About the City Budget

Information Series on the City of Madison Budget

Part 3: Financial Policies and the Levy Limit

Series Overview

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Part 3.a.

Role of Fund Balance in the City Budget

Takeaways:

- City policy establishes a fund balance target of 15% for the general fund. The fund balance is also known as the "Rainy Day Fund."
- Current fund balance is greater than the target due to variances between budget and actual revenues and expenditures; particularly due to rapid increases in interest rates.
- The City has a plan to use fund balance over 5 years to help balance the budget.

What is “Fund Balance”?

- Fund Balance is a measure of the fiscal position (“net position”) of each fund. This is calculated as the difference between a fund’s assets and liabilities. Fund balance can be a surplus (assets greater than liabilities) or a deficit (liabilities greater than assets).
- The methodology for calculating fund balance/ net position varies by fund based on financial reporting requirements under generally accepted accounting principals (GAAP).
- Fund balance/ net position for all City funds is reported in the Annual Comprehensive Financial Report (ACFR) (https://www.cityofmadison.com/finance/accounting/financial-statements)
- For budget discussions, fund balance typically refers to the **general fund unassigned balance** unless otherwise specified. This is an amount that is available for allocation by the Common Council through the budget and is not already assigned to other uses. This is also called the **“Rainy Day Fund”** because monies can be used to cover disruptions/ emergencies that are not planned for in the budget (for example, COVID-19 pandemic response).

Fund Balance Policy

What is the City's Fund Balance Policy?

- The City has a long-standing policy of maintaining an unassigned fund balance of at least 15% of the General Fund Budget. This policy is adopted in each annual budget.

How is Fund Balance Calculated?

- Fund Balance is reported in the City's Annual Comprehensive Financial Report (ACFR). The ACFR is finalized 5-6 months following the close of the fiscal year and is reviewed by an external auditor.
- The fund balance percentage is calculated by dividing the unassigned fund balance at the end of the year by the budget of the subsequent year. The calculation for 2024 is provided as an example.

$$\frac{\text{Fund Balance as of December 31, 2024 (\$110.6 m)}}{\text{General Fund Operating Budget for 2025 (\$410.3 m)}} = 27\% \text{ Fund Balance}$$

Why is this policy goal important?

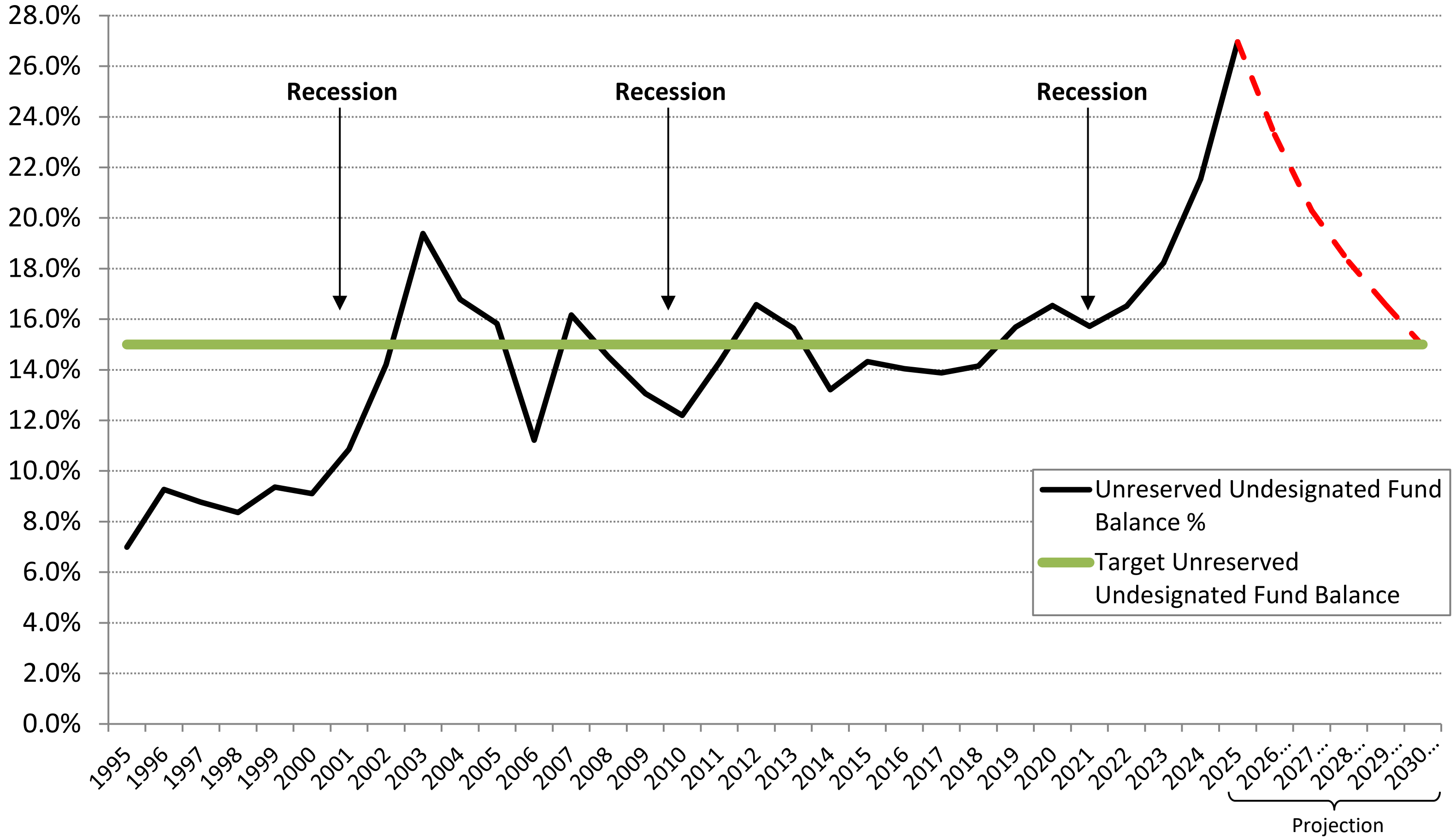
- Maintaining a positive fund balance is a budgeting best practice to protect against risks, including adequate cash to maintain City services in the event of unforeseen declines in revenues or increases in costs. The fund balance target is also a key element of maintaining a triple A bond rating. This highest possible rating helps the City secure the lowest possible interest rates on its debt for capital investments.

Strong Reserves – Fund Balance at 27% of Budget

2024 Year-End

- Revenues exceeded expenditures by $20m.
- Reduction in assigned balance of $8m
  - Fund balance applied down $9m
  - Life Insurance/ Disability plan reserves increased $2m
  - Compensated absences down $1 million – new GASB standard

General Fund Unassigned Balance as of January 1
1995 to 2030 Projected
Assumes applying $39 million to budget -- 2026 through 2030

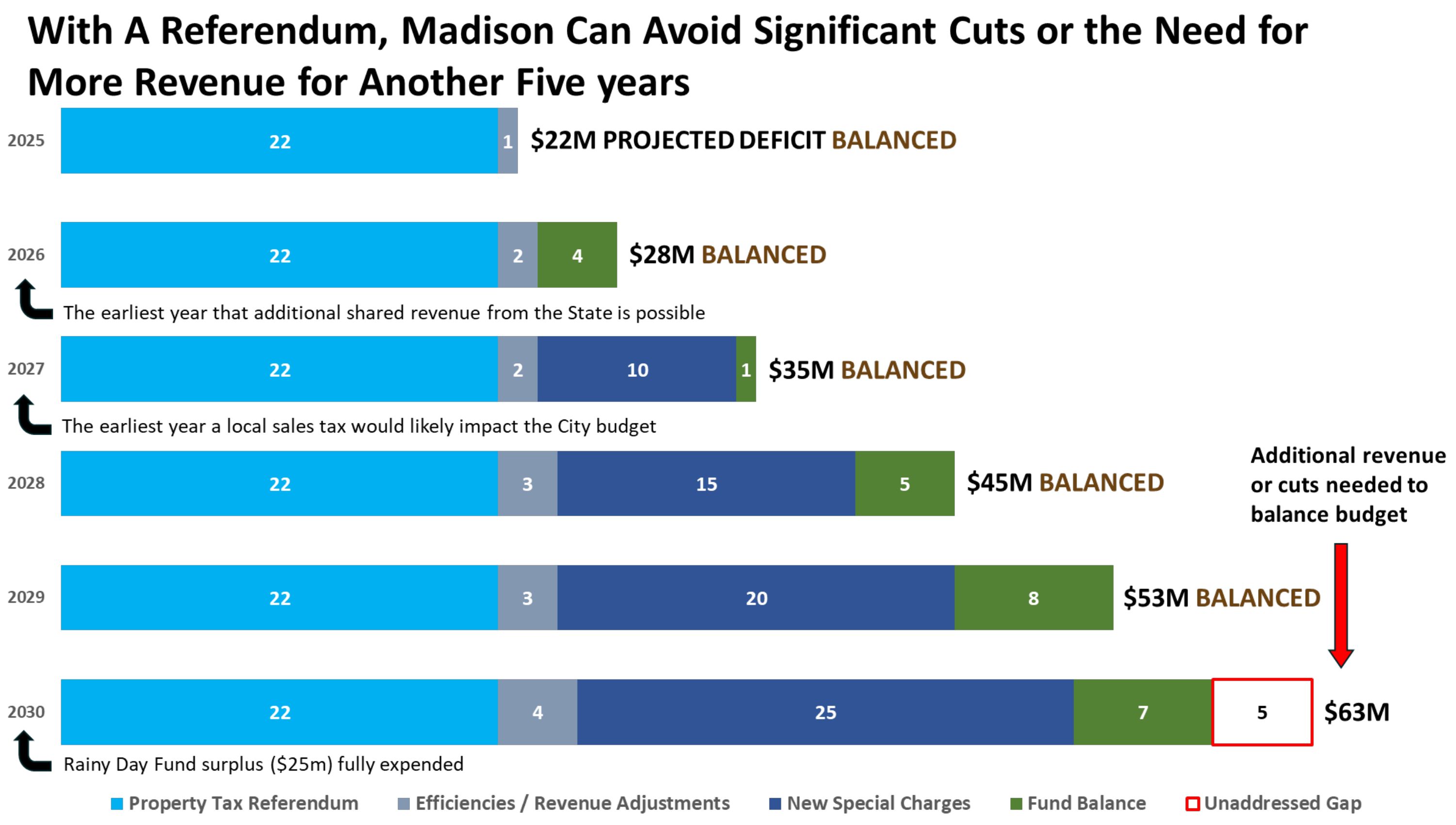


Fund balance history since 2022

- Underspending, combined with higher interest rates have resulted in increasing fund balance.
- Fund balance level a key part of City's debt rating.
- Use of fund balance is a one-time / short-term measure.

	2022	2023	2024	2025 Budget	2026 Projected
Opening Unassigned Balance	56,371,768	66,120,952	82,853,730	110,618,536	109,839,136
Revenues	340,298,754	378,385,393	404,417,135	409,528,859	421,850,998
Expenditures	328,648,521	347,163,791	384,668,364	410,308,259	431,850,998
Variance	11,650,233	31,221,602	19,748,771	(779,400)	(10,000,000)
Assigned Change	(1,564,026)	(14,572,171)	6,930,834	-	-
Other Changes	(337,023)	83,347	1,085,201	-	-
Ending Unassigned Balance	66,120,952	82,853,730	110,618,536	109,839,136	99,839,136
Subsequent Year Budgeted/ Estimated Expenditures	362,559,104	384,620,273	410,308,260	431,850,998	451,398,135
Fund Balance Share	18.2%	21.5%	27.0%	25.4%	22.1%
Fund Balance Policy Target	15.0%	15.0%	15.0%	15.0%	15.0%

Five Year Budget Outlook: Need for Ongoing Budget Balancing Strategies



The 2025 Adopted Budget includes a 5-year plan to address future deficits.

- The referendum amount is fixed ($22 million) so it will not grow with inflation or keep pace with increasing costs.
- Due to the structural nature of the deficit, this means a budget gap will reemerge in future budgets.
- Additional strategies will be needed to balance future budgets.
- The 5-year plan will be updated annually.

Part 3.b.

The Levy Limit and Impact of Debt Service

Takeaways:

- Growth in property tax revenues is constrained by state law requiring strict levy limits.
- Borrowing for capital projects is repaid through the operating budget. However, due to how the levy limit is calculated, reducing debt service does not increase the allowable levy for operations.
- Reducing borrowing in the capital budget will not have a meaningful impact on the operating budget deficit.

What is the Levy Limit?

- State Legislature limits the increase in property taxes for City operations by a “net new construction” factor.
- “Net new construction” is the value of new buildings in the City divided by the total property value in the City.
- “Net new construction” can vary from 1% to 3% annually, depending on economic conditions.
- Property taxes necessary to repay debt issued to finance capital projects are exempt from the levy limit.
- The levy limit can be exceeded through a voter referendum.

What is Debt Service?

- The City issues debt to finance its capital investments, such as reconstruction of a street, construction of a library building, or purchase of snow plows and ambulances.
- Repayment of that debt is called “Debt Service” which is included in the City’s operating budget.
- Many of the City’s funds, including the General Fund and property taxes, are used to pay Debt Service.
- The City must repay its debt – much like property owners must repay their home mortgage.
- If the City does not repay its debt, it would be in default. A default could mean either very high interest costs for future debt or the inability to issue debt to pay for capital investments.

Example: Atwood Avenue Reconstruction

Atwood Avenue reconstruction was included in the 2023 Adopted Budget. The project leveraged multiple funding sources, including $4.5 million in general obligation (GO) borrowing. This borrowing was issued in the form of GO bonds supported by the general fund. Repayment will occur over 10 years and will be reflected in the debt service section of the operating budget.

Below is a project snapshot from the 2023 adopted capital budget. The project also included federal funding that did not pass through the City, therefore is not shown in the budget totals.

Project	**Atwood Avenue**	Project #	**11127**
Citywide Element	**Land Use and Transportation**	Project Type	**Project**

Project Description

This project funds the reconstruction of Atwood Avenue from Fair Oaks Avenue to Cottage Grove Road to a three-lane boulevard with multi-use paths. Median and crosswalk enhancements are proposed for safe pedestrian crossing to Olbrich Gardens and Olbrich Park. The multi-use path will be utilized for the Lake Loop route around Lake Monona. A new pedestrian and bicycle bridge over the Starkweather Creek is included in the project. The goal of the project is to improve the facilities for pedestrians, bicyclists, motor vehicles and transit. Federal funds are approved by the Metropolitan Planning Organization (MPO). Funding shown is City cost share.

Project Budget by Funding Source

	2023	2024	2025	2026	2027	2028
GF GO Borrowing	4,530,000	-	-	-	-	-
Municipal Capital Participate	486,000	-	-	-	-	-
Reserves Applied	350,000	-	-	-	-	-
Revenue Bonds	797,000	-	-	-	-	-
Special Assessment	551,000	-	-	-	-	-
TOTAL	**$ 6,714,000**	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**

How the City determines actual borrowing amounts and debt service

Example Timeline for 2024 Budget

Budget Adoption

- Budget is adopted in November for following year
- Budget establishes total budget authority for a project.
- 2024 Budget adopted in November 2023

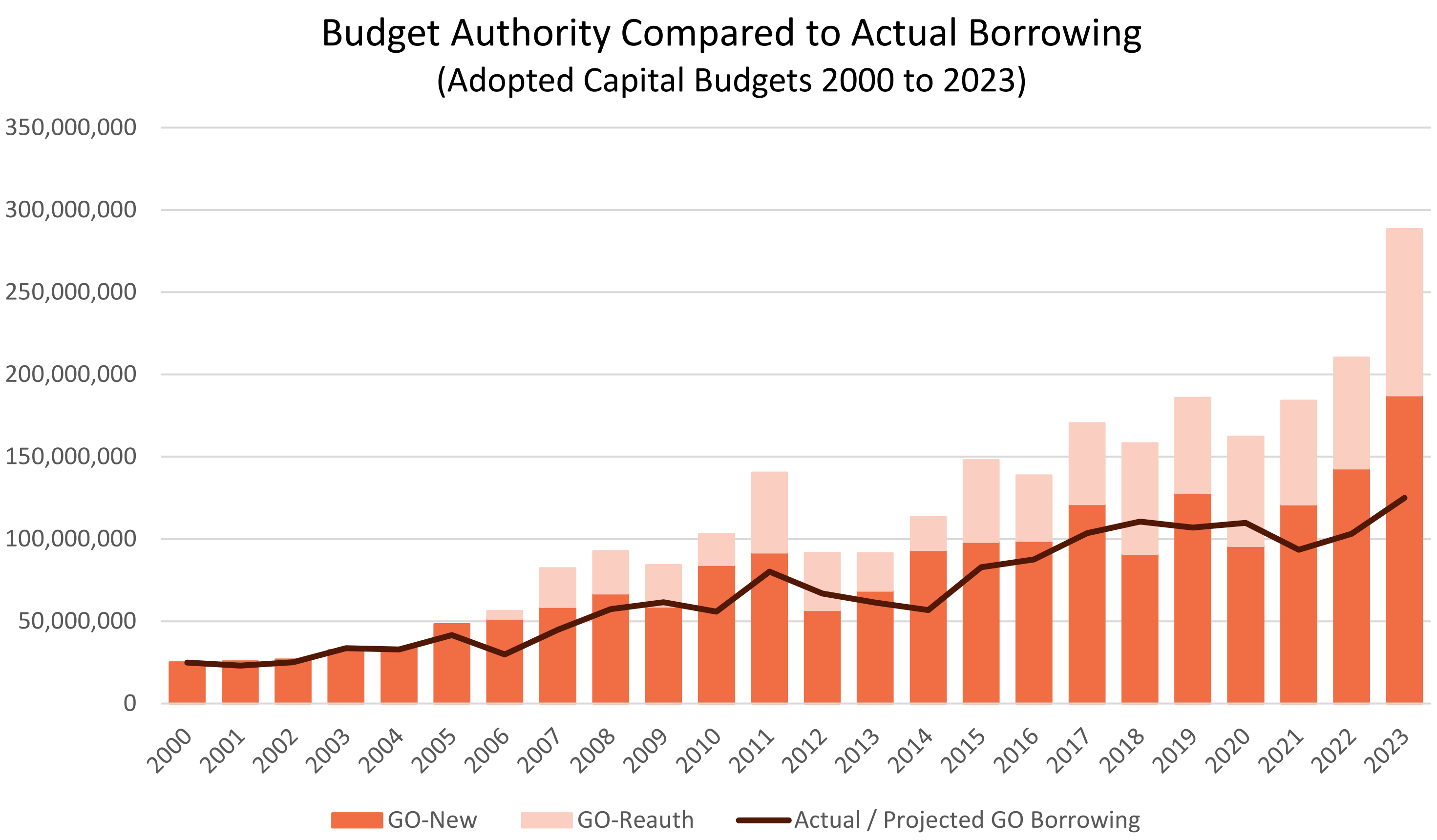
Borrowing Exercise

- Mid-year borrowing exercise to determine how much borrowing is actually needed for the project.
- May be less than the authorized amount
- Exercise in July 2024 to determine 2024 borrowing amounts

Bond Sale

- Bond sale in August/September to issue debt
- This amount is factored into the next year’s budget
- 2024 borrowing determines 2025 debt service

Actual borrowing is significantly lower than budget authority



- Actual GO borrowing is consistently less than budget authority
- Between 2000 and 2023, average borrowing = 69% of authorized budget
- Why is there a difference between budget and actual borrowing?
  - City practice is to budget for full cost of major projects (e.g. new facility) up front to let contracts
  - Projects may be delayed due to sequencing with other work, capacity, or other reasons
  - If a project is delayed or cancelled, the City does not borrow funds. APM 1-8 is the City policy for closing capital projects.

Interaction between Debt Service and the Levy Limit

- The growth of the City’s general fund budget is constrained by the state’s **strict levy limits**, which limits property tax growth to the value of net new construction.

- Levy Limit Calculation
  - Increases prior year levy by net new construction factor, ***excluding debt service***
  - Adds debt service for upcoming year based on amount borrowed in current year
    (ex. 2025 debt service in levy limit calculation = 2024 borrowing)

- Interaction between Levy Limit and Debt Service
  - Less debt service ***does*** lower allowable total property tax
  - Less debt service ***does not*** increase the allowable levy for operations
  - Debt service paid from other funds (e.g., Stormwater projects) helps the operating budget by creating allowable levy that does not need to be used for debt service
  - ***Reducing borrowing in the capital budget does not address the structural deficit***

Example: Reducing Debt Service

reduces total levy increase but does not increase allowable levy

Actual Levy Limit Calculation for 2024 Budget

	Allowable Levy	Debt Service	Total Allowable Levy
Prior Year Levy	166,704,583	107,986,613	274,691,196
Current Year	170,172,778	116,324,921	286,497,699
Difference	3,468,195	8,338,308	11,806,503

If Debt Service was $1 million lower ($7 million reduction in borrowing in 2023 capital budget)

	Allowable Levy	Debt Service	Total Allowable Levy
Prior Year Levy	166,704,583	107,986,613	274,691,196
Current Year	170,172,778	115,324,921	285,497,699
Difference	3,468,195	7,338,308	10,806,503

Reducing debt service lowers total levy but does not change allowable levy for operations

Same as Actual table above

$1m less than Actual table above