



Budget, Finance & Economic Development Committee

January 25, 2022

Summary and Motions

Committee chair, Council Member Amanda Bledsoe, called the meeting to order at 1:05 p.m. Committee members Vice Mayor Steve Kay and Council Members Richard Moloney, Chuck Ellinger, James Brown, Josh McCurn, Susan Lamb, Preston Worley, Fred Brown, and Kathy Plomin were present. Council Member Hannah LeGris attended as a non-voting member.

I. Approval of November 30, 2021 Committee Summary

Motion by Plomin to approve the November 30, 2021, Budget, Finance, and Economic Development Committee summary; seconded by F. Brown. The motion passed without dissent (J. Brown was absent for this vote).

II. Comprehensive Annual Financial Report, FY 2021

Jeanna Jones, of Strothman & Company, provided the report for the annual audit. Commissioner Hensley thanked the staff at Strothman for a great working relationship, easy accessibility, and a smooth process. LFUCG received an unmodified opinion, the highest level of opinion an organization can receive. Jones pointed out that General Fund Revenue for 2021 was \$386.02 million up 5% from 2020. Expenditures were \$362 million versus \$348 million in 2021 - a 4% increase. She noted that the net change was an increase of 12% year over year. Ms. Jones also discussed General Fund balances. In 2021, the balance was \$105.49 million, up \$25.1 million from 2020. She pointed out that the biggest change to Fund Balance was the amount assigned to General Government.

Next, Ms. Jones provided the required communications, including the disclosure of Significant Accounting Policies in Note 1 of the Audited Financial Statements. There were no uncorrected misstatements and no difficulties in dealing with management or disagreements with management. Ms. Jones also shared about the use of estimates, which are sensitive because of their potential to significantly impact financial statements. She also shared upcoming GASB standards that will be changing for FY22 and FY23. She pointed out the change to leases under GASB 87, which requires leases to be recorded as an asset and liability as opposed to an operating expense. They are still working on auditing some of the federal funds but will finish soon. Jones thanked the committee and the Finance staff for allowing Strothman & Co. to perform this service.

Lamb asked if receiving the highest audit opinion is unusual for municipalities. Ms. Jones said that most organizations receive the unmodified opinion, the highest level opinion. Lamb thanked Ms. Jones for their work and the relationship that exists between city staff and our auditors. No action was taken on this item.

III. Lexington Economic Outlook and Occupational License Tax Forecast FY 2022 & 2023

Chair Bledsoe welcomed Dr. Mike Clark from the University of Kentucky for the annual economic outlook and occupational license tax forecast. Dr. Clark began by looking at GDP, real Gross Domestic Product. GDP is the value of goods and services being produced in the economy and is a broad measure for how the economy is performing and is adjusted for inflation. Recent data suggests that GDP, nationally and at

the state level, has recovered from pandemic lows. We seem to be back to pre-pandemic levels. Clark shared labor market statistics. The unemployment rate for Lexington and the state of Kentucky are trending below national numbers. In November 2021, the unemployment was 2.4%, the lowest since the 1990s. Dr. Clark said this indicates good news for job seekers. He reminded Council that anyone not searching for employment is not considered “unemployed” and are not part of the labor force. He pointed out that prior to the pandemic, the unemployment rate was 2.8%. Clark also noted trends in the labor force, particularly people leaving. This happens for a variety of reasons – childcare, retirement, health and safety concerns, etc. Dr. Clark reported that 8,000 fewer people were employed from November 2019 to November 2021, and 9,400 fewer people in the labor force.

Next, Dr. Clark shared total nonfarm employment numbers since January 2020. He pointed out that employment is generally improving in Lexington, Kentucky, and nationally. He expects that rate of growth to continue but to slow down. Employment numbers are 4.3% below where they were prior to the pandemic. Dr. Clark also presented employment numbers by sector. He pointed out that manufacturing jobs are still recovering. Government employment has bounced back – this includes the school districts. Dr. Clark drew attention to the leisure and hospitality industry, which is still down by almost 18% (or 6,000 jobs) since November 2019. Dr. Clark once again referenced the tight labor market, where strong demand for workers is putting upward pressure on wages. Employers are having to increase pay to retain and attract workers. Private industry workers are making on average 4.6% higher than 12 months ago. Dr. Clark showed that this upward wage pressure varies in scope by industry, but it is occurring across the board. Next, Dr. Clark displayed Consumer Price Index trends since 2010. Normally, this number is around 2%, but it is higher now due to supply chain issues, labor shortages leading to higher wages, and other issues. Dr. Clark said he expects some easing of inflation at the end of 2022

Next, Dr. Clark shared Lexington’s Payroll Tax Revenue Projections for 2022 and 2023. Because of strong wage growth in the past 6 months, he expects to see 7.7% payroll growth in 2022. As wage growth slows in 2023, he expects payroll tax to grow, but more slowly at 3.8%. Next, he shared projections for Net Profit. He expects revenues from corporate profit tax to begin to decline by 1.3% heading into 2023. He noted that corporate profits are very challenging to project, especially with economic uncertainty. Some present factors he is monitoring for risk: Covid, consumer response to new Covid-19 variants, rate of growth in the labor market, and corporate profits. Bledsoe thanked Dr. Clark for this useful information.

Moloney asked about projections for 2024 and 2025 because of present bonding decisions the Council will soon make. Dr. Clark said they do not do a forecast for 2024-25 but could speak to general issues. Clark suggested we should see continued payroll growth because of the upward trend that was already in place prior to the pandemic but at a slower rate. F. Brown asked if 2022 projected payroll tax took into consideration the 6 months already behind us. Dr. Clark said yes, that is factored in. The second 6 months of FY22 will be compared to the same time in the prior year, which is when some growth had already taken place from the pandemic. Because of this base being higher, he would be surprised to see the same rate of growth the second half of the fiscal year. Brown asked how they forecast for inflation and wage growth. Dr. Clark said they look at national trends and ask – do they see unemployment and wage growth? Those two factors play into the forecast, and we are seeing growth in both areas. Brown said because we have had two good years, now would be a good time to reduce debt and invest in capital projects we may need in the future. He asked if those would be prudent investments. Dr. Clark said these are policy issues that the Council must decide, but that additional revenue does create the question about the most prudent course of action.

Vice Mayor Kay thanked Dr. Clark for not weighing in on policy matters. He asked whether wage growth will stabilize or continue. Dr. Clark said it is helpful to understand what is driving the wage growth. We currently have employers wanting to hire a smaller number of available workers, which has driven pay raises and hiring bonuses. As labor becomes more expensive, employers will either use labor or capital. As the cost of labor goes up, employers will either switch to capital and technology adoption which are cheaper, or pay higher wages, attracting workers into the labor force. Looking forward, he sees these two factors easing pressure on wage growth. Kay pointed out that companies like Amazon are issuing benefits unrelated to salary, like education. He asked if a shift away from direct compensation to other benefits will become more common. Dr. Clark said it isn't clear this will slow wage growth. However, as these other benefits are utilized, it would put less pressure on payroll taxes.

Ellinger referred to balanced budgets resulting from vacancies. Since many of our jobs are service-oriented, he noted that increasing wages and the impacts of bargaining agreements will impact the budget. He asked how we go forward to make sure wages don't overcompensate for growth. Dr. Clark said it is hard to calculate quantity and quality of workers for wages. He referred to private industry practices such as evaluating applicants and length of vacancies that would indicate a struggle to attract workers. These are hard to follow in real time. Dr. Clark verified that his team does not look at the LFUCG budget to make projections.

J. Brown thanked Dr. Clark for the valuable information. He reiterated that there could be a need to recruit from outside the region since labor force participation is lower. Dr. Clark said it is hard to predict why people are out of the labor force. J. Brown referred to retired employees who would need to be paid at a higher rate where recruiting new people would be less costly. Dr. Clark referenced barriers to being in the work force – childcare, virtual schooling. He said that identifying these barriers and how they can be addressed can be a helpful discussion. J. Brown spoke about diversifying the city's revenue streams. Moloney mentioned that many nurses are looking for new jobs, as are Corrections and 911. He noted that the pandemic has led to a lot of burn out, leading to career change. Bledsoe thanked Dr. Clark for his time and insight. No action was taken on this item.

IV. Quarterly Financial Update – December 2021

Commissioner Hensley presented the second quarter financials ending December 31, 2021. She noted that revenues exceeded expenses and transfers by \$25,226,453 for the period ending 12/31/21. One significant factor contributing to this is that we have received all library fund property taxes, but we have not paid that expenditure of about \$8 million. While we are seeing growth, we have been able to be proactive on the retention of staff through compensation changes. These compensation adjustments will begin to diminish savings from attrition.

Director Holbrook provided an overview for Revenue. He noted strong growth in payroll withholding and net profit. He also pointed out the national trend for one-time bonuses that may be pushing the payroll tax number higher. Early receipt of tax payments from businesses traditionally indicate a more profitable year. Holbrook presented a graph showing the performance of payroll withholding and net profits over budget. Holbrook also noted other accounts that are also performing ahead of budget – franchise fees, services which include golf courses, and insurance. F. Brown asked if the FY22 revenue to date of \$203,732,281 could be an indication that another \$200 million will come in for the rest of the fiscal year. Holbrook said many of these revenues are related to timing, such as property taxes which have already come in. He noted that revenue sources are volatile on their timing, which makes it hard to predict the second half of the year. F. Brown said that if we do receive another \$200 million, that would be \$400

million, which would be well ahead of budgeted revenue (\$376 million). Holbrook said the revenue budget is based on monthly trends, so the second half of the year depends on the timing of different revenue sources. F. Brown suggested there could be additional money for fund balance if this happens, which could impact ARPA discussions. Ellinger asked how compensation adjustments would impact the additional revenue coming in. Hensley reminded the committee that we balanced the FY22 budget using one-time funds, pre-funding from last year, and ARPA funding. If we bring in extra revenue, it would pay for what we budgeted. She noted that the police contract has already been implemented. She reiterated that while revenue is performing well, our payroll adjustments are dependent on those revenues. Hensley said they are using both higher revenues and operational savings to make necessary compensation adjustments. Ellinger reiterated that these expenses will continue to increase.

Director Leuker presented an overview of expenses. She noted a 2.4% personnel variance, a savings of \$2.6 million. She noted that some of those savings are diminished by over-time payments and payouts. She noted that January is a month with a lot of payouts related to sick checks and retirement payouts. Leuker pointed out the \$10.3 million savings in operating expenses. In division budget meetings, she found at least \$2 million in commitments to vendors that have not yet been processed. However, we are seeing savings in professional services and repairs & maintenance accounts. Leuker reminded the committee that the FY22 personnel decisions that have been made will begin to diminish personnel savings. She also provided an estimated impact of the FY22 personnel decisions. This slide projects an impact of \$4.7 million to the General Fund. Her team is working through variances to determine actual savings versus payment timing issues. Hensley provided an ARPA update with the ARPA dashboard with a breakdown of expenditures by ARPA expenditure category.

Moloney asked if Finance had run a formula indicating what would have happened if LFUCG had not received federal dollars. Hensley said our goal is to pay for expenses with regularly occurring revenue, not to balance the budget with one-time funding. She indicated that we are working towards a situation where our revenue can cover our expenses. F. Brown referred to the audited report's breakdown of Fund Balance. He asked for 12/31/21 fund balance amounts to compare to the audited amounts. Hensley referred to the fund balance presentation in October. Kay asked about the total budget in FY22. Hensley differentiated the revenue budget of \$376 million with the expense budget of \$400 million, the balance of which was paid by budget stabilization and pre-funding items. Hensley reiterated the timing of budgeted revenues and expenses, which are cyclical in nature. Ellinger noted that the budget wasn't balanced with recurring revenues in FY22. If we continue to overperform on revenue, we may not have to use other dollars to balance the budget.

Chair Bledsoe asked Finance to prepare a slide projecting expenditures related to bonding. We are currently at 12% of revenue for debt service. Including an estimated FY23 revenue increase, the graph indicates that there are points in time when the debt service will exceed 12%. Reynolds asked how ARPA discussions and potential bonding would impact this slide. Hensley noted that this graph is based on a \$30 million bond in FY23, which includes some of those ARPA expenditures. Ellinger noted that lower interest rates make it cheaper to bond. He asked how projected Federal Reserve interest rate increases will impact our ability to bond. Hensley noted that bonding and interest rate discussions are a policy decision for Council. She noted that Council might consider determining at what interest rate they would like to consider paying cash over debt service. Lamb asked for actual dollar amounts, not just percentages, of debt service. Hensley will send out the debt chart as well as those amounts.

The monthly financials were provided, reporting the first six months of the fiscal year as well as ARPA revenue and expenses to date. The property tax collection is included in the numbers. No action was taken on this item.

December 2021 YTD Actual Compared to Adopted YTD Budget

| <u>Revenue Category</u> | <u>Actual</u> | <u>Budget</u> | <u>Variance</u> | <u>% Var</u> |
|--------------------------------|----------------------|----------------------|------------------------|---------------------|
| OLT- Employee Withholding | 112,759,633 | 104,600,000 | 8,159,633 | 7.8% |
| OLT - Net Profit | 17,774,962 | 13,260,000 | 4,514,962 | 34.0% |
| Insurance | 18,026,040 | 17,830,000 | 196,040 | 1.1% |
| Franchise Fees | 12,375,682 | 11,990,000 | 385,682 | 3.2% |
| TOTALS | 160,936,317 | 147,680,000 | 13,256,317 | 9.0% |

December 2021 YTD/December 2020 YTD Current Year Compared to Prior Year

| <u>Revenue Category</u> | <u>Dec '21 YTD</u> | <u>Dec '20 YTD</u> | <u>Variance</u> | <u>% Var</u> |
|--------------------------------|---------------------------|---------------------------|------------------------|---------------------|
| OLT- Employee Withholding | 112,759,633 | 100,626,002 | 12,133,631 | 12.1% |
| OLT - Net Profit | 17,774,962 | 18,694,077 | (919,115) | -4.9% |
| Insurance | 18,026,040 | 17,763,957 | 262,083 | 1.5% |
| Franchise Fees | 12,375,682 | 11,772,146 | 603,536 | 5.1% |
| TOTALS | 160,936,317 | 148,856,182 | 12,080,135 | 8.1% |

FY2022 – Cash Flow Variance Revenue (Actual to Budget)

| <i>For the six months ended December 31, 2021</i> | | | | |
|---|------------------------------|------------------------------|-----------------------------|--------------------|
| | <u>Actuals</u> | <u>Budget</u> | <u>Variance</u> | <u>% Var</u> |
| <u>Revenue</u> | - | - | - | - |
| Payroll Withholding | 112,759,633 | 104,600,000 | 8,159,633 | 7.8% |
| Net Profit | 17,774,962 | 13,260,000 | 4,514,962 | 34.0% |
| Insurance | 18,026,040 | 17,830,000 | 196,040 | 1.1% |
| Franchise Fees | 12,375,682 | 11,990,000 | 385,682 | 3.2% |
| Other Licenses & Permits | 4,487,158 | 4,038,717 | 448,441 | 11.1% |
| Property Tax Accounts | 23,392,490 | 23,772,783 | (380,293) | -1.6% |
| Services | 12,697,602 | 10,977,853 | 1,719,749 | 15.7% |
| Fines and Forfeitures | 125,950 | 127,000 | (1,050) | -0.8% |
| Intergovernmental Revenue | 179,648 | 224,413 | (44,765) | -19.9% |
| Property Sales | 128,454 | 50,000 | 78,454 | 156.9% |
| Investment Income | 23,628 | 102,713 | (79,085) | -77.0% |
| Other Financing Sources | 40,000 | 40,000 | 0 | - |
| Other Income | 1,721,034 | 1,326,892 | 394,142 | 29.7% |
| <u>Total Revenues</u> | <u>\$ 203,732,281</u> | <u>\$ 188,340,371</u> | <u>\$ 15,391,910</u> | <u>8.2%</u> |

FY2022 – Cash Flow Variance Expense (Actual to Budget)

| <i>For the six months ended December 31, 2021</i> | | | | |
|---|------------------------------|------------------------------|-----------------------------|--------------------|
| | <u>Actuals</u> | <u>Budget</u> | <u>Variance</u> | <u>% Var</u> |
| <u>Expense</u> | | | | |
| Personnel | 108,610,112 | 111,227,200 | 2,617,088 | 2.4% |
| Operating | 20,842,131 | 31,233,603 | 10,931,472 | 33.3% |
| Insurance Expense | 1,265,324 | 1,236,904 | (28,420) | -2.3% |
| Debt Service | 30,269,422 | 31,913,178 | 1,643,756 | 5.2% |
| Partner Agencies | 10,994,218 | 11,203,389 | 209,171 | 1.9% |
| Capital | 746,238 | 1,202,149 | 455,911 | 37.9% |
| <u>Total Expenses</u> | <u>\$ 172,727,445</u> | <u>\$ 188,016,423</u> | <u>\$ 15,288,978</u> | <u>8.1%</u> |
| <u>Transfers</u> | <u>\$ 5,778,383</u> | <u>\$ 6,000,931</u> | <u>\$ 222,548</u> | <u>2.5%</u> |
| <u>Change in Fund Balance</u> | <u>\$ 25,226,453</u> | <u>(\$ 5,676,983)</u> | <u>\$ 30,903,436</u> | |

V. Legislation Impacting the Budget.

Chair Bledsoe thanked Hilary Angelucci for putting LFUCG and state regulations related to directing the budget in once place for Council. This will be a helpful tool when it is time to work on the budget. Angelucci

thanked David Barberie, Law Department, for helping. The document includes links to ordinances where possible. She pointed out the state KRS which relate to the budget. Angelucci highlighted obligations related to collective bargaining agreements, the ESR resolution, as well as an outline of LFUCG funds. She also noted contractual obligations. This document is included in the packet and will be available for Council to use for the FY23 budget process. Bledsoe reiterated that the budget ordinance supercedes other ordinances and resolutions and welcomed Dave Barberie to provide clarity. Barberie noted that this has happened by adding sections to the budget adopted by Council. In FY22, Council suspended the requirement to put \$50,000 per month in the contingency fund. Barberie noted the way we suspend other pieces of local legislation is by adding to the budget ordinance. No action was taken on this item.

VI. Items Referred to Committee

No action was taken on this item.

Motion by Lamb to adjourn at 2:57 pm; seconded by McCurn. The motion passed without dissent.

Materials for the meeting:

<https://lexington.legistar.com/MeetingDetail.aspx?ID=909881&GUID=BED8F5B3-879D-4605-9CD5-23402EFFAF04&Options=&Search=>

Video recording of the meeting: https://lfucg.granicus.com/player/clip/5509?view_id=4&redirect=true

SD 1/31/22