director Amy Gilson has worked with her staff to prepare an eleven-year equipment replacement schedule found elsewhere in the agenda packet. As you will see, anticipated costs vary from year to year. It is expected that the City will expend $1,779,700 over this period.

I have prepared an historical perspective of cash flows in the MVP which you will also find as a separate document in the agenda packet. The data included in this report are from the audits for the various fiscal years covered.

Examining the amounts shown on the line “Purchase of capital assets” shows significant year-to-year fluctuations in expenditures. For the period in question, and excluding the 14-15 fiscal year in which the Armory was purchased, the highest was the 07-08 fiscal year with $227,182 and the lowest two years later with a tenth that amount.

The replacement schedule previously referenced provides some perspective on future outlays for equipment replacement. Another measure of future needs will be found by looking at “Depreciation and amortization.” Here we see a peak for the period in FY11-12 of $135,607 with a steady decline to FY 14-15 of $101,347. What this decrease reflects is that some equipment has been fully depreciated but not yet replaced. Some of this is due to the rebuilding of trucks as opposed to their replacement, a measure that contributed to increases in end-of-year cash. At the same time, this decrease hints at the need for larger future expenditures, as the replacement schedule suggests.

The line “Net cash provided by operations” offers a measure of the typical resources available for investing in capital assets in the fund after paying for supplies and labor. There were several years in which equipment rental receipts were abnormally high, perhaps due to more severe winter weather. Ignoring this variability, which should smooth out over longer cycles, the total net cash provided for the period of $1,314,405. Total investment in capital assets for the period, including the Armory purchase, was $1,313,781. Depreciation for the period equaled $1,207,816. (None of these totals is shown on the spreadsheet.) If the Armory purchase is removed from the calculations, and as suggested by the discussion of depreciation in the previous paragraph, it is clear that investment in capital assets is falling behind accumulated depreciation. While this might appear to be a worrisome trend, the impact was mitigated for the period of analysis by the rebuilding of dump trucks that would have ordinarily been replaced.

This analysis provides the foundation for comparing financial trends with projected capital investments. The eleven-year replacement schedule Ms. Gilson has prepared would require $1,779,700. Assuming the observed net cash trend continued, this replacement schedule would exceed that resource by about $325,000. This negative balance would be offset in part by revenues associated with Armory rental charged to other departments that would equal an estimated $150,000. Net cash at the end of the FY 26-27 would be expected to stand at $100,000. This amount is 25% above the lowest net cash shown on the MVP cash flows report. It represents less than 5% of the cost of all machinery and equipment owned by the MVP at June 30, 2015 and less than 6% of the machinery and equipment expected to be purchased in the next eleven fiscal years.

It would appear, then, that reducing equipment rental rates would have an adverse impact on the ability to replace equipment.