



Town of Ocean View, Delaware

Financial Condition Assessment and Forecast Step 2: Options and Recommendations

Presented by:

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Agenda

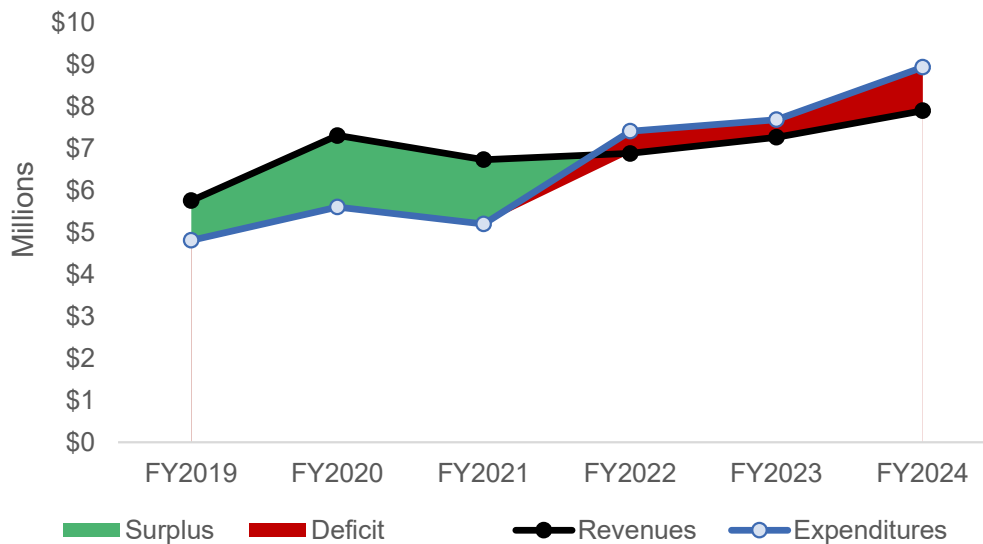
- ◆ Recap of the Financial Condition Assessment – “Diagnosis”
 - A look at the past
 - A look at the future
- ◆ Step 2: Options and Recommendations
 - Create policy guardrails
 - Develop capital funding alternatives
 - Workforce strategy
- ◆ Considerations and next steps



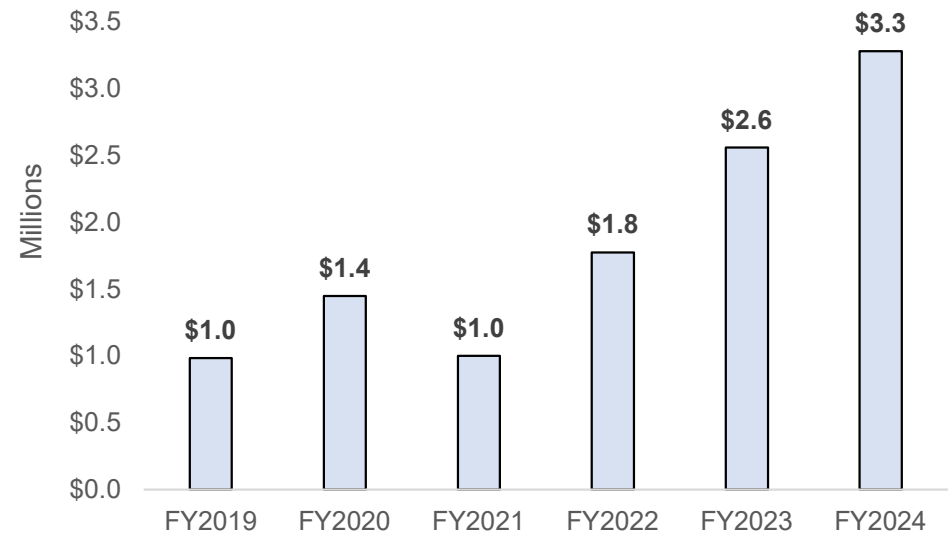
Historical Financial Picture

- The Town's General Fund includes both the operating and capital budgets
- From FY2019 to FY2024, the Town consistently had positive net operating results
- However, increased capital spending resulted in the drawdown of restricted fund balances. As a result, the Town's financial statements shows a \$1.0 million reduction in restricted fund balance from FY2019 to FY2024. The total fund balance dropped from \$10.2 million in FY2021 to \$8.2 million in FY2024 as a result
- Major capital projects funded by the Town with some restricted fund balance in the last several years include Woodland Avenue sidewalk walkability projects, drainage projects, and facility improvements

General Fund Surplus/Deficit, FY2019 to FY2024



Capital Outlay



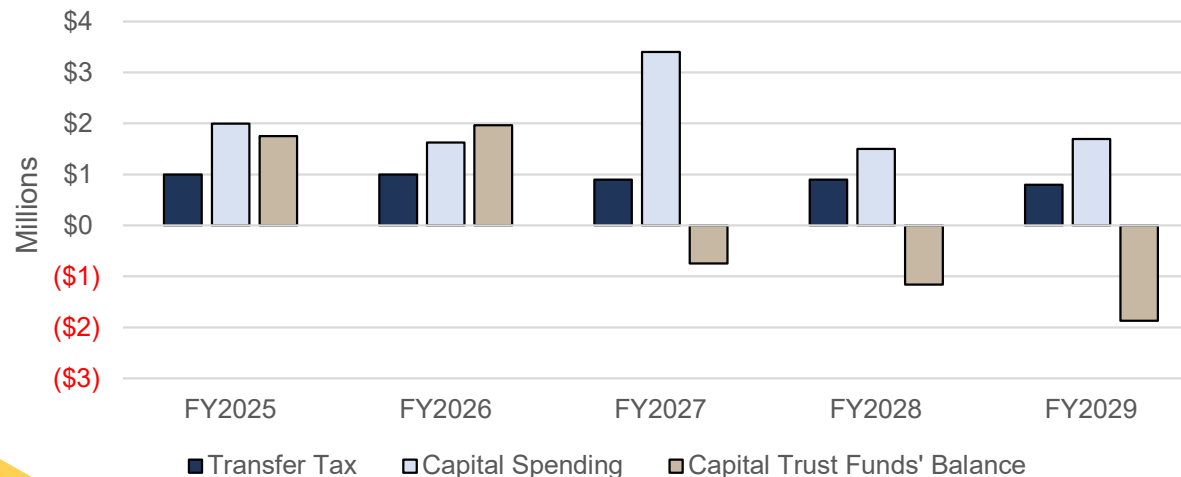


Five-Year Financial Projection

- 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 increases in capital spending (based on the preliminary FY2026 CIP) and declining transfer tax revenue could result in the depletion of the Town's restricted trust funds as soon as FY2027
- Reductions in the operating budget may 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 (including capital projects)	\$6,747,303	\$10,010,496	\$7,725,693	\$8,134,966
Net Financial Result	\$36,334	(\$3,086,885)	(\$597,461)	(\$880,646)

Projected Capital Trust Fund Balances, FY2025 to FY2029





Financial Assessment Key Findings

- Our baseline forecast indicates that **simply increasing tax rates is not a sustainable strategy for the Town** (our forecast utilized primarily FY25 figures as the FY26 Budget was in development) :
 - Even with the assumed real estate tax rate increases, the Town is projected to have overall **operating deficits** in the outyears
 - 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 depleted as soon as FY2027 or projects will have to be delayed or abandoned
 - The baseline projection does not include any salary adjustments beyond those contractually negotiated and 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 likely start falling below the Town's accustomed four-to-six-month threshold absent corrective actions
 - Even though the mainstream expectation is that the **economy** will experience 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
 - In summary, it will be harder to maintain projects and service levels absent changes to the status quo



From Diagnosis to Treatment: Options for Consideration

◆ Create policy guardrails

- Reserve policies to mitigate different types of risk
- Real estate tax policy to ensure long-term fiscal balance

◆ Develop capital funding alternatives

- Strategic investment of water infrastructure sale reserves
- Debt-funding a portion of the CIP (for larger projects with longer useful lives)

◆ Workforce strategy

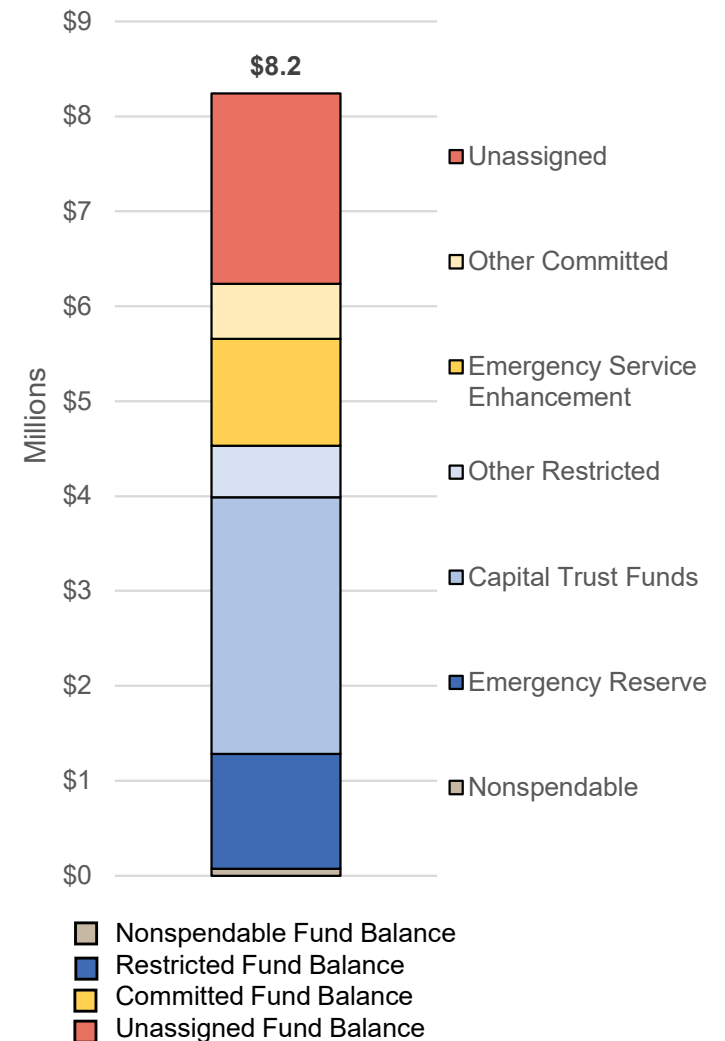
- Compensation analysis
- Headcount review and discussion



Policy Guardrails – Current Reserve Policy

- The Town’s Reserve Policy currently requires that the **Emergency Reserve Trust** (included as part of the restricted fund balance and funded via transfer tax revenue) must be maintained at no less than 20% of the current operating budget
- The following are the permitted uses of the Emergency Reserve Trust:
 - If the Town is within a geographical area declared by the state or federal government to be a natural disaster
 - If Town Council declares a public emergency
 - If the Town experiences reduced transfer tax revenues
- The use of funds must be concurred upon by a majority of the Town Council and must be replenished over time (the Town must start contributing 20% of the expended funds within four years after the use of funds)
- The Town established by practice the goal that the total **unassigned fund balance** should not fall below the threshold equivalent of four to six months of the operating budget

FY2024 Fund Balance





Restricted and Unrestricted Fund Balances

Reserve Type	Reserve	Funding Source(s)	Purpose	Fund Balance Requirement
Primary Restricted Funds	Capital Reserve Trust Fund (CRTF)	12.5% transfer tax revenue + General Fund (if needed)	Capital Improvements	Based on reserve study requirement
	Street Repair and Replacement Trust Fund (SRRTF)	25% + excess transfer tax revenue		N/A
	Emergency Service Enhancement Trust Fund (ESEF)	ESEF Impact Fee / Permits	Emergency Services	N/A
	Emergency Reserve Trust Fund	Supported by transfer tax revenue	Emergency Reserve	20% of the operating budget
Unassigned Fund Balance	Unassigned Fund Balance	General Fund excess revenue or year-end surplus	Budget Reserve	4 to 6 months of operational reserves (based on GFOA best practice recommendation of <u>at least 2 months</u> in reserves)



Using Reserves to Mitigate Revenue Volatility

- ◆ Reserves can often provide a buffer, both against the overuse of unsustainable revenue growth and unfavorable service/budget cuts when revenues do not meet expectations. Many local governments maintain at least one reserve fund, and restrictions on the use of reserve funds generally fall into three broad categories:
 - Significant revenue shortfalls or declines
 - Declared natural disasters or economic emergencies
 - Specific program over-runs or shortfalls
- ◆ In practice, **the use of reserves is necessary**, even when improved revenue forecasting is in place. The key steps for establishing and maintaining effective reserves¹ are:
 1. Maintain at least one account for budget stabilization. It is common to have more than one reserve fund depending on issues related to budget volatility and government responsibilities
 2. Deposit higher/unsustainable revenue, including above-average tax revenue and one-time collections, into the fund(s). This helps ensure that one-time positive expenditure/revenue fluctuations do not lead to ongoing commitments
 3. Define clear withdrawal conditions which helps maintain basic operational needs
 4. Tailor reserve caps and targets based on the economy, tax structure, revenue volatility, and financial flexibility



Benefits of Budget Reserves

- ◆ The GFOA's Research and Consulting Center has noted that “**Reserves are the cornerstone of financial flexibility.** Reserves provide a government with options to respond to unexpected issues and afford a buffer against shocks and other forms of risk”¹
- ◆ The primary cause of fiscal stress is the cyclical variability of revenue, and revenue is much more sensitive to the business cycle than spending (i.e., revenue tends to decline during recessions while expenditure tends to grow absent spending cuts)
- ◆ This is a good point in time for governments to shore up budget reserves:
 - Significant federal assistance in recent years has helped to cover government costs in key areas, including health, safety, and infrastructure
 - At the same time, the economy faces multiple risks/uncertainties, including... post-election policy change, ongoing war in Ukraine and the Middle East, and U.S.-China tensions, etc.

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

“U.S. election outcome uncertainty has lifted, but the unpredictability of the incoming administration policies still looms.”

The Conference Board Economic Forecast for the U.S. Economy, updated January 15, 2025



Why Build Up Reserves? How Much is Enough?

- The two primary goals of reserves are to mitigate current and future risks (e.g., revenue shortfalls and unanticipated expenditures) as well as to ensure stable tax rates
- Reserves also support a strong bond rating by signaling to investors that the local government has resources to pay back debt even with potential disruptions to its financial position
- At the same time, there is an opportunity cost to building reserves. For that reason, it is helpful for the Town to step back and ask, “***what are the risks we are trying to mitigate***” and develop reserve policies accordingly (see next page)
- For example, New Castle County (with a Aaa credit rating) has several General Fund reserves to mitigate different risks:
 - A **Budget Reserve** (or “Rainy Day Fund”) maintained at a minimum of 20% of operating revenue was created to give added protection against a turbulent economy, or any unfunded legislated mandates
 - A **Tax Stabilization Reserve** aimed to stabilize tax rates and ensure the fiscal stability of New Castle County government
 - New Castle County also has a separate reassessment reserve account to fund tax assessment expenses
- While the Town’s current emergency reserve is an important tool, the intention of that reserve is primarily to mitigate risks related to disasters and emergencies. Additional reserves that aim to mitigate other budgetary risks would be a prudent consideration



Town of Ocean View – Primary Risks to Mitigate

- ◆ **Limited revenue options:** Like other Delaware municipalities, most of the the Town’s revenue comes from the real estate tax, resulting in the primary burden being on property owners through the property tax rate
- ◆ **Approaching full build-out:** As the Town approaches full build-out, it is expected to see reduced transfer tax revenue that funds the Town’s Trusts and capital investments
- ◆ **Service demands and compensation:** In addition to allocating resources based on the public safety services currently provided to residents and businesses in the area, the Town of Ocean View also needs to maintain a competitive compensation package to recruit and retain officers
- ◆ **Revenue growth lagging expenditure growth:** Slowing assessed value growth in recent years and the anticipated decline in transfer tax revenue mean that the Town will have to make adjustments to maintain the level and quality of services



Recommendation: Formalize Reserve Policies

- ◆ We propose the following reserve recommendations for the Town of Ocean View given its revenue risks and projected financial challenges:
 - Maintain its **emergency reserve** at 20% that is aimed primarily for emergency purposes
 - Codify the requirement (currently adopted by Town as best practice) to maintain the unassigned fund balance equivalent to four to six months of the operating budget (i.e., **budget reserve**)
- ◆ These two reserves aim to mitigate existing risks related to emergencies, revenue shortfalls, and economic risks
- ◆ We propose a third reserve recommendation aimed specifically to stabilize tax rates given the financial challenges projected and the interest to lessen the overall burden on property owners
 - The Town should consider establishing a **tax stabilization reserve** to spread the necessary real estate tax increase across multiple years and reduce the impact on taxpayers when a large increase is needed to balance the budget in a given year
 - It is important that the policy is accompanied by a replenishment mechanism so that the Town remains structurally balanced over a multi-year period, even if it draws from the tax stabilization reserve in a given year to phase-in a tax rate increase. **PFM recommends a three-year replenishment policy based on our best practice research**



Recommendation: Establish a Tax Rate Stabilization Reserve

- ◆ To establish the tax rate stabilization reserve, PFM recommends using a portion of the water infrastructure sale reserves to build up a new tax stabilization reserve
 - The Town of Ocean View Water Distribution (or conveyance system) was put in service in 2008 primarily to facilitate the provision of public water to those with wells
 - The Town Water Distribution System does not service all town properties, and the Town does not have control of the water supply
 - For that reason, the Town determined that continued engagement as a Water Distribution System provided little benefit to the Town or the properties in the Town's service area
 - The Town is currently finalizing the sale of its water distribution system. In addition to being able to pay off all its outstanding debt, the Town anticipates it will maintain approximately \$1.0 million of unrestricted water fund reserve to seed a tax rate stabilization reserve
- ◆ A 5% tax rate stabilization reserve requirement is equivalent to approximately \$500,000, or a 3.5-cent real estate tax rate based on FY2024 values
- ◆ Dedicating \$500,000 to establish a tax rate stabilization reserve would maintain approximately \$500,000 for other one-time investments, or supplementation of existing trust funds



Recommendation: Develop Real Estate Tax Rate Policy

- To complement the tax rate stabilization reserve and ensure that the Town remains structurally balanced in the long term, PFM recommends the Town adopt a real estate tax policy that requires an annual tax adjustment equal to, at the minimum, inflationary growth, often referred to as incremental or leveled rate increases
- The rationale for such a policy is to ensure that the Town's revenues grow at a rate that at least meets long-term expenditure growth
- The Town of Milton recently adopted a real estate tax rate policy that reads:

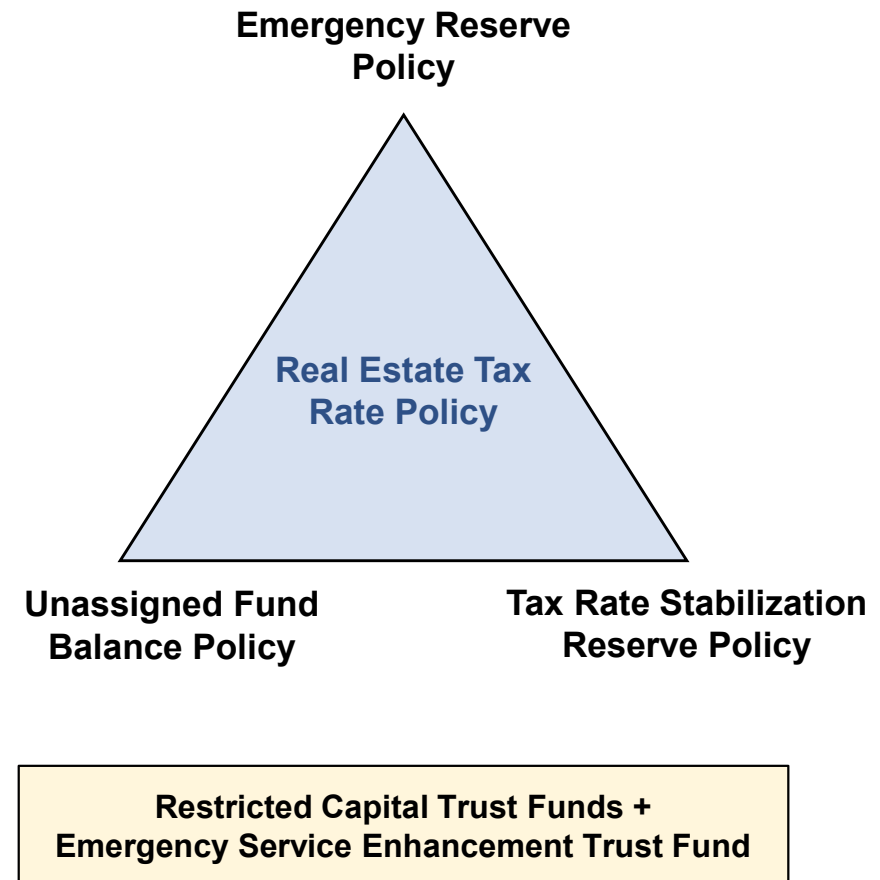
During preparation of the annual Town Budget, the Town Manager shall use the year-ended May of the Consumer Price Index for All Urban Consumers, and the most recent quarter report of the Employment Cost Index as data points to average and determine a base minimum property tax rate increase for the ensuing fiscal year. The Mayor and Town Council shall then determine in budget review if an increase is required to fund the fiscal year operating and capital expenditures.

- This transparent policy will complement the tax stabilization reserve and ensure that, instead of using the reserve to perpetually delay necessary rate increases, the Town adheres to the intention of the reserve and uses it to smooth out a significant real estate tax increase over multiple years
- PFM recommends the real estate policy follow the same CPI measure as the measure used for compensation adjustments (CPI-U Mid Atlantic)



Three-Pronged Reserve Strategy for the Town of Ocean View

- ◆ In summary, PFM recommends the Town adopt three separate reserve policies:
 - An unassigned fund balance policy that serves as the Town's budget reserve (equivalent to four to six months of the operating budget)
 - An emergency reserve trust policy aimed to mitigate cost overruns from public emergencies or reduced revenues from the transfer tax (Ord. 339, codified in 2017)
 - A tax rate stabilization reserve aimed to reduce the impact on taxpayers when a large increase is needed to balance the budget in a given year (with a replenishment requirement)
- ◆ The real estate tax policy, which is a separate policy, complements these three reserves by requiring annual tax adjustments and prevents the Town from relying on and depleting its reserves to fund recurring spending
- ◆ In addition, the Town still has its capital trust funds and emergency services enhancement fund with dedicated spending purposes

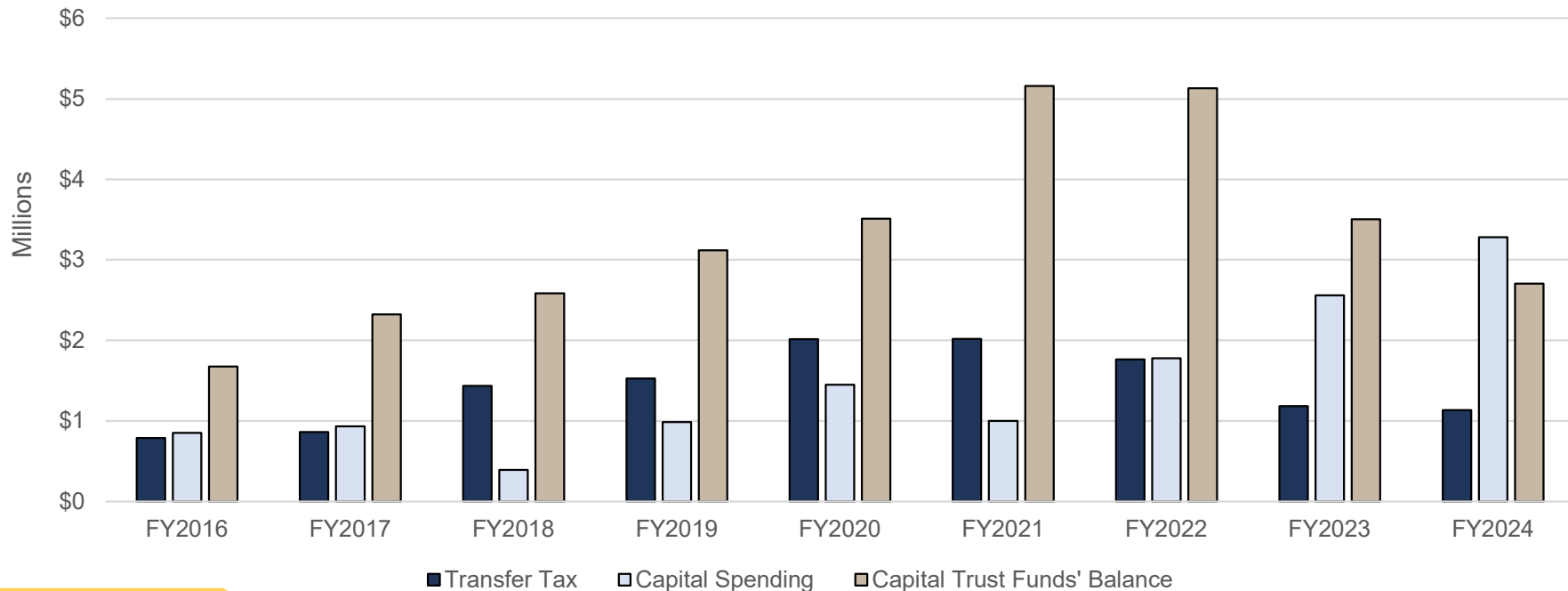




Historical Capital Funding

- The Town has been funding its capital improvements using transfer tax revenue
- Each year, the Town dedicates at least a portion of its transfer tax revenues to its restricted capital trust funds. Capital improvements are paid out of the two capital trust funds: Capital Repairs Trust Fund and Streets and Sidewalk Replacement Trust Fund
- However, the recent transfer tax revenue trend presents a significant risk to this capital funding strategy

Capital Spending and Balances





Recommendation: Consider Capital Funding Alternatives

- ◆ To ensure a sustainable capital funding strategy and financial path forward, PFM proposes a two-pronged capital funding strategy:
 - **Near-term strategy - Investment of water distribution system reserves maintained after sale:** The Town should continue matching one-time proceeds with one-time capital investments and prioritizing investments that maintain existing assets and infrastructure
 - **Long-term strategy - Consider debt-funding a portion of the CIP:** In the long-term and depending on the transfer tax revenue performance in the next several years, the Town may want to consider funding large improvement projects for assets with a longer useful life (e.g., infrastructure maintenance) using some type of debt financing
 - Because municipal bonds are generally repaid over 20 to 30 years, many local governments fund a portion of their capital budget using pay-as-you-go funding so that current resources are used to pay for capital projects that have a shorter useful life (e.g., vehicles, equipment). In contrast, debt financing is used as a tool to fund capital projects that last for a longer period of time (e.g., building renovations)
 - While borrowing money has a higher cost than using pay-as-you-go resources since the borrowed money has to be repaid with interest, it can free up current resources and help prevent large tax increases necessary to maintain fiscal balance
 - From an equity perspective, debt financing also helps prevent putting the financial burden of maintaining facilities with longer useful lives on current taxpayers and instead requires future taxpayers to pay their fair share of the maintenance costs



Long-Term Capital Planning

- The following table highlights the general differences between the two primary ways of funding capital projects
- To move forward, it would be helpful to identify a set of criteria to be used to determine whether a project should be debt financed. This will provide a useful framework for what-if scenario analyses to be used as an additional tool for capital funding in the long-term (e.g., parks and playground improvements, large renovation projects)
- In the near-term, the Town should monitor its transfer tax revenue performance and trust funds' balances closely and focus on the strategic investments of the water distribution system sale proceeds

Capital Planning Methods¹

	Pay-as-you-go (PAYGO)	Debt financed
Ideal for Funding:	<ul style="list-style-type: none"> • Small projects • Assets with shorter useful lives • Projects with a local match requirement 	<ul style="list-style-type: none"> • Large projects • Assets with longer useful lives • Projects with a predictable stream of future revenue
Pros	<ul style="list-style-type: none"> • Saves interest and issuance costs • Preserves flexibility and borrowing capacity 	<ul style="list-style-type: none"> • Provides more money upfront • Easier to distribute spending over time through scheduled debt repayments (i.e., allows current users to contribute to capital improvements over time)
Cons	<ul style="list-style-type: none"> • Insufficient to fund all needs • Uneven expenditures • Lack of "intergenerational equity" (i.e. today's taxpayers fund projects that will be used for years to come) 	<ul style="list-style-type: none"> • Adds interest and issuance costs • Limits financial flexibility and reduces borrowing capacity



Workforce Strategy (Compensation)

- Like many other local governments, workforce spending – including cash compensation and benefits – is the largest cost center for the Town of Ocean View
- The Town has attempted to provide salary increases based on inflationary growth and has adjusted police starting pay in an attempt to maintain regional competitiveness

Wage Adjustments, FY2021 to FY2026

	FY2021 Actual	FY2022 Actual	FY2023 Actual	FY2024 Actual	FY2025 Actual	FY2026 Proposed
Non-Public Safety	2.4%	1.1%	6.6%	6.4%	3.9%	3.0%
Public Safety	2.4%	1.1%	6.6%	6.4%	11.7%	7.615%

- Recent compensation changes in the local labor market suggests that additional adjustments may be required
- While the Town should seek to maintain its market position for recruitment and retention reasons, the financial projection suggests that it has limited ability to do so
- Better understanding how the Town's compensation structure compares with other comparable jurisdictions can be useful so the Town can have a baseline understanding of its relative position in the local labor market



Workforce Strategy (Workload and Headcount)

- To balance between keeping compensation competitive and maintaining fiscal balance, the Town may eventually need to evaluate overall staffing levels, given that headcount is the other option the Town has to control costs

$$\text{Per Employee Cost} \times \text{Headcount} = \text{Total Workforce Cost}$$

- Understanding how current staffing levels relate to workload (e.g., call volume, number of complaints) and service quality (e.g., turnaround time, customer satisfaction) can be an effective way to evaluate headcount
 - Staffing discussions can be a difficult and emotional process. That is why framing these questions from the perspective of cost-benefit (“what is the cost of the additional headcount and how does that compare to the benefit?”) can be helpful
 - Alternatively, Town officials can also ask “are we willing to increase taxes by X% to maintain headcount?” and/or “how will reduced staffing impact turnaround time or other service quality indicators? Are we okay with that outcome?” to have more meaningful and deliberate discussions regarding ways to control workforce costs
 - Developing analyses focused on workload, deployment, and operational risks can also help the Town determine the best way to allocate limited resources while achieving its operational and strategic goals



Proactive and Sustainable Considerations for Ocean View

- The five-year financial projection indicates that simply increasing tax rates is not a sustainable strategy for the Town
- That said, because the Town is preemptively developing this diagnosis exercise when its reserves are still at fairly healthy levels (30% unassigned fund balance + 20% emergency reserve), a phased implementation plan can help avoid the financial results indicated in the baseline projection
 - **Reserve policy guardrails:** In FY2026, the Town should focus on creating policy guardrails (i.e., codifying the current unassigned fund balance practice and establishing the tax rate stabilization fund)
 - **Compensation analysis:** The Town should also evaluate the local labor market to determine ways to keep compensation competitive in a fiscally responsible way
 - **Capital strategy:** In the near-term, the Town would benefit from updating its capital improvement plan and creating the tax rate stabilization reserve fund from water infrastructure reserves. In the long-term and depending on the transfer tax revenue performance in the next several years, the Town may want to consider funding large improvement projects for assets with a longer useful life (e.g., infrastructure maintenance) using some type of debt financing
 - **Tax rate adjustment:** Tax increases will continue to be one of the most important revenue options the Town uses to maintain long-term fiscal balance. The policy guardrails and planning recommendations provided will help ensure that it is not the only solution to the Town's fiscal challenges, but part of a multi-pronged strategy for the Town's long-term financial well-being. The tax stabilization fund will also help phase-in any necessary large increase in a given year and reduce the impact on taxpayers



Next Steps

Strategy	Action Item	Goal
Reserve Strategy	Codify the current unassigned fund balance requirement (equivalent to four to six months of the operating budget)	Create policy guardrails; improve credit worthiness
	Develop an implementation policy for the new tax rate stabilization fund; Establish the fund using one-time proceeds from the maintained water fund reserve	Reduce impact on taxpayers
	Establish a real estate tax rate policy aligned with CPI-U Mid-Atlantic	Eliminate operating deficits; Ensure financial substantiality
Capital Strategy	Identify a list of strategic investments that could be funded by the water infrastructure reserves and quantify the return on investments or use a portion of the water system reserves to increase capital trust fund balances	Maintain capital trust funds; Strategic capital improvements
	Identify a set of criteria to be used to determine whether a project should be debt financed (e.g., useful lives threshold, project size etc.)	Strategic capital improvements; Ensure financial substantiality
Workforce Strategy	Develop a police compensation study (to better understand how the Town's compensation structure compares with other comparable jurisdictions)	Ensure financial substantiality; Keep compensation competitive
	Analyze public safety workload, deployment, and operational risks	Ensure financial substantiality



Bringing It All Together

Challenge	Solution
Depletion of Capital Trust Funds	Investment of One-Time Proceeds & Future Debt-Financing
Reserves Falling Below Best Practice Thresholds	Reserve Policy and Guardrails
Compensation Competitiveness	Compensation Study and Risk Analysis
Declining Revenues	Real Estate Tax Policy
Impact on Taxpayers	Tax Stabilization Fund

