

2021 Budget Message

Honorable Mayor and City Councilmembers,

On behalf of the entire Rochester team, it is a privilege to present the recommended 2021 Operating and 2021-2026 Capital Improvement Plan (CIP) budget. For your consideration, the budget is the result of many teammates' efforts to address the extreme hardship our community is experiencing, while quantifying the magnitude of City's revenue reductions and delivering a responsible spending plan.

The unanticipated financial effects of the COVID-19 pandemic have distressed the Rochester community and in many ways, instantaneously reshaped our future. Individual community members, families, non-profit organizations, private business, and government have been impacted.

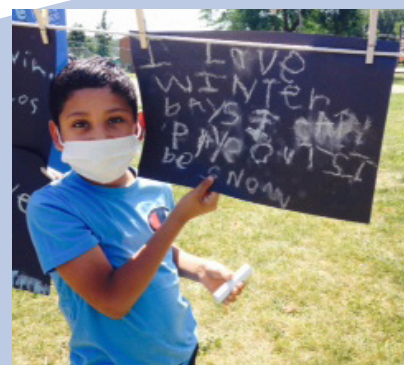
The immediacy of the COVID-19 economic shutdown required the City Council to approve \$26.6 million in 2020 budget adjustments, simultaneously with the development of the 2021 recommended budget. This included significant expenditure reductions, use of contingency funds, and Federal Coronavirus Aid, Relief, and Economic Security Act (CARES) funds.

To balance the realities of the pandemic's community impacts with the City's ability to deliver quality services during a time of need, the same strategies applied already this year are recommended for the 2021 budget. Notably, the recommended budget includes:

- **No tax levy increase**
- **No electric or water rate increases**
- **No parking ramp or transit rate increases**
- **\$97.8 million reduction in total expenses from 2020 (17 percent reduction)**

The Mayor and City Council's Foundational Principles, Strategic Priorities, and longstanding tradition of being fiscally responsible provided the framework for developing the recommended budget. Understanding our community is under significant financial strain, we committed to keeping the property tax levy flat early in the budget development process.

I want to recognize the efforts of Dale Martinson, Aaron Parrish, Rachel Houdek, Noloan Schild, the Leadership Team, and the Finance/Information Technology team for their involvement in the process. Also, a special thanks to Mark Kotschevar and Peter Hogan from our very own Rochester Public Utilities (RPU) for their collaborative efforts in taking the initial steps to combine RPU with the other City budgets. For the first time, the Mayor, City Council, and community are able to view one document containing all City budgets.

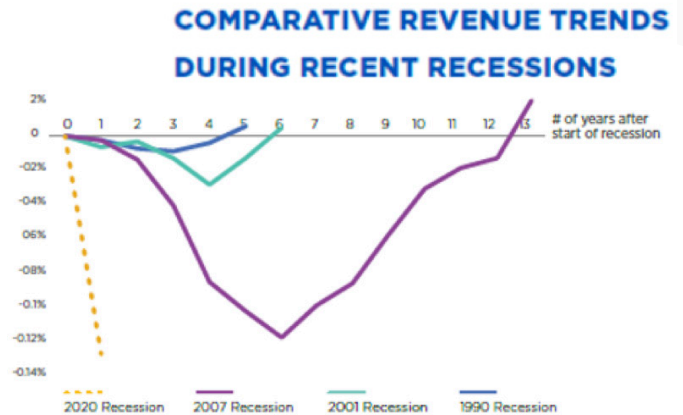


Economic Outlook

According to numerous reliable organizations, COVID-19 will have long-lasting financial impacts. Recently, the National League of Cities (NLC) issued its 2020 City Financial Conditions Report that states “the consequences of this economic fallout are impacting our hometowns faster than we could have imagined...the revenue decline that took 6 years for cities to fully feel in the Great Recession is already happening in just the few short months of this pandemic-downturn and it won’t go away easily.” As NLC’s chart demonstrates, “it took over a decade for local revenues to bounce back from the Great Recession. It’s predicted that it will take years for local economies to recover from this recession.”

Furthermore, the State of Minnesota may experience a multi-billion dollar deficit during the current biennium, which could result in intergovernmental aid reductions to local government. The recommended budget does not account for any speculative reductions, though realizing the State has its own financial challenges does cause concern.

As impactful as the pandemic has been to date, not knowing when the public health emergency will end nor the length of the economic recovery causes great uncertainty. It also leaves many unanswered questions that could affect the City’s ability to deliver services.



- How long will our once vibrant and successful hospitality and tourism sector take to recover?
- Will remote work and consumer safety perceptions have long-term financial consequences for our public transit, airport, and parking operations?
- Will property valuations be impacted in future years compounding the financial effects on City revenues?
- Will financial impacts at the state and federal levels lead to reduction in intergovernmental aid that have historically supported City operations and public infrastructure projects?
- Will the City need to re-prioritize its current services so it has the resources to meet basic community needs such as childcare, housing assistance, and food supply?
- Will additional CARES funds be made available to address local governments’ revenue shortfalls?

As we move forward with the 2021 budget, we recognize the necessity to closely monitor our many revenue assumptions and determine if adjustments may be necessary. This is especially true for hotel/motel, Rochester International Airport (RST), public transit, parking, parks & recreation, planning/building permits, and intergovernmental revenues. We are very appreciative of the CARES funding totaling \$18.5 million that we anticipate receiving over the years 2020 and 2021. This funding is vital to assist in mitigating our financial challenges for RST (\$2.5 million) and public transit (\$7.2 million), as well as the \$8.8 million to support the City’s 2020 COVID-19 response and more importantly the Rochester community.

Revenue Summary

The first step in the budget development process is forecasting the availability of non-property tax revenues to fund City services and projects. The revenue-first approach was even more critical in developing the 2021 recommended budget, knowing property tax revenue would remain flat. In total, the recommended budget includes \$476 million in revenue of which \$79.5 million is funded with property taxes.

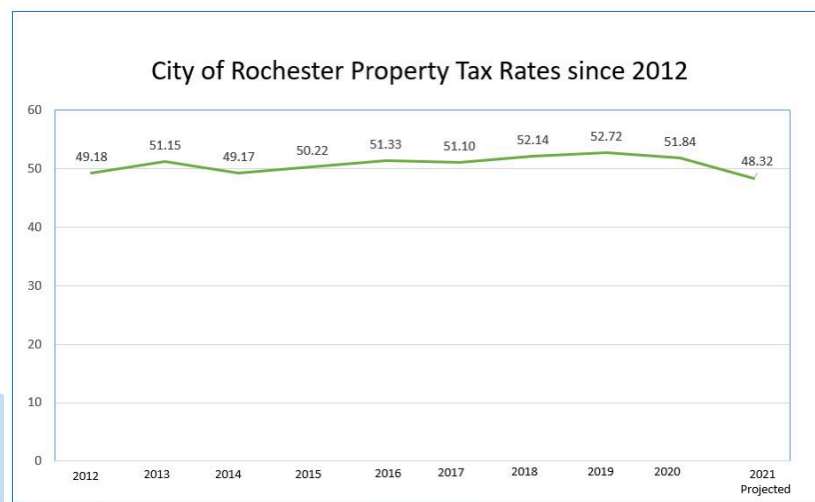
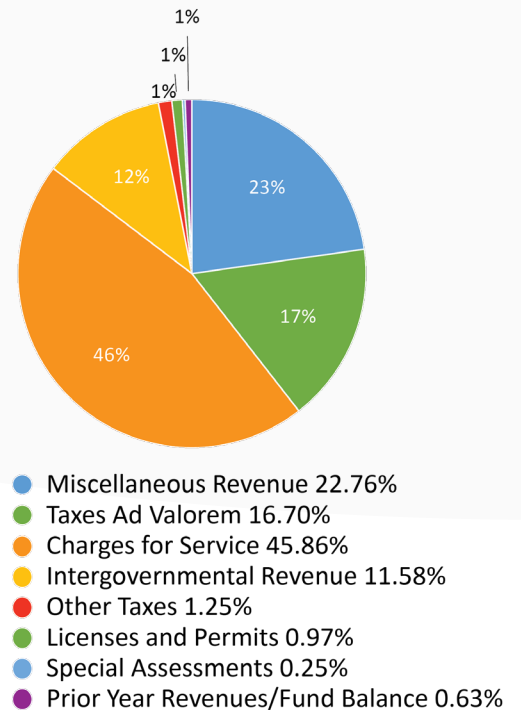
General Fund

The City's property tax accounts for approximately one-third of a Rochester taxpayer's total bill (the others being Olmsted County, Rochester Public Schools, and State of Minnesota). As previously mentioned, the recommended budget does not include a tax levy increase from 2020. At the same time, Rochester's property values are estimated to increase by approximately 7.3 percent due to new construction (2.4 percent) and existing property value appreciation (4.9 percent).

$$\text{Local Tax Rate} = \frac{\text{Property Tax Revenue Needed (Levy)}}{\text{Total Tax Capacity (For All Properties)}}$$

As shown in the local tax rate formula, the City's tax rate will actually decrease as there is a larger base to spread the same tax levy amount over; underscoring the City's commitment to support our entire community during this unprecedented time. As a comparison, applying the same tax rate as 2020 would generate an additional \$5.8 million while including tax base from new construction only would generate an additional \$1.9 million.

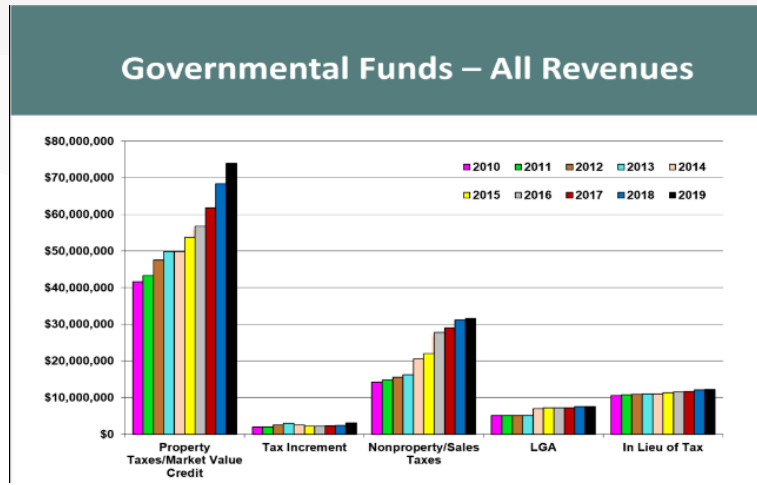
2021 Total Operating Revenue Inclusive of RPU



Even though property taxes only account for 16.7 percent of all revenues, it is the most visible and often discussed revenue source, as it supports police, fire, community development, library, parks, public works, and many administrative functions. The General Fund disproportionately relies on property tax revenue to fund these services, as demonstrated in the Governmental Funds chart.

This reality added to the complexity of developing the recommended budget, as many revenues have declined due to COVID-19. We also were informed Local Government Aid (LGA) was being reduced by the State of Minnesota prior to the pandemic. More specifically, the City's General Fund non-property tax revenues are estimated to significantly decrease from 2020. Notable revenue reductions include:

- \$1.7 million decrease in hotel/motel tax
- \$1.14 million decrease in LGA
- \$466 thousand decrease in licenses and permits



Prior to COVID-19, the City Council indicated a willingness to consider new revenue opportunities to cover a greater portion of service delivery expenses rather than continuing with its historic level of tax subsidy. However, due to the community impacts of the pandemic, City Council new revenue source decisions have been delayed until an unspecified future date.

That said, the City Council has placed a revenue measure on the November 2020 ballot to increase park funding by \$2 million annually. Rather than deciding on its own, the City Council believes it is important for Rochester voters to decide if this is a priority. A median valued home would pay an additional \$33 annually for the park levy. New park revenue has not been included in the 2021 recommended budget and would be added if passed by voters prior to budget adoption in December.

To assist in mitigating the loss of revenue, the recommended budget includes using \$721,000 of General Fund reserves. It is also recommended the Payment In Lieu of Taxes (PILOT) paid to the General Fund from enterprise operations be maintained at 2020 levels rather than the existing City Council formulaic policy. Without this approach, General Fund revenue would further decrease by approximately \$286,000. As part of this recommendation, we plan to work with the Mayor and City Council on a more equitable and simpler PILOT program for 2022 and beyond.

All Funds

To fund all recommended expenditures, Table 1 provides the detail of the proposed 2021 Major City Revenues. For comparison, the 2020 Adopted Budget revenues are also provided. Noticeable is the fact that the majority of revenues are remaining flat or decreasing from 2020 straining the City's ability to fund the services our community has come to expect.

CITY OF FINANCIAL DISTINCTION

The City of Rochester has a AAA Rating

Rochester has received a Certificate of Achievement for Excellence in Financial Reporting for almost 50 years, the longest in the state of Minnesota.

TABLE 1

2021 MAJOR REVENUES VS 2020 INCLUSIVE of RPU

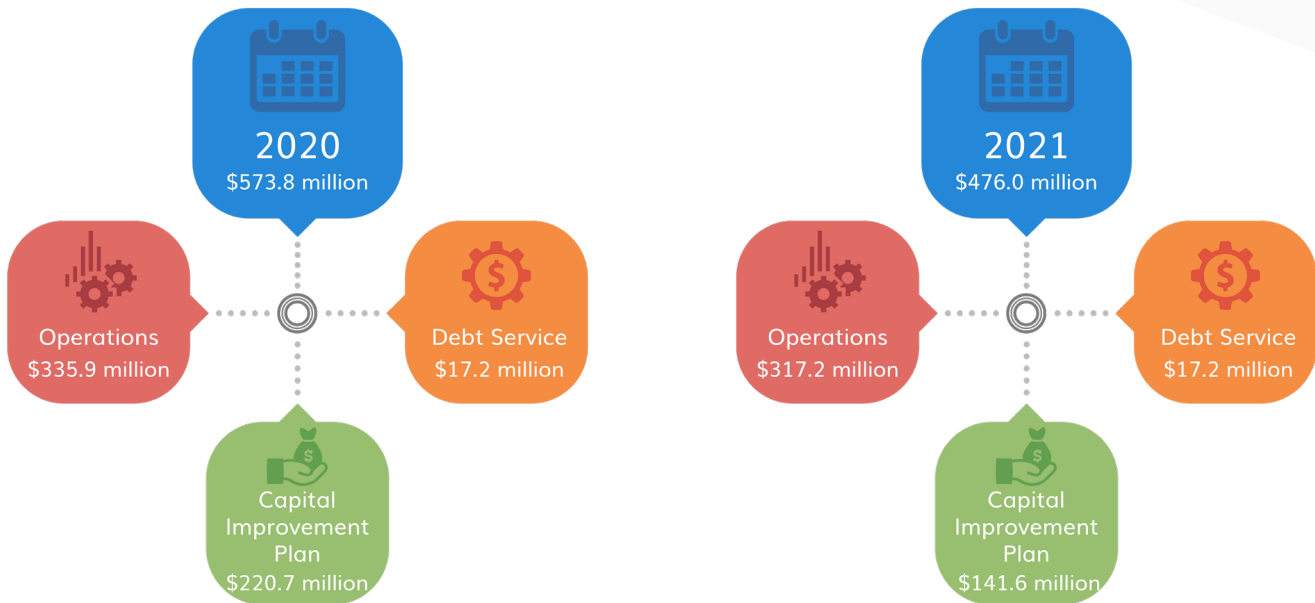
| | 2020 Adopted Budget | 2021 Recommended Budget | Increase/(Decrease) | Percent of Change |
|----------------------------------|---------------------|-------------------------|---------------------|-------------------|
| Tax Levy & Tax Abatements | 79,524,771 | 79,524,771 | 0 | 0.00% |
| Local Government Aid | 7,509,361 | 6,372,634 | (1,136,727) | -15.14% |
| Hotel/Motel Tax | 6,275,000 | 4,580,000 | (1,695,000) | -27.01% |
| Cable TV Franchise Fee | 1,440,000 | 1,350,000 | (90,000) | -6.25% |
| Inspection Permits | 3,795,000 | 3,325,000 | (470,000) | -12.38% |
| In Lieu of Tax | 12,884,858 | 12,884,858 | 0 | 0.00% |
| Sewer Utility Charge | 28,500,000 | 28,100,000 | (400,000) | -1.40% |
| Storm Water Utility Fee | 8,572,000 | 8,572,000 | 0 | 0.00% |
| Library Fund | | | | |
| City Share-Levy | 7,158,871 | 7,127,713 | (31,158) | -0.44% |
| County Share | 1,047,209 | 1,092,097 | 44,888 | 4.29% |
| Municipal Recreation Fund | | | | |
| Fee Revenues | 4,294,872 | 4,317,072 | 22,200 | 0.52% |
| Non-Fee Revenues | 8,341,017 | 8,285,916 | (55,101) | -0.66% |
| Parking Fund | | | | |
| Parking Fines | 370,000 | 370,000 | 0 | 0.00% |
| Parking Ramps | 7,418,756 | 4,618,275 | (2,800,481) | -37.75% |
| Street Meters | 1,075,000 | 1,175,000 | 100,000 | 9.30% |
| Parking Lots | 574,000 | 401,800 | (172,200) | -30.00% |
| RPU | | | | |
| Charges for Services | 175,246,000 | 163,275,000 | (11,971,000) | -6.83% |
| Private Funds | 6,976,000 | 10,023,000 | 3,047,000 | 43.68% |

Expenditure Summary

As mentioned, the total 2021 recommended budget is \$476 million which includes all operating and CIP expenditures. The recommended budget is compared to the City Council's 2020 adopted budget to show where changes have occurred in the operating, CIP, and debt service portions of the budget.

City of Rochester Adopted Budget 2020, inclusive of RPU

City of Rochester Budget 2021, inclusive of RPU



The 2021 recommended budget is a decrease of \$97.8 million from the 2020 adopted budget through a combination of CIP and operational savings. For the General Fund, 2021 expenditures are \$886,900 lower than 2020. This was achieved by making significant decreases in the departments' proposed budgets. I want to once again thank the Leadership Team for their unwavering commitment to support our community by making these reductions. Most notably from the General Fund:

2021 General Fund Budget Reductions

\$860,000

from unfilled position vacancies

\$457,000

overtime reductions

\$282,000

in various miscellaneous reductions from multiple departments

\$280,000

travel/training reductions

\$200,000

legal consultant services reduction

\$200,000

Experience Rochester payment reduction

\$100,000

Rochester Sports payment reduction

\$85,000

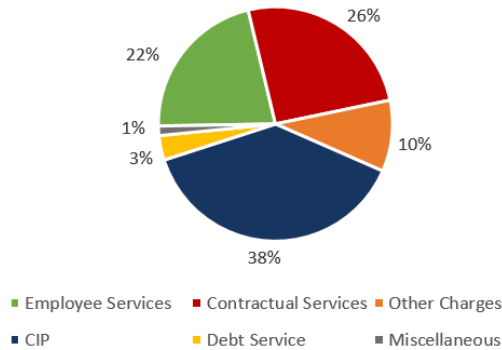
Outside Agency funding reduction

\$75,000

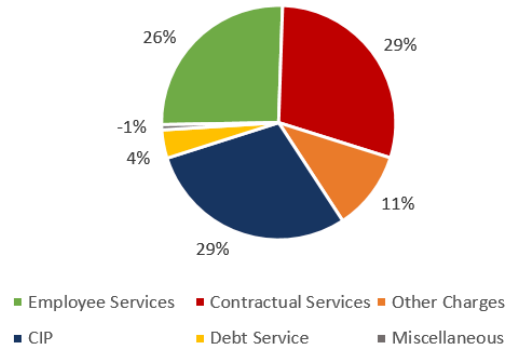
temporary employee reductions

The recommended budget includes expenditures in six major categories for all funds. Historically, employee services account for approximately 30 percent of total expenses. The actual percent generally depends on the CIP budget as this is the largest annual expenditure and fluctuates from year-to-year.

2020 Adopted Budget



2021 Recommended Budget



Teammates

The City's full-time and part-time teammates are the most important resource for the delivery of high quality services. Of the City's annual investment in its professional team, approximately 71 percent is related to salaries and the remaining 29 percent is attributed to benefits (health insurance, retirement, etc.). The 2021 cost of employee services in all funds will increase by \$1.1 million over 2020 with the majority of the increase in base compensation per the existing collective bargaining agreements. Of the \$1.1 million, \$0.5 million is for General Fund teammates with the remaining in special revenue and enterprise funds.

The City currently negotiates with 19 different bargaining groups, with varying degrees of compensation structures and features covering approximately 935 full-time teammates. As a result, base pay is the primary component of the City's overall compensation philosophy. The 2.47 percent increase in the City's 2021 budget for wages represents a general increase of 2.5 percent which applies to all bargaining groups and the remaining .03 percent net decrease covering a variety of salary adjustments (step increases, etc.) throughout the City which is offset by the recommended frozen positions.

The City is self-insured for health insurance. In 2021, the overall cost to the City, for health and dental premiums is projected to be reduced by 3.4 percent. This is due to the elimination of the two tier insurance program and the fact our bargaining units agreed to pay an additional 1.25 percent of health insurance costs starting with our current labor agreements. Thank you again to all of them for their willingness to further share in insurance costs.

The majority of the City's agreements go through 2022. It is understood per the City Council's recent discussions there is an expectation that future agreements better balance the City's long-term financial sustainability with wages and benefits.

Contingency

Annually, the City Council's adopted budget includes a \$1 million contingency in order to respond to unanticipated expenses throughout the year. For 2021, the recommended budget includes an additional \$250,000. To advance the City Council's social equity foundational principle and 2020 teammate wellness program priority, it is recommended the funds be appropriated as follows in the adopted budget.

\$160,000 (City Administration)

Diversity+Equity+Inclusion Director

\$25,000

City Council Discretion

\$65,000 (Human Resources)

Teammate Wellness Program

During the budget presentation, further explanation of the new position and wellness program will be discussed with the Mayor and City Council.

Capital Improvement Plan

The final significant piece of the recommended budget is the 2021-2026 CIP which totals \$703 million. The CIP is divided into 23 categories and funded by 34 different sources. For 2021, the CIP totals \$141.6 million of which \$4.235 million (or 3%) is funded through the tax levy. Notable 2021 projects include:

\$9.9 million

Marion Road Substation

\$3 million

Water Reclamation Plant
Upgrades Phase II

\$6.2 million

Street improvements

\$1.5 million

Recreation Center Air Handling
System Replacement

\$4.1 million

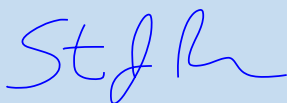
Electric Distribution Expansion

Summary

I want to thank the Mayor and City Council for their leadership during these difficult times. Achieving a zero percent increase in the 2021 property tax levy during a time of reduced LGA and the financial impacts of COVID-19, is a testament to the City's commitment to our community. Moving forward, there continues to be great uncertainty with COVID-19 and the ensuing economic recovery. We must remain prudent in containing expenses, while meeting our community's diverse public service needs. We will also need to diligently monitor revenues and be immediately prepared to make adjustments as was the case with the 2020 budget.

Finally, I am extremely proud the recommended budget prioritized the hiring of the City's first Diversity+Equity+Inclusion Director. This is an important step forward as we further recognize diversity, equity, and inclusion as an organizational value. This intentional investment will provide us the ability to better serve and work with our entire community; ultimately achieving a more equitable Rochester, MN.

Sincerely,



Steve Rymer
City Administrator