Town of Milton, DE

Special Services District – General Fund Financial Impact

July 1, 2024

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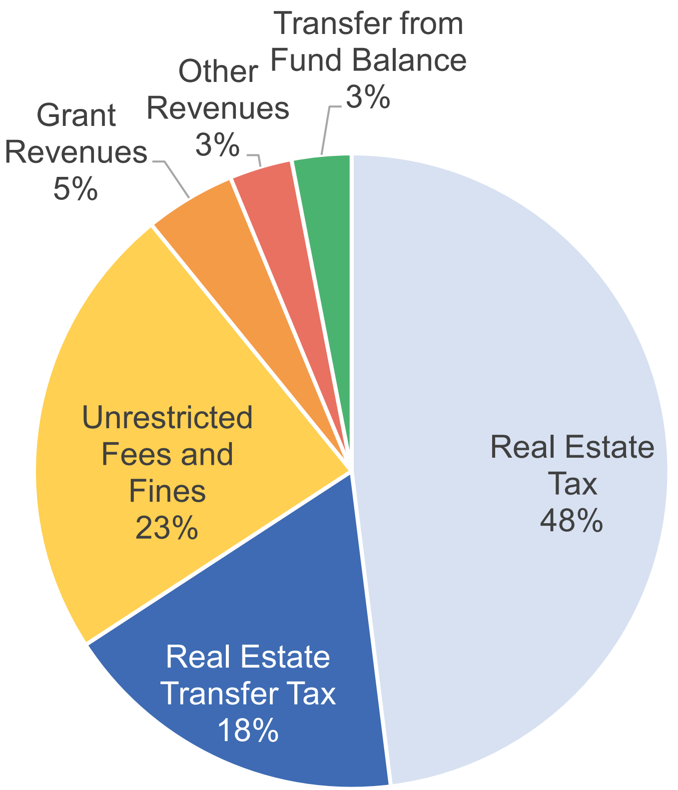
Introduction

- In February 2024, the Town of Milton engaged PFM to develop a financial projection of the Town's General Fund to evaluate the impact of the additional service demands brought by the special development district
- PFM started the engagement with a kick-off meeting with the Town Manager in March 2024 and subsequently developed the following analyses:
  - A baseline projection of the General Fund to evaluate any fiscal pressure the Town may experience *before* additional service demands brought by the special development district;
  - A special development district module to account for the General Fund revenue and expenditure impact of new developments, including the Granary at Draper Farm District; and
  - A combined financial forecast showing the overall impact of new developments and high-level next steps as the Town considers ways to scale up operations while maintaining fiscal balance
- The rest of this report summarizes our findings based on these three analyses

General Fund Revenue

- In FY2024, almost half of the General Fund budget comes from the real estate tax and another 18% of the budget comes from the real estate tax transfer. In aggregate, tax revenues represent more than 65% of the Town's General Fund revenue[1]
- The second largest revenue category is unrestricted fees and fines. The largest revenue within this category is building permit fees, representing almost 40% of all fees and fines
- The FY2024 budget also includes $106,000 in transfer from reserves to balance the budget
- In addition to the revenues shown, the Town also budgeted $61,000 in community enhancement and emergency services fees that are dedicated to a committed fund balance used only for capital projects. At the end of FY2023, the committed reserve had a balance of $112,000

FY24 General Fund Revenue Budget ($3.5 Million)

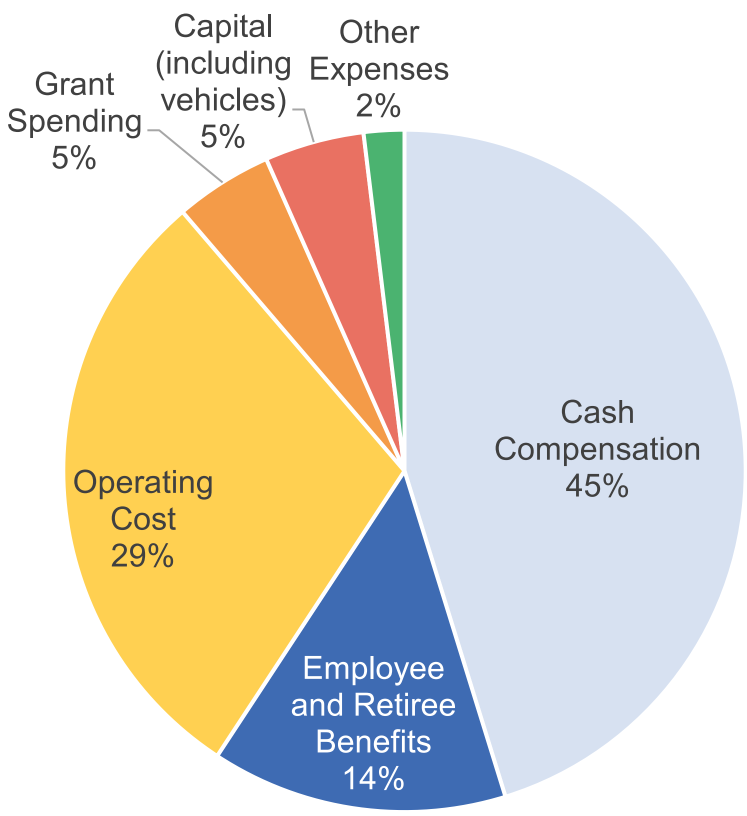


[1] Per the Town's policy, the real estate transfer tax should not be budgeted for operating expenses but transferred to the restricted reserve.

General Fund Expenditure

- Like most local governments, the majority of the Town's General Fund spending is on personnel costs
- More than half of the Town's spending is on personnel costs, including salaries, other cash compensation, and benefits
- Almost 30% of the General Fund budget is on operating cost, including contracted services, utilities, liability insurance, supplies, equipment, and repair and maintenance
- The Town also dedicated $164,000 (or 5%) of the General Fund budget toward capital spending, more than half of which was dedicated toward patrol vehicles and building repairs

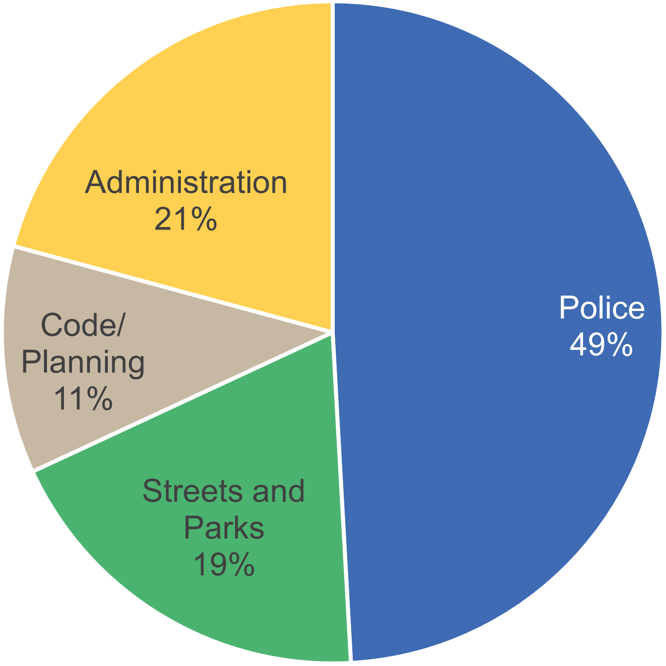
FY24 General Fund Expenditure Budget ($3.5 Million)



General Fund Expenditure by Department

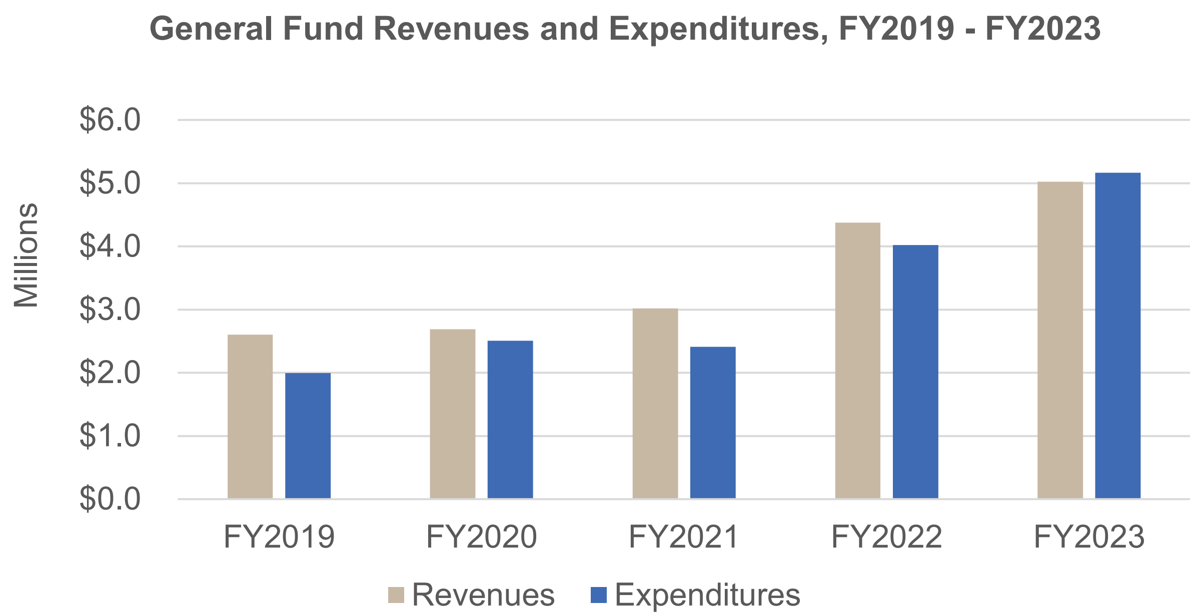
- From an operational perspective, the Town's Police Department represents almost half of total General Fund spending and exceeds the Town's total cash compensation across all departments (45% of the total budget)
- Streets, Parks, Code Enforcement, and Planning represent another 30% of General Fund spending. The remaining budget is dedicated to Administration, which includes townwide spending such as liability insurance and legal fees

FY24 General Fund Expenditure Budget ($3.5 Million)



FY2019 to FY2023 Financial Performance

- From FY2019 to FY2022, the Town had positive operating results and the unrestricted fund balance grew from $2.5 million to $3.0 million due in part to:
  - Taxable assessed value growing by 4.0% annually
  - Real estate tax rate growing by 5.3% annually
  - Vacancy and attrition savings relative to budget
- In FY2023, however, the Town had a $143,000 deficit despite the real estate tax rate growing by 17% in part due to growing headcount
- In FY2024, the budget projects another $100,000 deficit despite another 10% increase to the real estate tax



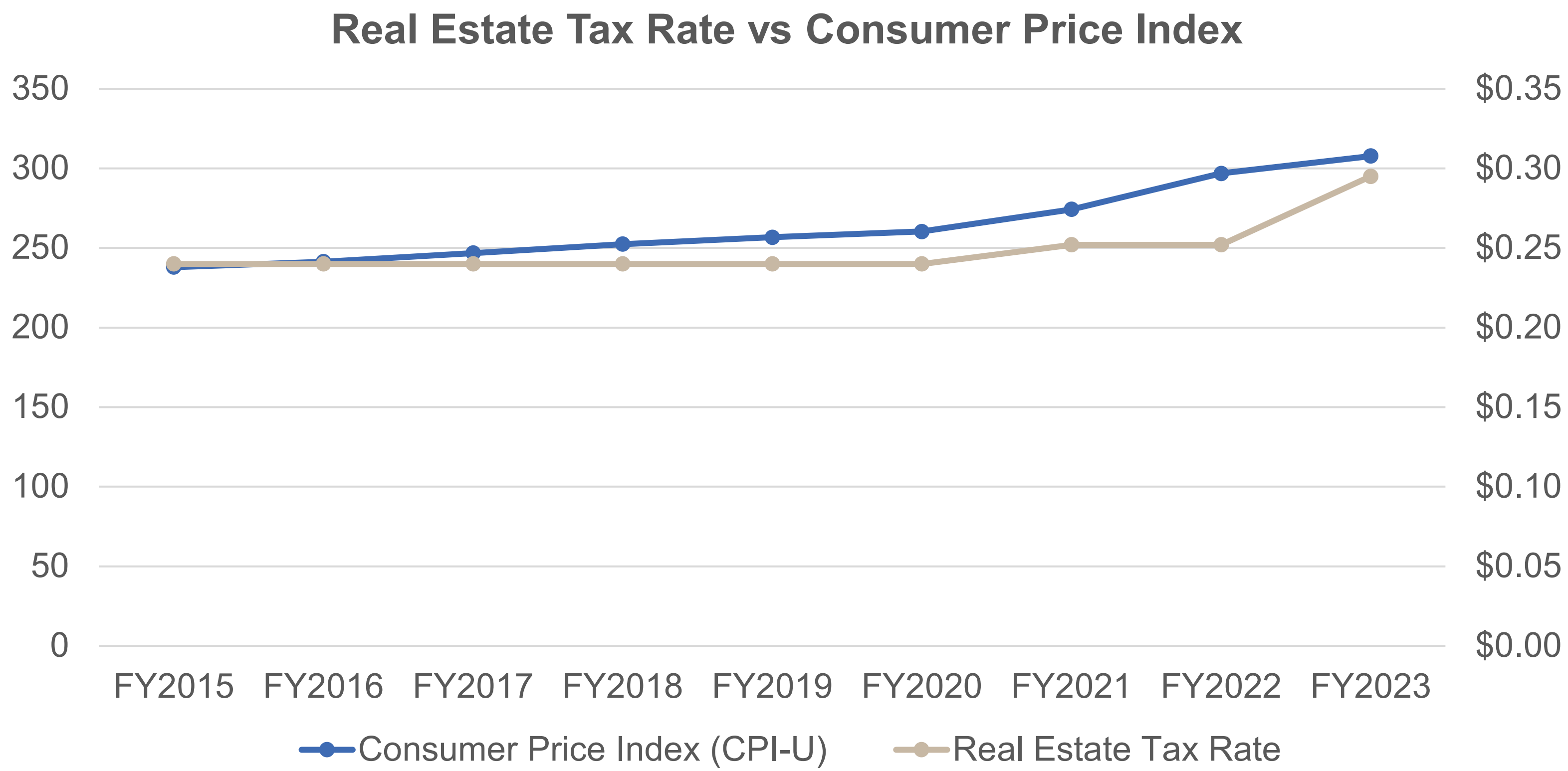
	FY2019	FY2020	FY2021	FY2022	FY2023
Revenues	$2,602,954	$2,688,426	$3,019,867	$4,375,288	$5,021,403
Expenditures	$1,994,755	$2,504,136	$2,410,208	$4,020,391	$5,164,209
Net Operating Result	**$608,199**	**$184,290**	**$609,659**	**$354,897**	**($142,806)**
Unrestricted Fund Balance[1]	**$2,457,011**	**$2,805,095**	**$2,977,828**	**$2,443,851**	**$2,423,350**

Source: Annual Financial Statements

[1] Includes assigned and unassigned balances. Excludes restricted, committed and non-spendable fund balances.

Historical Real Estate Tax Rate vs Consumer Price Index (CPI)

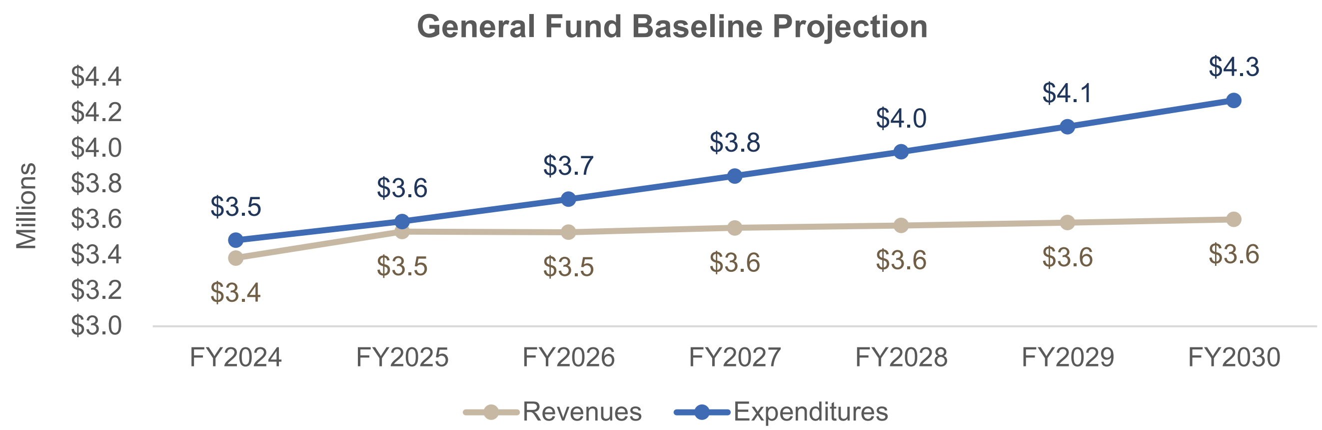
- The Town has been increasing its real estate tax rate since FY2021. However, because the tax rate remained flat at $0.24 per $100 taxable assessed value for six years from FY2015 to FY2020, recent years' tax increases have only allowed the Town to "catch up" with inflationary growth



Source: Bureau of Labor Statistics, U.S. City Average Consumer Price Index for All Urban Consumers (CPI-U) as of September of each year

Baseline Projection

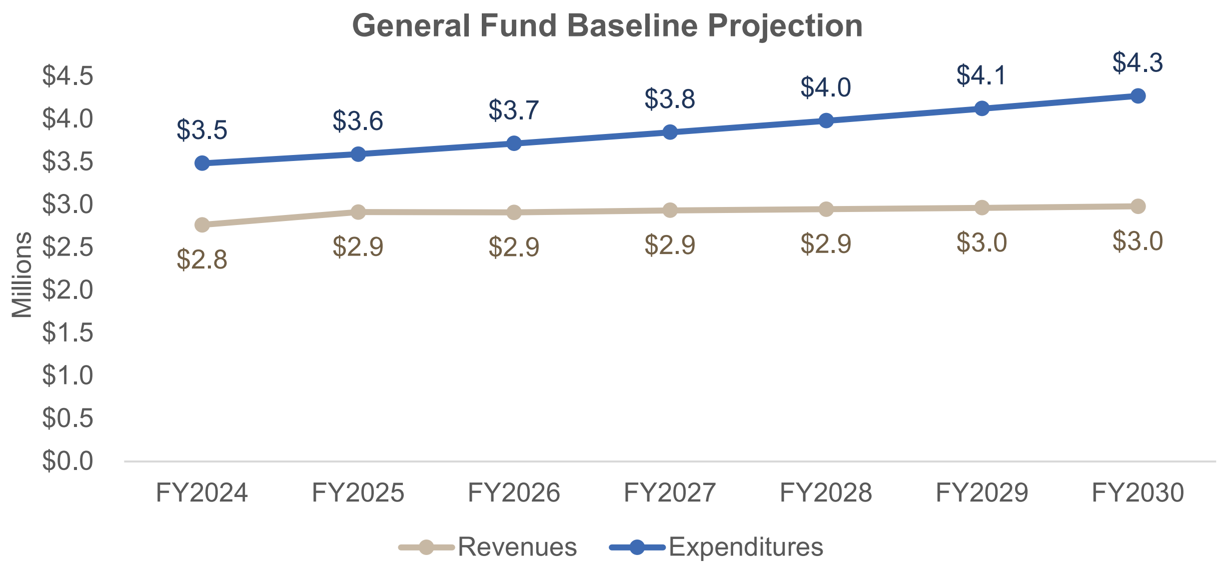
- Based on carry-forward projections in a baseline scenario, the Town's deficits will continue absent additional tax rate increases, fee adjustments, or new revenues
- The projected deficit will drop to $57,000 in FY2025 due to additional tax base from the new Cypress Grove development, but expenditure growth will eventually outpace revenue growth due to salary increases, benefits growth, and inflationary pressures to maintain status quo
- The baseline projection also does not include any headcount increases or additional infrastructure investments beyond the small amount budgeted in FY2024. **It also assumes using the real estate transfer tax to fill the gap when those revenues should be dedicated to a restricted fund balance for capital investments**



	FY2024	FY2025	FY2026	FY2027	FY2028	FY2029	FY2030
Net Operating Result	($100,000)	($56,539)	($185,955)	($291,938)	($414,308)	($540,055)	($670,395)
Unrestricted Fund Balance	$2,323,350	$2,266,811	$2,080,855	$1,788,917	$1,374,609	$834,554	$164,160

Baseline Projection

- If the Town adheres to its policy and dedicates the real estate transfer tax to the restricted capital fund,[1] the deficits would be even larger. By 2027, the Town would run out of reserves by FY2027 under the baseline scenario



	FY2024	FY2025	FY2026	FY2027	FY2028	FY2029	FY2030
Net Operating Result	($720,000)	($676,539)	($805,955)	($911,938)	($1,034,308)	($1,160,055)	($1,290,395)
Unrestricted Fund Balance	$1,703,350	$1,026,811	$220,855	($691,083)	($1,725,391)	($2,885,446)	($4,175,840)

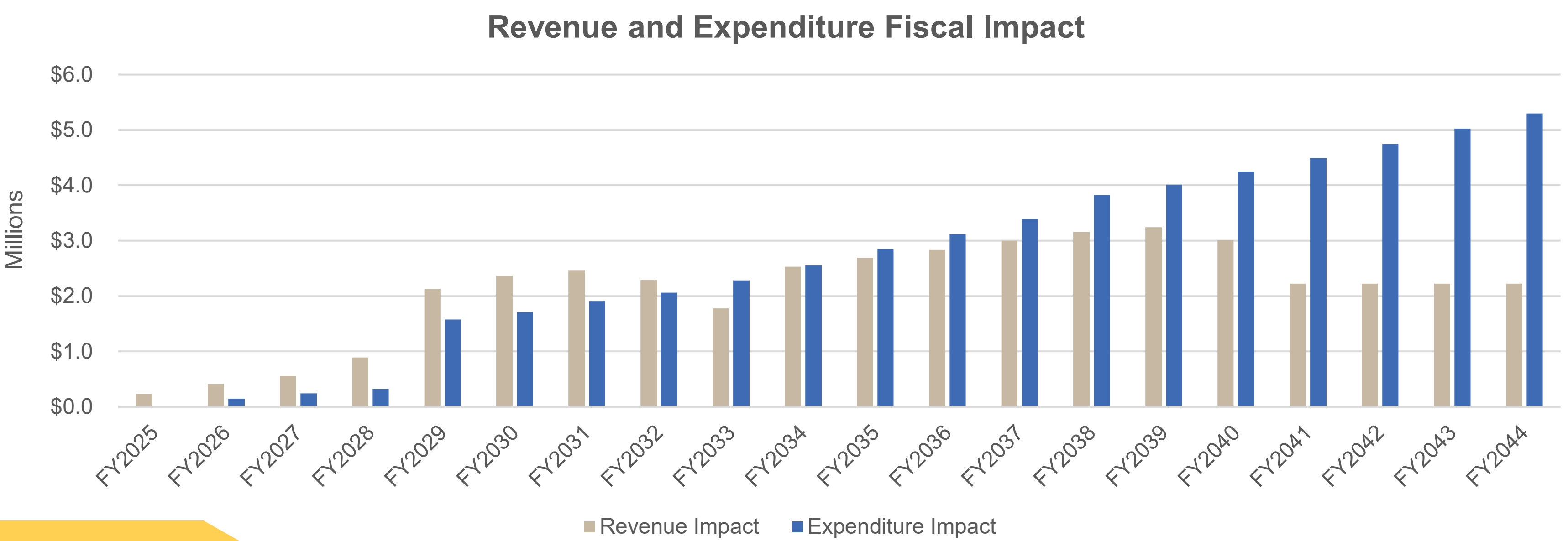
[1] Delaware Code, Title 22, Chapter 16 requires that any realty transfer tax be expended solely for the "capital and operating costs of public safety services, economic development programs, public works services, capital projects and improvements, infrastructure projects and improvements and debt reduction."

Special Development District Impact

- The Scarlett Oaks and Granary developments will bring additional revenues to the Town (from tax base growth) but will also add additional service needs and spending pressures
- On the revenue side, these developments will bring:
  - Additional recurring real estate tax revenue from taxable assessed value growth
  - One-time revenue from the real estate transfer tax, building permits, and other fees
- On the expenditure side, these developments will require the Town to scale up operations and meet additional service demands, including:
  - The need for new municipal building(s)
  - Additional staff (currently expected to require additional police officers, public works employees, and additional administrative staff once fully built out)
  - Additional operating costs (e.g., supplies, equipment, vehicles etc.) related to scaling up operations
  - Additional capital costs (e.g., additional public infrastructure and community needs such as parks and recreation)
- The next page shows the estimated revenue and expenditure impact of the new developments based on staff input and the Special Development Market Study conducted by RCLCO Real Estate Consulting

General Fund Fiscal Impact

- Additional revenues from new developments do not follow a consistent growth trend partly because some of the additional revenues (primarily the real estate transfer tax and building permit revenues) are one-time only. Once all the units are completed and sold in FY2040, revenue would significantly reduce
- Additional expenditures, on the other hand, have a more consistent trend assuming the Town would issue new debt for land purchases and building construction and increase headcount gradually over the next 15 years
- Given the “lumpiness” of the net fiscal impact, the Town should develop a fund balance policy and a comprehensive long-term strategy beginning with the FY2025 budget to ensure fiscal sustainability



Capital Investment and Planning Needs

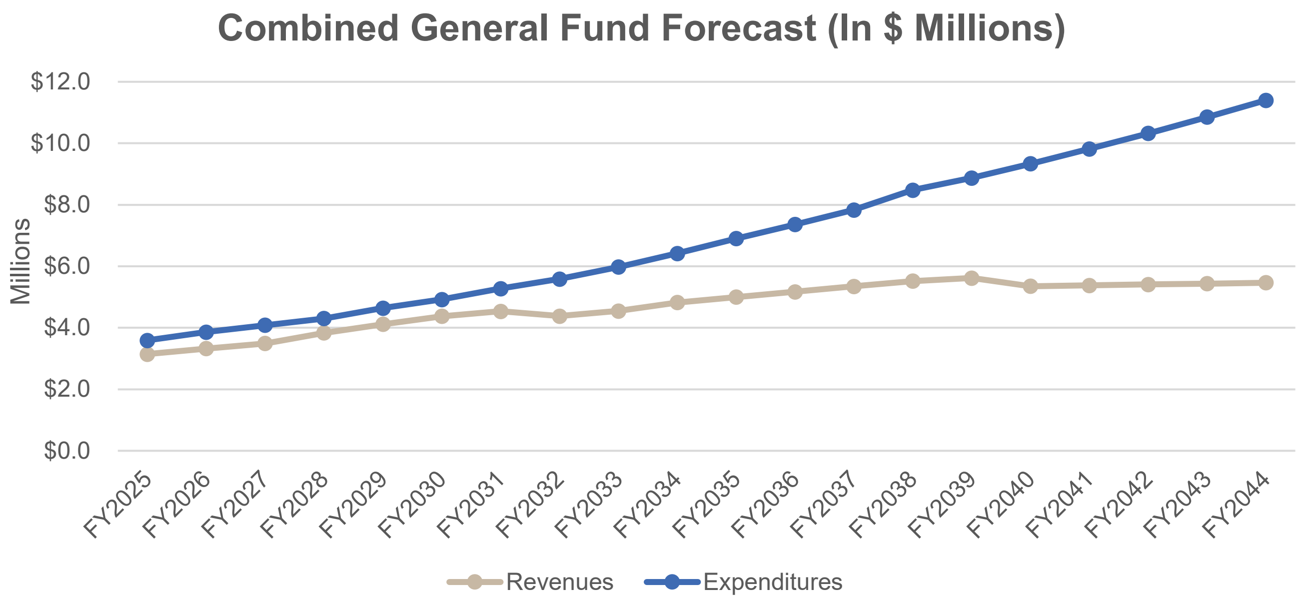
- The new developments will generate additional one-time and recurring revenues, but they also heighten the need for capital investments and planning. For that reason, we show the Town setting aside its real estate transfer tax revenue in a separate restricted fund – consistent with how those dollars are currently accounted for in the financial audit – to help the Town pay for future debt service and capital investments
- Even after setting aside the real estate transfer tax revenues, the amount available (including the $3.1 million restricted fund balance reported in the FY2023 financial statements) can barely pay for the estimated debt service amount for the new municipal buildings
- The only remaining funding source available to the Town to fund additional capital investment needs (e.g., road paving, public infrastructure, park and recreation needs etc.) is the revenue from the community enhancement and emergency services fees that are dedicated to a committed fund balance. That fund only had $112,000 at the end of FY2023

Real Estate Transfer Tax As a Funding Mechanism for New Municipal Building(s)	
Estimated Principal Needed for Land Purchase, Building Construction, and Building Outfitting	$35,000,000
Town Portion[1]	60.47%
Assumed Interest Rate	5.0%
Assumed Pay Back Period	30 Years
Est. Debt Service	**$32 Million**
Projected Real Estate Transfer Tax Over 30 years	**$30 Million**

[1] PFM Analysis on Granary at Draper Farm Special Development District – Town Improvements to be financed with proceeds of Bonds, dated October 2, 2023

Combined Forecast

- To illustrate the fiscal impact of the new developments, PFM developed a combined forecast. As shown, the additional revenues from the new developments help reduce the baseline deficits, but the deficits remain absent correction action as some of the positive impact is offset by increased expenditures from scaling up operations



	FY2025	FY2026	FY2027	FY2028	FY2029	FY2030	FY2031	FY2032	FY2033	FY2034	FY2035
Net Operating Result	($0.4)	($0.5)	($0.6)	($0.5)	($0.5)	($0.5)	($0.7)	($1.2)	($1.4)	($1.6)	($1.9)
Unrestricted Fund Balance	$1.9	$1.3	$0.7	$0.3	($0.2)	($0.8)	($1.5)	($2.7)	($4.2)	($5.8)	($7.7)
Fund Balance as a % of Revenue	48%	34%	16%	6%	-4%	-13%	-25%	-46%	-77%	-93%	-121%

Note: The combined forecast assumes dedicating the real estate transfer tax to the restricted reserve for capital purposes.

Key Findings

- The baseline projection indicates that Milton has an underlying structural deficit with expenditure growth outpacing revenue growth absent tax rate adjustment or correctional action
- New developments at Cypress Grove, Scarlett Oaks, and the Granary provide additional growth to the Town's tax base, which in turn generate recurring real estate tax revenue as well as one-time revenues (e.g., building permits, real estate transfer tax)
- At the same time, these new developments also require the Town to upscale operations to meet additional service demands. Milton also has limited municipal building space and requires new/expanded building(s) to upscale operations
- The combined forecast indicates that, despite the additional projected revenues from these new developments, the Town still faces several key challenges in the coming years:
  - The underlying structural challenge means that the Town will have to continue making rate adjustments and diversifying its revenues to maintain fiscal balance
  - The need to scale up operations adds additional budget risks (e.g., revenues realized later than expected; service demands requiring even more headcount increases; land purchase and building construction costs exceeding original budget; additional community and infrastructure needs from a growing service population)
  - At the same time, the Town will continue to face uncertainty related to collective bargaining and the broader economic environment (interest rate risks, recession risks etc.)

Next Steps – Ensure Fiscal Sustainability

- Develop a long-term financial strategy using the projection tool provided by PFM, beginning with the FY2025 budget process
- Develop a fund balance guideline or policy that establishes a process for using reserves and a minimum unrestricted fund balance threshold
  - Given the heightened budget risks, the significant size of the developments, and the anticipated need to use some of the fund balance in the coming years, the Township's fund balance threshold should be significantly higher than the minimum 16.7% fund balance recommended by the Government Finance Officers Association (GFOA)
- Continue its historical practice of adjusting rates and diversifying revenues to keep up with expenditure growth
  - Town Council already adopted an ordinance to use the Consumer Price Index (CPI) and Employment Cost Index (ECI) to determine a base minimum tax increase for the ensuing fiscal year
  - From May 2023 to May 2024, the Consumer Price Index for all Urban Consumers grew by 3.3%
  - From Q4 2022 to Q4 2023, total compensation for state and local government workers grew by 5.1%
  - If the Towns eliminates the $106,000 budget imbalance in the FY2024 (equivalent to 6.0% in real estate tax increase) and accounts for inflationary and employee cost increases (with no headcount increase or service enhancement), it will need, at the minimum, a 10% increase in real estate tax increase in FY2025
  - If the Town starts dedicating its real estate transfer tax to the restricted fund balance instead of using it to fund operating expenses, the tax increase would be even larger. The $620,000 in budgeted real estate transfer tax is approximately equivalent to the amount generated by $0.11 in real estate tax (per $100 in assessed value)

Next Steps – Communicate the Town's Fiscal Story

- Communicate the Town's financial opportunities and challenges through its annual budget process, for example:
  - Craft a budget document that tells the Town's financial story as well as the value and services taxpayers receive from its real estate tax
  - Explore budgeting tools that can help the Town have more intentional discussions regarding ways to allocate and prioritize resources and investments
  - Establish capital and fund balance guidelines to ensure long-term fiscal sustainability despite additional budget challenges and risks from the special development district

FY2024 Revenues

Sample Expenditures by Program