City of
CHARLOTTE

MEMORANDUM

TO: Mayor Lewis and City Council Members

FROM: Gregg Guetschow, City Manager

SUBJECT: Achieving Fiscal Stability

DATE: August 9, 2019

You will recall our discussion during budget review regarding the long-term challenge of addressing funding for capital improvements, pension and retiree health insurance obligations. In this memorandum, I will briefly summarize these fiscal challenges and suggest some alternatives that Council might consider.

The following areas of the budget are those we have identified as needing attention:

- Costs associated with addressing current street conditions are estimated in the range of $50 million to $75 million. Our spending to address these needs over the last couple of years falls between $1 million and $2 million. At least a doubling of the investment in street reconstruction is required to make meaningful progress in this area.
- Utility infrastructure is aging. City staff and consultants are completing asset management plans that will identify precisely the investments required. Primary areas we expect to be the focus of future investments will likely be:
    - Upgrading and replacing components of the waste water treatment plant that are at or beyond their useful life. We expect the cost of such investments to be about $1 million annually;
    - Replacing water mains and sewer lines in conjunction with street reconstruction projects. Costs will vary depending upon the amount of street reconstruction funded in each year but are likely to be $200,000 annually.
- Regulatory compliance associated with utility systems will increase both operating and capital costs associated with the systems. Of particular note is the obligation to locate and replace lead and galvanized iron water service leads from the street to within private residences. Until recently, these costs were borne by individual property owners. The state has mandated that cities assume these costs as a part of their operation of utility systems, necessitating passing them on through rates.
- As of December 31, 2018, the City's pension system assets were equal to just 56% of its liabilities. Over the next twenty years, the City's annual required contribution to the pension system will increase from about

$900,000 to $2.1 million. After that point, the annual required contribution will drop to a more manageable $500,000, assuming no additional changes in pension plans.
- As of June 30, 2018, liabilities associated with retiree health insurance benefits equaled $1.9 million. Assets associated with this program, in the form of assigned general fund fund balance, equaled $200,000. Annual required contributions are approximately $135,000 in the current fiscal year and are expected to increase to approximately $150,000 before declining due to mortality. All employees eligible to participate in the program have now retired and the program will wind down completely over the next thirty or so years.

We believe that limited opportunities exist to achieve operational cost savings beyond those already realized through staffing and other reductions over the last decade. We are currently exploring possible modifications to pension plans and alternative health insurance programs. Any savings achieved through changes in these programs, however, will be far less than necessary to boost funding to the levels necessary to achieve fiscal stability over the long term.

It seems equally unlikely that relief from fiscal pressures will be achieved through action at the state level to reverse the impact of cutbacks in state revenue sharing that started in 2001 and the effects of Proposal A on limiting taxable value growth following property value losses in 2008-9.

Investments necessary to address aging utility infrastructure can, and should, be achieved by annually reviewing and adjusting rates as the City's utility ordinance requires. The recent staff recommendation, approved in part by City Council, incorporated a level of funding that we believe will be sufficient to meet requirements for upgrading infrastructure. Debt service associated with a bond issue for waste water treatment plant upgrades, currently exceeding $500,000 annually, will essentially disappear from the budget after the 2022-23 fiscal year. This could provide an opportunity for some rate relief depending upon infrastructure needs at the time.

Addressing the other funding challenges that are outlined above will necessitate other solutions. Council is already considering seeking voter approval for a Headlee override vote in November as a means of funding retiree health insurance costs. I have also recommended that Council consider the following:

- Instituting special assessments to finance a portion of the costs associated with the reconstruction of streets. The use of special assessments, through which benefiting property owners pay some of the costs for improving streets that abut their properties, would stretch the dollars the City has available to it through gas and weight taxes and the County road millage. Special assessment costs for street projects are typically spread based on the number of feet of property abutting the street.

- Utilizing special assessments to fund costs associated with public safety programs. This tool is available to cities under $10,000 population. Unlike special assessments for streets, those for public safety costs are spread based on taxable value with tax exempt properties being excluded from the assessments. While it is feasible to assess all costs of public safety, I see two primary areas in which its use might be considered: police and fire pension costs and debt service associated with replacing fire trucks.

Revenue equivalent to that which would be generated through special assessments could also be realized by increasing property taxes. Such measures have been successful in other communities in recent elections, including those held this week in some area communities, particularly as a means of funding street reconstruction. Increasing property taxes as a means of generating additional revenue has the advantages of familiarity to taxpayers and ease of administration.

Such measures have not been successful in Charlotte, however, leaving the problems unresolved. Using special assessments for street reconstruction has two advantage over general property taxes: first, there is a direct connection between who pays for the project and who benefits; second, tax exempt properties, such as churches and schools, are subject to special assessments.

The same advantages do not pertain to the use of special assessments for public safety costs where they function as a direct substitute for the levying of property taxes.

This brief background is not intended as a comprehensive overview of this important topic. It is intended, however, to outline the issues and set the stage for a conversation with Council about how to better achieve fiscal stability.