

**STAFF SUMMARY
CITY OF MINNETONKA
CITY COUNCIL STUDY SESSION
MONDAY, AUGUST 18, 2008
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Council Present: Dick Allendorf, Bob Ellingson, James Hiller, Terry Schneider, Tony Wagner, and Mayor Jan Callison.

Staff: John Gunyou, GERALYN Barone, Merrill King, Julie Wischnack, Dave Johnson, Darin Nelson, Brian Wagstrom, Joe Wallin, Mark Raquet, and David Maeda

1. 2009 preliminary budget review

Gunyou noted the state adopted levy limits for the next three years that cap an increase in the tax levy to 3.9 percent per year with some exceptions. In addition to the levy limit, he said there are other budgetary issues the city is facing as well. There is more uncertainty about salaries than in past years, because all of the labor contracts are up for renewal this year. Health insurance costs likely will increase 16 percent. The impact of rising energy costs is a big unknown. The most recent estimates show that gas prices will be decreasing by the end of the year. A recent survey of comparable cities shows Minnetonka about in the middle in terms of budgeting for fuel costs. Two other issues are: the multi-year fix of PERA funding liabilities; and a continuing rise in court related costs imposed by Hennepin County and the state upon the city.

Gunyou said the staff recommendation is to limit the increase in the levy for basic services to 3.9 percent. There would be another 0.7 percent increase to annualize costs for fire department duty crews. With the additional debt service for the park and open space referendum bonds, the total proposed levy increase would be 5.5 percent. The EDA is recommending an \$800,000 HRA levy that would represent an additional 2.9 percent increase.

He said under the staff recommendation and due to the continuing shift of the property taxes burden from residential to commercial properties related to market value changes, the average homeowner in the city would see a 3.4 increase. The EDA recommended HRA levy would add an additional 2.8 percent to the average homeowner.

The city has taken other steps to address budget issues. Gunyou said he has implemented a "soft freeze." Rather than automatically filling vacant positions or entering into major contracts, there will be a second round of review. One example is an opening in the police department that will be filled but delayed until the end of summer to accrue some budget savings. There also is an opening in the code enforcement area and Community Development Director Julie Wischnack is looking at current staffing levels to determine better methods to manage the work demand and seasonal peaks in the division. Gunyou said any new budget items would have to be financed by cutting the budgets of other areas.

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Gunyou said the city has been fortunate to be able to delay implementing fire department duty crews, because most other cities are already using them. He described an incident the past Saturday when there was a mutual aid call to Eden Prairie, and there were no paid on-call firefighter responses twenty minutes after the page was sent out. Duty crews will eliminate the uncertainty in the response to those type calls.

Gunyou said Wischnack did an analysis of the permit and license revenue, which demonstrated that the revenue fluctuates greatly from year to year. Even though there can be derived an historical base, staff recommends taking a more detailed look at fees and adjusting them at regular intervals to buffer the city from larger economic swings. Gunyou said it might make sense to look at complex projects that require much more review and staff time and possibly charge some type of escrow or surcharge. Staff also recommends establishing a contingency budget plan identifying capital projects that can be delayed until later in the year. This would allow time to get a better estimate on the level of revenue being generated and whether all or some of the projects should be budgeted in a future capital budget year.

Gunyou said at a previous study session, council asked the EDA to examine potential uses for an HRA levy. The EDA is now recommending an \$800,000 levy, which is equivalent to about half of the maximum that could be levied. The levy would meet the need for an ongoing source of funding for the Development and Livable Communities Funds. Gunyou said a number of neighboring communities use an HRA levy. The EDA is recommending \$270,000 be allocated to WHAHLT, \$30,000 be allocated for affordable housing support programs, and \$430,000 be allocated for new initiatives.

Gunyou said the proposed 5.5 percent levy increase for the city's services is similar to other comparable communities.

Hiller asked for an update on the 2008 budget. Gunyou said one of the reasons the soft freeze has been imposed is because building permit revenues are running below what was anticipated. Finance Director Merrill King said at this point it appears the city will run short but not dramatically so. She said there was an excess fund balance from 2007 to accommodate some of the imbalance in the 2008 budget.

Schneider asked for information on what percentage property tax increase commercial properties will see. King said she would get the information for the council.

Ellingson asked if there were other exceptions the city could use to increase the amount of the proposed levy. Gunyou said there are narrow exceptions for

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pension related costs. King said that exception would provide for a very minor amount for the city. She said another exception the city may qualify for is the value of commercial growth to the tax base. She said this would amount to around \$20,000 more that could be levied. There are also exceptions for cities with a substantial number of foreclosure properties. Gunyou said the other exception is for public safety wages and benefits.

Allendorf asked what projects would qualify as complex that would be subject to the escrow or surcharge. Gunyou said the details are yet to be worked out, but one idea is to track and charge back the actual costs for controversial projects that require multiple meetings and notifications. Another possibility is if a project is located in one of the village areas identified by the comprehensive plan, a surcharge might apply. Wischnack said it is not unusual for other cities to charge an escrow fee. She said it is similar to engineering fees charged to a development for engineering review. Allendorf said he was not opposed to the concept, but a developer should be able to recognize the cost up front.

Allendorf asked for additional clarification of the contingency budget plan. Gunyou said it is uncertain if the city will collect around a half a million dollars of anticipated permit and license fees in 2009. When the budget is adopted in December staff will identify a half million dollars worth of CIP projects that could be delayed until it is determined there are sufficient revenues coming in. He said the criteria that will be used are that no street or public safety projects will be put on hold.

Wagner asked if staff currently tracks staff time for development projects. Gunyou said currently that is not done. Wagner said that the United Heath Group development brought in around \$700,000 in permit fee revenue, and it seemed unfair that they would be charged more when they helped the city meet its budget that year. Gunyou said one reason staff began to look at the idea was the volatility in the revenue. As the city has increased its public notification and community meetings for an increasing number of more complex projects, it has become evident more general fund money is being spent on those projects. The idea is for a development to pay for more of the actual costs. Wagner said he supported the concept but had concerns on how it would be implemented.

Wiersum said he was surprised that the average fire response time has increased from six to eight minutes. Information in the staff report indicated one of the reasons for going to duty crews was to maintain the response time. He asked if this meant six minutes or eight minutes. He also asked if the response time remains at eight minutes would it affect insurance rates. Fire Chief Joe Wallin said the goal is for the response time to go back down to six minutes or less. The duty crews will have a positive impact on the insurance service office rating. Wiersum noted the proposal is for the crews to have three- to seven-hour shifts. He said three-hour shifts seemed short. Wallin said the shift lengths came

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out of focus group discussions. The shorter shifts will be used during time periods like 4 a.m. to 7 a.m. where traditionally it has been difficult to get firefighters to respond to calls.

Callison asked Gunyou how long he anticipated the soft freeze would be in place. Gunyou said it would make sense to extend it at least through the three-year levy limit period.

Hiller asked what hardships staff thought would occur if the city adopted a smaller levy increase. He asked what areas were looked at for cutting back. Gunyou said with the likely salary amounts, employees will still likely lose money due to rising health insurance costs. He said non-personnel costs will see a slight decrease with the exception of fuel and LOGIS fees.

Allendorf said residents could say the city just automatically went to the 3.9 percent levy limit. He said he didn't think that was what was done, but he would like to see an explanation provided as to why the average homeowner would see a 3.4 percent property tax increase.

Callison said the decision last year to hire an extra police officer to address speeding issues included taking a look back the following year to evaluate the effectiveness of the measure. She said she would like to get an update from the police department. Gunyou said that would be provided.

Schneider said with the increase in insurance, salaries, and other costs the city likely would have levied even more had it not been for the levy limit. Cuts were made to come down to the 3.9 percent limit. He said the recommendation to go to the limit was made because that is the amount needed to provide basic services.

Wagner agreed there will be a perception the city automatically went to the maximum levy amount. The discussion needs to include information about what was taken out of the budget to come down to the limit.

Wiersum said the staff report did a good job comparing the proposed levy with other cities. He said it would be helpful to have statistics on the consumer price index and the rate of inflation. Gunyou said the current CPI is 4.2 percent, and the government implicit price deflator is at 6.2 percent.

Callison said she was concerned that three years of levy limits and a soft freeze would put the staff in a difficult situation. It will be difficult to provide the same services.

Schneider noted Minnetonka is better able to weather budget difficulties than other cities due to the planning that is done and the fund balance approach that

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is used. Gunyou agreed the city faces a challenge but is in good shape to meet the challenge.

Gunyou asked if the council agreed with the recommendation on nonprofit funding. Schneider said he agreed with the idea but cautioned against allocating \$18,000 in prior-year CDBG monies to organizations without making it clear it would be one-time funding.

HRA Levy

Wagner said three years ago, the EDA discussed the prospects for more affordable housing and whether or not the city was doing enough to meet its goals. At that time, the city was already at 85 percent to 89 percent in meeting the 2010 goal. He said over the last year and a half, the EDA has moved to aiming for the Met Council's goal, that 47 percent of the new housing starts should be affordable. Eventually the Livable Communities Fund used to fund WHAHLT will run out. Looking at the fund balances and the potential for large development opportunities, concern is growing about whether the city can meet its goals. Wagner said he believes there is no way under the current circumstances the city can meet those goals. The EDA discussion on affordable housing fueled the decision to consider an HRA levy and also to include the village concept in the comprehensive plan. WHAHLT

Wiersum said the demographic changes in the city will continue regardless of whether the city responds with necessary changes. He said the EDA spent less time talking about the amount of the proposed levy and more time discussing the need for the levy. The EDA recognized that given the situation with the budget and with the economy, it is a difficult time to ask for an HRA levy. But the funds used to finance the programs are going down rapidly.

Wagner said the EDA members talked about how much would be used to buy single family properties versus funding new programs. He said there was some disagreement among the EDA members and further discussion is needed.

Schneider said the concept of a stable, long term, dedicated source of funding for affordable housing is essential. His preference is to phase in the levy. He said he wasn't inclined to use the HRA levy for economic development if that meant using the levy to attract new businesses. Wagner said the term "economic development" in the EDA discussion related to how the city helps developments move forward to help meet the affordable housing goals.

Schneider said he did not support using the HRA levy for village connections. He said those connections relate to parks and trails. Wiersum said the EDA discussed that issue, and for him the connections are something that would be

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nice to have, but the focus should be on the “must haves.” Because there was disagreement among the EDA members, the item was included. Schneider said he was comfortable phasing in the levy with an initial amount from \$400,000 to \$600,000.

Allendorf said most of the staff report talks about managing existing programs rather than creating new ones to stay within budget. But the EDA recommendation is \$430,000 for new programs. He said it isn't the time for new programs. He noted in 2007 there was a 3.0 percent levy increase for basic services and a 6.3 percent increase for road improvements. The reason the council approved those amounts was based on being able to show residents what they would get for the increases. If he were to ask residents if they would like to increase their taxes this year by 3 percent so that WHAHLT could buy six or seven houses, there could be housing support programs and two new initiatives, he would receive a negative reaction. He sees benefit in the WHAHLT funding and the support programs but the new initiatives are contrary to what is being discussed for next year's budget. Allendorf said the total levy increase including the HRA levy should be communicated to residents.

Wiersum noted a one percent HRA levy would amount to \$276,000. A two percent levy would amount to \$552,000. A 2.9 percent levy would amount to \$800,000.

Wagner said only funding WHAHLT while fund balances are going down, raises the issue of how the city would be capable of participating in future developments. If there was a redevelopment on the north side of I394 involving higher density and affordable housing, would the city contribute to meet the affordable housing goals or would the council be okay with not meeting the goals? Allendorf said there needs to be discussion about using TIF or other options for high density and affordable housing proposals. If the levy has been initially implemented, the tax could be used in the future to meet those needs.

Hiller said he sees the economic development aspect as critical because it would provide a return on investment. He said his problem with the HRA levy was that he could not explain it to residents, because it looked like a generic fund to pay for miscellaneous projects. He said there needed to be a better definition of what the levy would ultimately provide for residents.

Ellingson said he was sympathetic to the levy but thought specific proposals would be provided. He noted the staff report included a new initiative for a project on Rowland and Baker Roads where there are five or six houses including a couple of city-owned houses. He said the proposal he has heard about is for the city to buy the houses and put up a 100-unit apartment or condominium building. The comprehensive guide plan process emphasized a village concept with higher density housing in the villages. The Rowland and Baker Road proposal would not

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incorporate the village concept. He said there seemed to be a disconnect between the guide plan process and the proposal. Ellingson agreed with Schneider that the HRA levy should not be used for trails.

Callison said listening to the comments, it appears the idea for the HRA levy is not quite fully developed. She said looking at the overall budget picture, she agreed it is not the right time to fund new initiatives. She supports the goals of the program including the proposed village connections that are integral to what the city is trying to accomplish. However, she said the city might be overlooking some resources like the Minnesota Housing Finance Agency's programs designed to allow communities to purchase land while the market is down. She said the Martha Lane proposal is one that has been looked at for a couple of years. The project might include affordable housing, but Callison suggested the city look at selling the property to a developer and putting the money into the Livable Communities Fund. Selling properties would allow the city more time to develop a long term strategy.

Schneider said WHAHLT has a track record of nearly a decade where they have kept nearly 60 homes in the area permanently affordable. He said the city knows that funding for WHAHLT is being used effectively to serve a need. Establishing the HRA levy while keeping it to defined programs would allow residents to see its effectiveness.

Gunyou said by establishing a stable balance in the fund, the city would have the capacity to move quickly with council approval, but there would need to be a long term replacement into the fund. The new initiatives would include situations where the city would have an opportunity to buy a property.

Wiersum agreed with Callison that there are investment opportunities with properties that might become available. He said of all the items on the list, WHAHLT is a program that works and should be supported. He also said it is important to establish the levy because of the need for an ongoing source of funding used to meet specific goals.

Allendorf asked if there was an inventory of land that the city could purchase to avoid having to create the HRA levy. Gunyou said the city has an inventory list. Allendorf said in the past the city has loaned money from one fund to another and thus there is flexibility of an opportunity arises and a \$300,000 HRA levy isn't sufficient.

Wiersum asked if it was possible to trade city-owned property with a developer for another piece of property to avoid transaction fees and to create opportunities that otherwise would not exist. He said the problem with selling properties is values are down. Gunyou noted the Rowland Road proposal involves a couple of

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city-owned properties in an area that a developer wants to do something. The city did not initiate that process.

Hiller said the EDA discussion of the WHAHLT homes included comments that while the homes would add to the number of affordable housing in the city, the city will never meet the goals by continuing down the same path. He questioned if the city should continue proceeding down that path. Schneider said it is not an either or issue. To meet the goals, the city needs the flexibility to partner with developers that want to do dense, multi-family housing. He said there also is a huge need in the community for the single, homeowner occupied, affordable unit. The city has to continue to grow the overall package.

Ellingson said there is a natural process for individuals to buy foreclosed homes on their own without government needing to get involved. Callison said the market has changed, and a lot of people cannot afford to buy homes without programs like WHAHLT. She said WHAHLT is a long term program, and what might be affordable today may not be affordable five years from now. Ellingson agreed market conditions change, but as housing prices decrease, people might be able to buy the homes on their own without the need for the city to get involved.

Callison said what she heard from the evening's discussion was support for the proposal that would include an HRA levy at a maximum of \$400,000. Certification of the levy would occur at the September 15 meeting. Gunyou suggested the EDA be used to gather public feedback on the HRA levy.

2. Adjournment

The study session adjourned at 8:10 p.m.

Respectfully submitted,

David E. Maeda
City Clerk