Town of Ocean View, Delaware

Financial Condition Assessment and Forecast

(Step 1 – Diagnosis)

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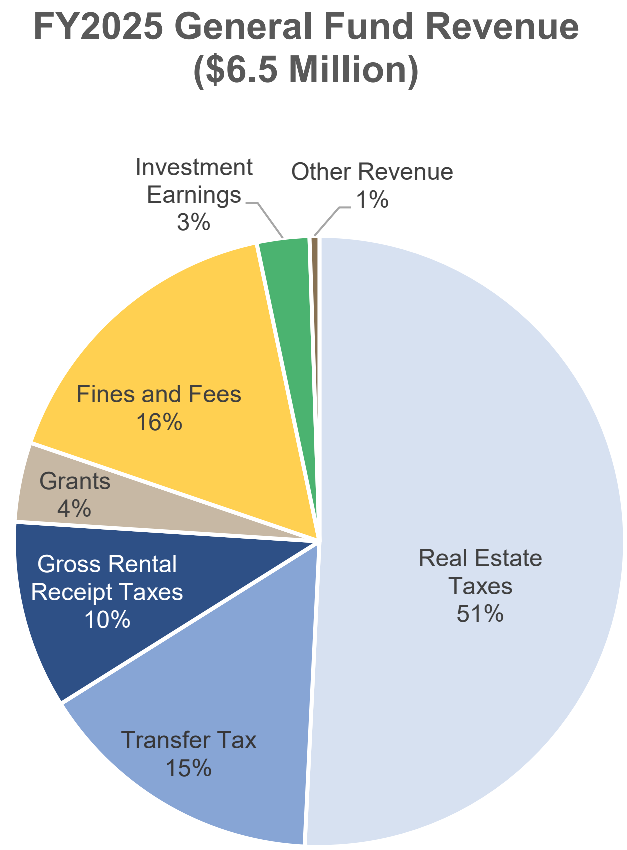
Agenda

- General Fund Revenue and Expenditure Overview
- A Look at the Past:
  - Historical Net Operating Results
  - Historical Use of Reserves
- A Look at the Future:
  - Projected Capital Funding
  - Projected Capital Needs
  - Operating Spending Pressures
  - Revenue Risks
  - Overall Economic Context
- Bringing It All Together: Five-Year Financial Projection
- From Diagnosis to Treatment

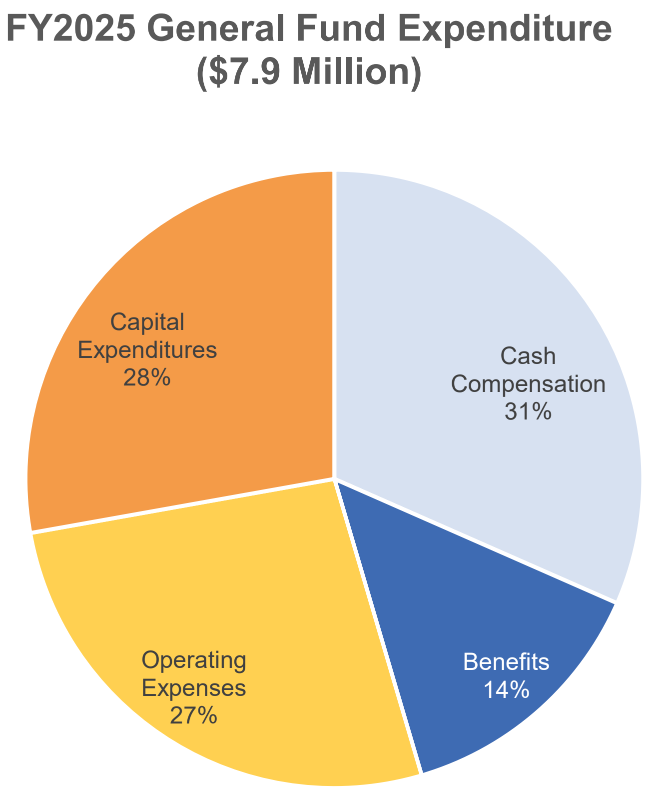
General Fund Operating Revenue

- More than half of the Town's revenue comes from the real estate tax
- Another 15% of the budget comes from the transfer tax, which is transferred to the Capital Repairs Trust Fund (CRTF), the Street Repair and Replacement Trust Fund (SRRTF), and the Emergency Reserve Trust Fund (ERTF)
- Gross rental receipt tax represents another 10% of the budget
- In aggregate, tax revenue represents more than three-quarters of the Town's total General Fund budget
- The remaining budget comes primarily from intergovernmental revenue, fines and fees, and investment earnings



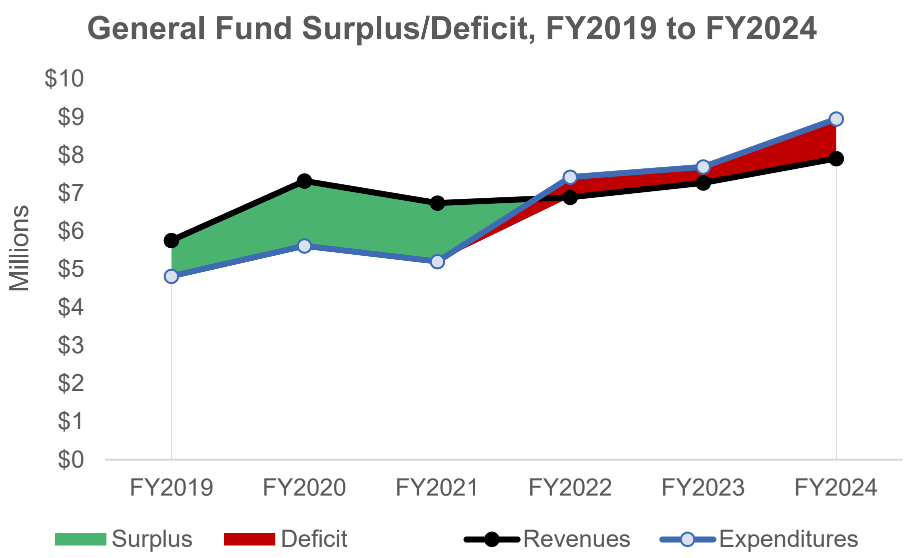
General Fund Expenditures

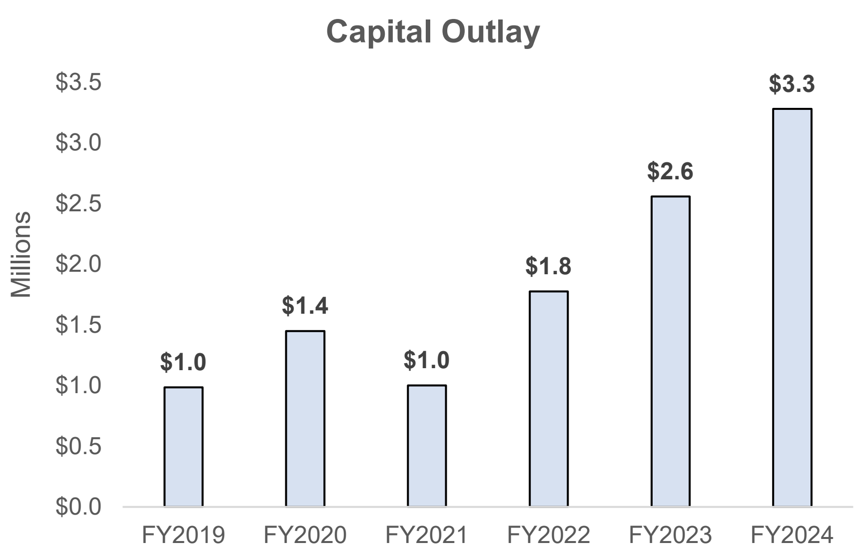
- Almost half of the Town's expenditure is personnel-related, including employee salaries, payroll taxes, active employee health benefits, and retiree benefits
- More than 25% of the budget is allocated to non-personnel operating expenditure, including contracted services, utilities, supplies, and professional services
- The FY2025 budget allocated $2.0 million to capital expenditures, including $1.2 million on sidewalk connectivity improvements and $0.4 million on drainage improvements
  - As noted in the FY2025 budget, with revenue totaling $6.5 million and expenditure totaling $7.9 million, the Town projects drawing down $1.3 million from the Trust Funds to pay for a portion of planned capital investments



Historical Financial Picture

- The Town’s General Fund includes both the operating and capital budgets
- From FY2019 to FY2024, the Town consistently had positive net <u>operating</u> results
- However, increased capital spending resulted in the drawdown of restricted fund balances. As a result, the Town’s financial statements show the Town going from a $1.0 million surplus in FY2019 to a $1.0 million in deficit in FY2024. Total funding balance dropped from $10.2 million in FY2021 to $8.2 million in FY2024 as a result
- Major capital projects in the last several years include Berzin's Natural Area and Park improvements, Woodland Avenue Sidewalk repairs, Woodland and Daisy Avenue street repairs, and municipal building improvements





Source: FY2019 to FY2024 financial statements

Use of Reserves

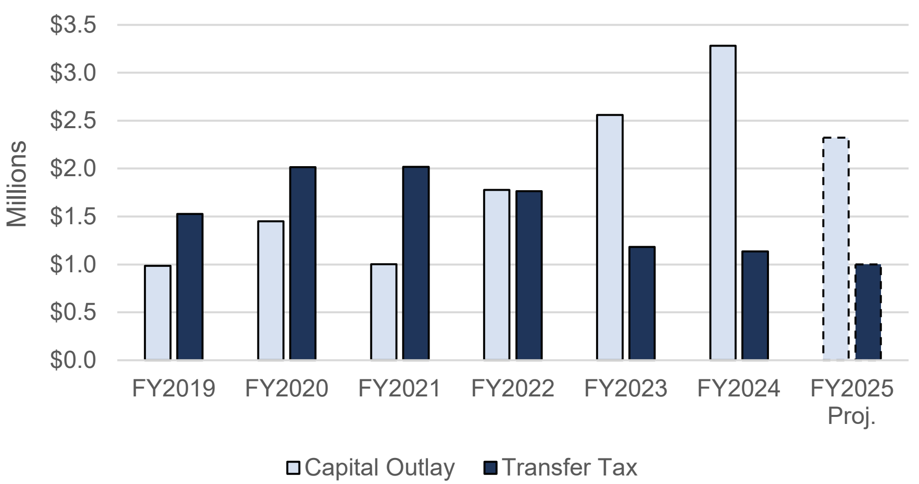
- The Town's practice of drawing down restricted fund balance to meet capital needs is aligned with best practice
- Because the Town built up its reserves in years when it experienced robust transfer tax revenue growth, drawing down the reserve to pay for one-time investment needs was a reasonable approach
- As of the end of FY2024, the Town had $2.7 million in total capital reserves and a healthy level of unassigned and emergency reserves
- However, as transfer tax revenue growth begins to subside, the Town must find alternative ways to ensure that it can sustainably invest in its capital needs. Otherwise, the Town will eventually deplete its reserves without a way to address future infrastructure needs

Key Reserve Metrics

	As of 4/30/24
Total Capital Reserves*	$2.7 Million
Emergency Reserve as a % of Operating Revenue	20%
Unassigned Fund Balance as a % of Operating Revenue	30%

** Includes Capital Repair Trust Fund and Street Repair and Replacement Trust Fund*

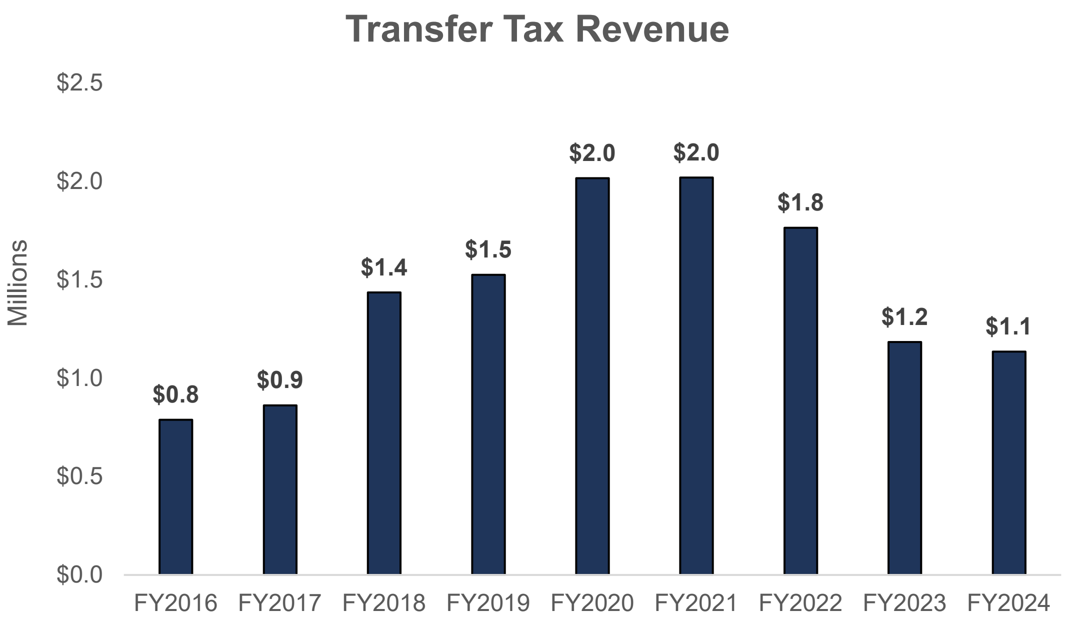
Capital Reserves



Projected Capital Funding

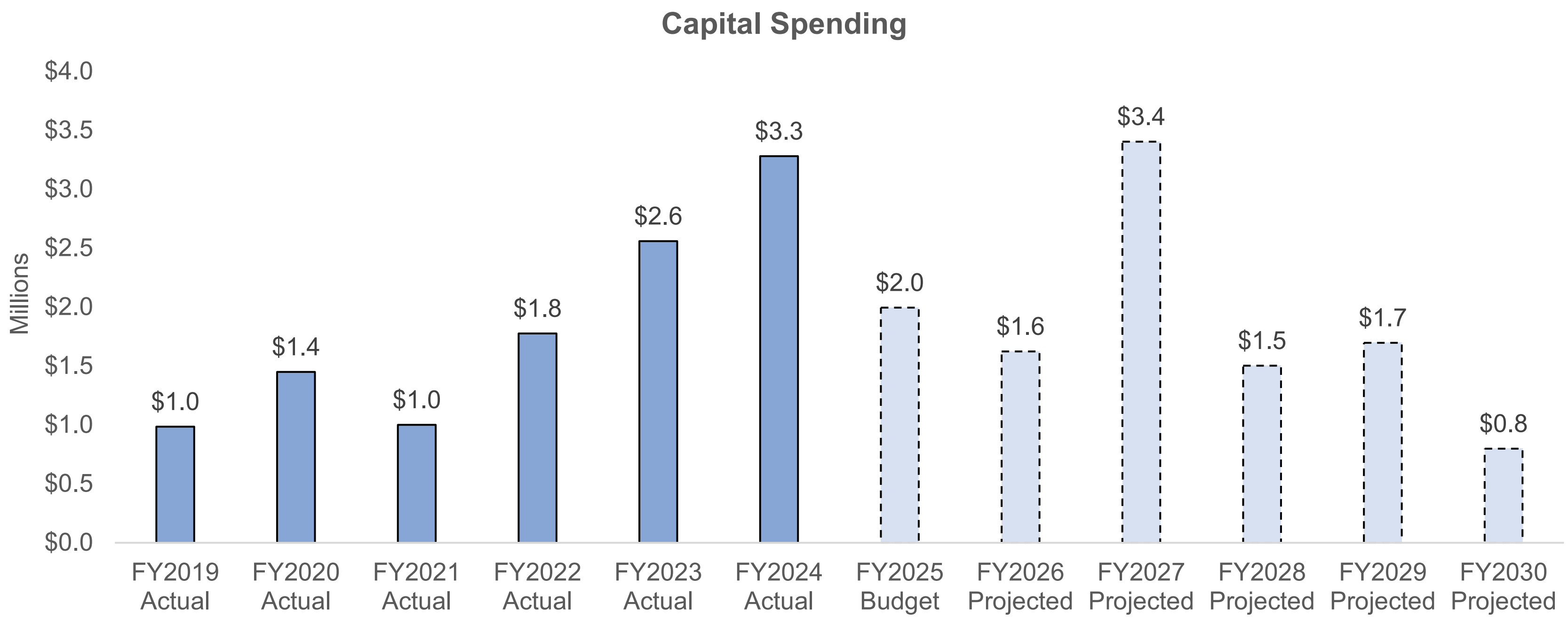
- The Town is projected to have $1.4 million in total restricted capital reserves by the end of FY2025
- Theoretically, the Town could continue paying for its future capital needs using transfer tax revenue
- However, recent transfer tax revenue trend presents a significant risk to this capital funding strategy

  - Transfer tax grew from $0.8 million in FY2016 to the peak of $2.0 million during the pandemic years
  - Since then, transfer tax has dropped significantly to $1.1 million in FY2024 as the Town is now mostly built-out
  - Moving forward, transfer tax revenue will likely drop below the $1.0 million threshold, returning to revenue levels prior to FY2018



Projected Capital Needs

- Over the last five years, capital spending averaged $2.0 million annually, ranging from $0.9 million to $3.9 million
- The FY2026 preliminary Capital Improvement Plan (CIP) shows capital spending averaging $1.8 million annually based on the most recent reserve study and review of the Town's drainage, street, and sidewalk projects



Note:
Of the $2.0 million in projected capital needs in FY2026, $1.2 million is expected to be funded by grants ($0.9 million of which is related to Berzin's Natural Area and park).
FY2027 capital projects include the $1.2 million Hunters Run pipe replacement project and the $1.8 million Woodland to Oakwood via Central Sidewalks projects.

Why Invest in Capital Improvements?

- One could argue that the Town could solve its future financial challenges by significantly reducing its capital spending. This would be a short-sighted solution that is neither operationally practical nor financially feasible
  - Capital investment is important from an *operational perspective* because the Town uses its capital infrastructure to deliver core services to its residents, businesses, and visitors. Deteriorating infrastructure impacts residents' quality of life and the quality of service the Town provides
  - Capital investment is also important from a *financial perspective*. The results of inadequate capital investment may escape notice in the short-term, but result in increased costs in the longer-term, and can lead to asset failures with even more dire financial consequences
- The Town's January 2024 update to the Reserve Study already indicates that additional General Fund contributions (beyond the transfer tax revenue) is necessary for the Town to keep its capital assets on life cycle replacement schedules

Operating Spending Pressures

- Turning to the operating budget, the Town is faced with increased spending pressures, including:
  - **Compensation pressures**: While the Town historically provided cost-of-living adjustments (COLA) adjustments to salaries, the FY2025 budget also increased sworn police officers' starting pay by $5,000 to keep compensation competitive
  - **Benefits pressures**: The FY2025 budget included almost 23% increase in benefit cost based on projections from the Statewide Benefit Office. In the long-term, the Town should continue to expect health benefits cost growth to be above inflation. According to the 2025 Segal Health Trend Survey, which surveys nationwide health insurance providers and healthcare management organizations that cover 80% of the commercially insured and self-insured market, health plan premiums are projected to grow by almost 8%
  - **Inflationary pressures**: Even though inflationary pressures have declined, the pace of full return to 2.0% targets continues to be monitored closely by the Federal Reserve. Changes to federal policies may also have an impact on future inflationary growth

2025 Segal Health Trend Survey

	Year	PPOs/POS Plans	HMO/EPO Plans
Actual	2011	7.5%	8.0%
	2012	7.3%	6.7%
	2013	5.7%	6.1%
	2014	6.5%	6.3%
	2015	6.8%	6.4%
	2016	7.1%	6.3%
	2017	5.7%	6.6%
	2018	6.3%	6.0%
	2019	6.8%	6.6%
	2020	-2.1%	0.8%
	2021	14.0%	13.3%
	2022	2.5%	3.2%
	2023	6.9%	6.8%
Projected	**2024**	**6.8%**	**7.6%**
	2025	**7.9%**	**7.8%**

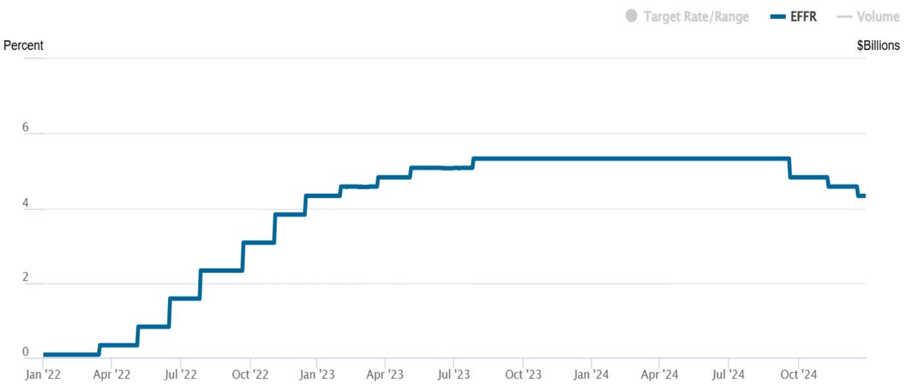
Revenue Risks

- On the revenue side of the financial ledger, the Town will also see pressures and risks as well:
  - **Transfer tax growth subsiding**: As the Town becomes mostly built-out, it will likely see transfer tax at least leveling at $1.0 million if not dropping below the $1.0 million threshold
  - **Impact fee revenue subsiding**: As new construction slows, the Town should also expect to see impact fees subside as well, which would impact the amount it can dedicate for emergency services absent other revenue subsidy
  - **Assessment growth declining**: In the last two years, the Town has already seen assessment growth declining. Prior to the reassessment in FY2023, the Town's taxable assessable value grew by at least 4% annually. Since then, assessment growth has declined and FY2025 assessment only grew by 1.3%
  - **Interest rate risks**: The Town has benefited from rising interest rates since 2022 and the FY2025 budget included over $180,000 in revenues from interest earnings. However, further rate cuts by the Federal Reserve would erode this revenue source

Taxable Assessments, FY2020 to FY2025 (In $ Millions)

FY2020	FY2021	FY2022	FY2023 (Reassessment)	FY2024	FY2025
$913M	$958M	$1,000M	$1,318M	$1,348M	1,366M
N/A	*5.0%*	*4.3%*	*31.8%*	*2.3%*	*1.3%*

Effective Federal Funds Rate, Dec 2021 to Dec 2024



Source: Federal Reserve Bank of New York

Overall Economic Context

Ongoing economic uncertainty:

- Inflation has declined significantly from pandemic-driven peaks
- Job production remains positive, but has slowed
- The Federal Reserve remains committed to managing interest rates to moderate inflation while also seeking to maintain strong employment
- In a best case, the economy experiences a "soft landing" with inflation continuing to decline without a recession but with a softening jobs market. This is the current mainstream expectation
- In a worst case, increased borrowing costs or other developments could lead to a recession
- The economy faces multiple risks/uncertainties. As noted in the January 2025 Conference Board Economic Forecast, "U.S. election outcome uncertainty has lifted, but the unpredictability of the incoming administration policies still looms."

This creates a cloudier picture for revenue forecasting than in more stable periods:

- CPI pressures have declined significantly, but the pace of full return to 2.0% targets continues to be monitored closely by the Federal Reserve
- Revenues available and taxpayer impacts in the outyears are uncertain under a slowed economy and with heightened potential for post-election policy changes

Federal Reserve Statement:

"The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. The Committee has gained greater confidence that inflation is moving sustainably toward 2 percent, and judges that the risks to achieving its employment and inflation goals are roughly in balance. The economic outlook is uncertain, and the Committee is attentive to the risks to both sides of its dual mandate."

Federal Reserve Board, Federal Open Market Committee Statement, 9/18/2024

Bringing It All Together: Five-Year Forecast

- To illustrate the impact of the revenue and spending pressures, PFM developed a five-year financial forecast from FY2026 through FY2030
- The forecast incorporates the following assumptions:
  - Real estate tax rate increasing from $0.2378 in FY2025 to $0.2978 in FY2030 (two-cent increase in FY2026 and one-cent increase in subsequent years)

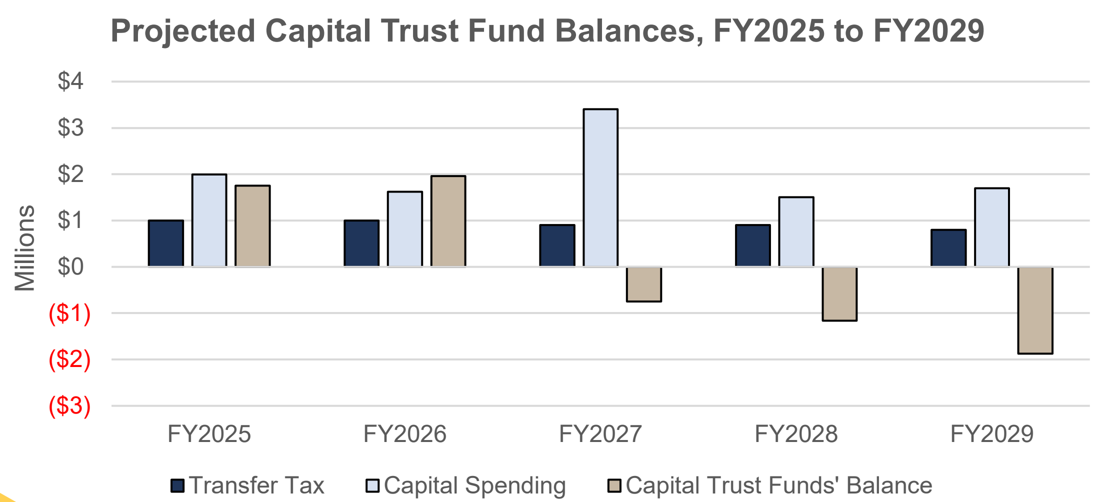
FY2025 Budget	FY2026 Projected	FY2027 Projected	FY2028 Projected	FY2029 Projected	FY2030 Projected
$0.2378	$0.2578	$0.2678	$0.2778	$0.2878	$0.2978

  - Town-funded reassessment in FY2027
  - Gross rental receipts tax increasing from 5.0% in FY2025 to 6.0% in FY2026
  - Annual salary increase of 3.0% plus adjustment to the Town Manager and Police Chief salaries
  - Capital spending based on the FY2026 preliminary capital improvement plan (CIP)
- A baseline forecast is sometimes described as a “diagnosis” that highlights future risks and points to potential treatment that mitigates them
- The goal of developing this financial projection is to provide the Town and its stakeholders a quantifiable way to consider a financially sustainable path forward

Five-Year Financial Projection

- The five-year forecast shows a positive net result in FY2026 assuming a two-cent real estate tax increase and gross receipts tax increasing from 5.0% to 6.0%
- In the longer term, however, projected increase in capital spending (based on the preliminary FY2026 CIP) and declining transfer tax revenue will result in the depletion of the Town’s restricted trust funds as soon as FY2027
- Deficits in the operating budget will also require additional drawdowns from the unassigned fund balance

	FY2026 Projected	FY2027 Projected	FY2028 Projected	FY2029 Projected
General Fund Revenue	$6,783,637	$6,923,611	$7,128,232	$7,254,320
General Fund Expenditure	$6,747,303	$10,010,496	$7,725,693	$8,134,966
Net Financial Result	**$36,334**	**($3,086,885)**	**($597,461)**	**($880,646)**



Key Findings

- **Revenues are projected decline absent rate increases**: With the Town approaching built-out, both transfer tax and impact fee revenues are projected to decline in outyears. When coupled with slowing assessment growth and anticipated interest rate decreases, General Fund revenue is projected to decline absent rate increases
- **Personnel spending growth is a major deficit driver**: Even without any headcount changes, personnel cost is projected to grow by 4.0% annually, adding $150,000 to $200,000 in spending each year. These figures only assume salaries to grow by 3.0% annually and do not include increases to starting salaries or other compensation adjustments
- **Projected capital spending will deplete the capital trust funds**: The imbalance between transfer tax revenues and projected capital spending will result in the eventual depletion of the capital trust funds. Based on projected capital spending in the FY2026 preliminary CIP, the capital trust funds' balances may be deleted as soon as FY2027
- **Even with the assumed rate increases, unassigned fund balance is projected to fall below best practice thresholds**: The baseline forecast also projects operating deficits with unassigned fund balance falling below two months of revenue (or 16.7%) beginning in FY2028

Key Reserve Metrics

	As of 4/30/24	FY2030 Projected
Total Capital Reserves*	$2.7 Million	($1.7 Million)
Emergency Reserve as a % of Operating Revenue	20%	20%
Unassigned Fund Balance as a % of Operating Revenue	30%	10%

** Includes Capital Repair Trust Fund and Street Repair and Replacement Trust Fund*

From Diagnosis to Treatment

- The baseline forecast indicates that simply increasing tax rates is not a sustainable strategy for the Town:
  - Even with the assumed real estate tax rate increases, the Town is projected to have an **operating deficits**
  - The imbalance between projected transfer tax revenues and planned **capital improvements** included in the preliminary FY2026 CIP will result in the eventual depletion of the Town's capital trust funds
  - The baseline projection does not include any salary adjustments beyond the assumed 3.0% in annual growth, which offers little flexibility to provide funds to keep **compensation** competitive
  - While the Town would still be able to maintain a 20% emergency reserve, the **unassigned fund balance** would start falling below the two-month threshold absent correction actions
  - Even though the mainstream expectation is that the **economy** will experiences a "soft landing" with inflation continuing to decline without a recession, there continues to be significant economic uncertainty, which creates an even cloudier picture for revenue availability and increases the need for thoughtful planning
- This is a timely opportunity for the Town to chart a financially sustainable path forward:
  - The water infrastructure sale is expected to generate at least $1.0 million for the Town – strategic investment of this one-time revenue will be important in ensuring long-term fiscal sustainability
  - The Town should also explore alternative capital funding options and policy guardrails to improve the financial projection while addressing funding pressures and needs