



September 19, 2018

Honorable Mayor, City Council Members, and Residents of Killeen:

It is my pleasure to submit the City of Killeen's Fiscal Year 2019 Annual Budget and Plan of Municipal Services. The City Council formally approved this document, which includes operating budgets and funding for the Capital Improvement Program on September 18, 2018. The budget establishes the framework the City will follow in providing for the delivery of services, facilities, and infrastructure to the citizens of Killeen.

This budget and plan of municipal services represents the combined efforts and input from citizens, City Council, and City staff. Essential components of our success are the confirmation of priorities by City Council and adherence to the City's mission. During the past year, each department has worked hard to create a business plan. Each plan has a clearly defined mission, mission elements, functions to support each element, along with goals and targets. This budget is in alignment with those department business plans.

In January, 2018, the City Council adopted the Financial Governance Policies document. This comprehensive set of financial policies provides parameters to be followed in the development of the budget. The proposed budget is being presented in compliance with all of those adopted policies.

The budget was prepared by providing departments with budget targets. The budget targets were calculated based upon the estimated available resources the City will have for each respective fund. Departments submitted budgets that enabled them to best meet their basic mission. Department heads created decision packages for programs or services that could not be funded within their budget target. The decision packages were evaluated and approved or disapproved based on enterprise-wide priorities and available resources.

There are five strategic issues that were considered in the development of the budget. The strategic issues include 1) adopting a balanced budget, 2) compensation equity, 3) the Texas Municipal Retirement System (TMRS), 4) deferred street maintenance, and 5) deferred building maintenance. Each of these strategic issues will have a significant service and financial impact on the City of Killeen's future. Below, they are further explained.

Balanced Budget

The City must strive to adopt a structurally balanced budget. It is becoming increasingly difficult to accomplish this in the General Fund. This is primarily due to the disproportionate impact the disabled veterans' exemption has on Killeen. In FY 2019, the total exempted value attributable to the disabled veterans' exemption is \$706.9 million, which represents more than 11% of the City's net taxable value.

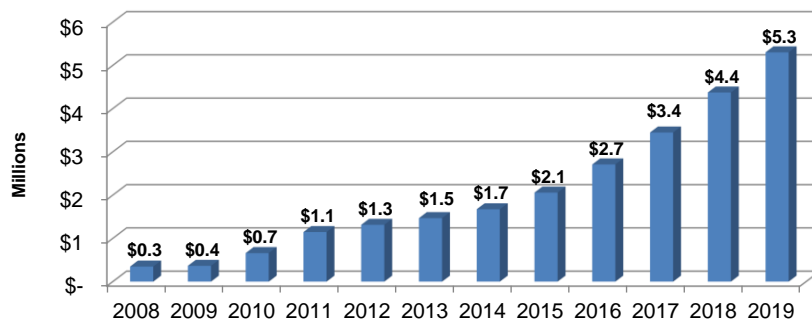


Figure 1: Revenue Loss from Disabled Veteran Exemptions

The associated revenue loss in property tax will reach \$5.3 million in Fiscal Year 2019. This loss in revenue represents nine cents on the tax roll. Disabled veteran exemptions have grown on average more than 20% per year. The

growth in exemptions is unsustainable and threatens Killeen's financial future. Figure 1 shows the loss of revenue due to exemptions since inception in 2008.

The impact of the exemption on Killeen's ad valorem tax revenue is twenty times the statewide average. Figure 2 projects the estimated shortfall in the City's ability to keep pace with projected inflation. The City's ability to continue to provide the same level of services to citizens is in jeopardy.

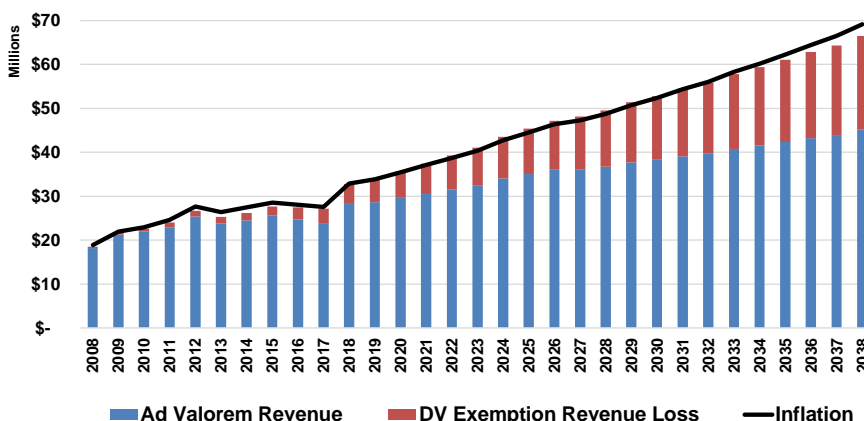


Figure 2: General Fund Revenue Compared to Inflation

Given current tax rates and other conditions, it is not practical to make up this disproportional impact through tax increases. The best solution is to solicit help from the state legislature so as to allow the entire State the privilege of supporting our disabled veterans.

Staff will recommend that this issue be our primary legislative priority for the 2019 legislative session.

Even with the significant challenges to our revenue stream, this operating budget is being presented as balanced wherein projected expenditures are equal to projected operating resources.

During the FY 2018 budget process, we clearly separated operating budgets from capital budgets. The FY 2019 capital budget is also balanced, using accumulated existing resources from fund balances and bond proceeds to accomplish specific projects in equal amounts.

Compensation Equity

Fair compensation of employees is one of the most important issues facing the City. The average classified employee is more than 13% below market and as high as 40% for specific classes of employees. Civil service employees are more than 7% below market. Closing the inequity in employee compensation will be challenging.

Compensation that is not competitive with the market place creates several significant problems. For example, the City's turnover rate is in excess of 19% for classified employees and 7% for civil service. This creates hidden costs for recruiting and training. It also makes us less efficient than we would otherwise be. Being able to recruit and retain a competent workforce is vital to our success. Plus, it is part of our ethical foundation to treat people fairly.

The estimated cost to bring all employees to market is more than \$7 million. The FY 2019 Budget increases salaries citywide by 2.6%, which is the estimated inflation rate for next fiscal year. Although the increase will not move the City closer to market, it will at least prevent employees from losing more ground. The disparity in employee compensation must be addressed in order for the City to attract and retain a talented workforce.

Texas Municipal Retirement System (TMRS)

The Texas Municipal Retirement System permits municipalities to adopt plan changes on either an ad hoc or annually repeating basis. The ad hoc basis considers a shorter actuarial term for its contribution rate. The ad hoc for the City of Killeen is currently 11.15%. It is recalculated and, because by its very nature, retirement is a long-term commitment, it goes up every year.

On the other hand, the annually repeating basis is actuarially long-term. It more accurately reflects the realities of a retirement system. If the City contributed on this

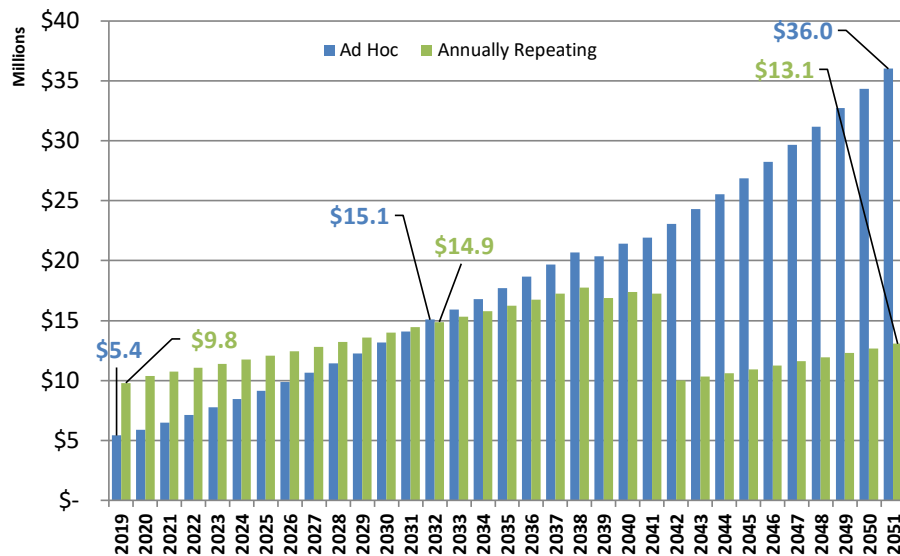


Figure 3: TMRS Contribution Comparison

basis, the rate would be 20.12%, but in 2037 it would flatten out and in 2042, it would drop. Figure 3 clearly shows that the lowest long-term cost is to contribute on an annually repeating basis. However, to make that change would require an additional \$4.4 million per year.

Deferred Street Maintenance

A study performed in 2013 rated the City's street condition according to the Pavement Condition Index (PCI). The PCI rates the condition of street surfaces on a scale of 0 to 100, where 86-100 is Good; 71-85 Satisfactory; 51-70 Fair; and anything below is Poor. In 2013, the City's streets were rated 83.

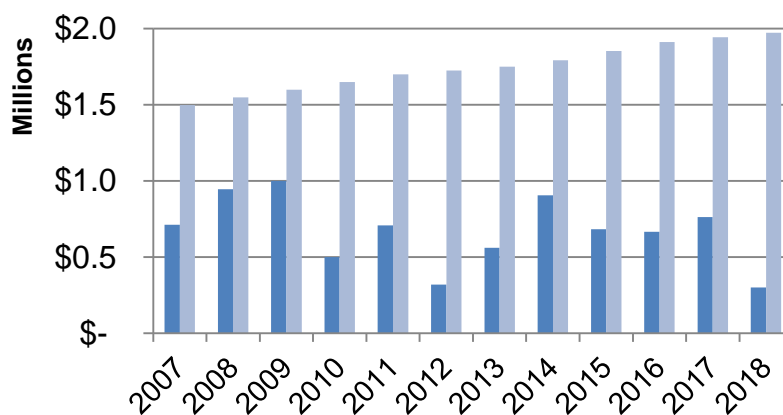


Figure 4: Street Maintenance Funding Level

The study recommended dedicated budgeting of \$900 per lane mile. Figure 4 indicates what the recommended versus actual funding has been. When the streets are not properly maintained, they deteriorate at an exponential rate. The future cost of

maintenance will be much higher than the current cost. In other words, the City is building deferred maintenance cost by not maintaining the streets now at the

recommended level. To fully fund street maintenance would require about \$2 million per year more than has traditionally been budgeted.

Due to the City being unable to fund street maintenance at the recommended level, the City's streets are estimated to have downgraded to a rating of 74 in 2018. Without proper funding during Fiscal Year 2019, the streets PCI rating will further reduce to a rating of 71.

Deferred Building Maintenance

The final strategic issue concerns building maintenance. The City operates out of a total of 41 major facilities citywide. Over half of these facilities are 20 years of age or older. Although the City does a good job of custodial and minor maintenance, a total of \$42 million of rehabilitation and/or general maintenance costs have been identified over the next ten years for major maintenance, such as roofs, parking lots, HVAC systems, etc. There is a lack of funding to address the total cost of doing major maintenance to the City's facilities. Deferred building maintenance contributes to the decline of facilities and creates higher costs for future years.

In the FY 2019 budget, the only issue that was even partially addressed is compensation equity. The budget contains funding for a 2.6% cost of living adjustment. While this will not advance us closer to the market, it should counter balance projected inflation and keep our position from getting worse. Further, that group of employees that are further from market average (about 40% below market) are being recommended for a 12% increase. Again, this will not totally correct the problem, but it is a step in the right direction.

Summary of Revenues and Expenditures

The combined operating revenue budget for FY 2019 totals \$179.9 million, which is \$1.6 million or 1% lower than the FY 2018 adopted budget. The operating revenue budget is lower than the FY 2018 adopted operating revenue budget due to a change in accounting for fleet purchases. Beginning in FY 2019, fleet purchases will be made out of a capital fund, instead of an operating fund, to continue the effort of clearly separating operating budgets from capital budgets. Adjusted for this change, the operating revenue budget for FY 2019 would be \$3 million or 1.6% higher than the FY 2018 adopted budget.

There are no proposed changes to the property tax rate or user fee rates. The increase in revenue is primarily attributed to increases in ad valorem taxes due to higher

reappraisal valuations and new property value added, as well as projected population growth that will increase sales tax and utility revenues.

The budget as presented has a total combined operating expenditure budget of \$181.5 million, which is a \$1.3 million or 0.7% increase from the FY 2018 adopted budget. The increase in expenditures is primarily due to an allowance for an inflationary increase to operating budgets and addressing compensation equity.

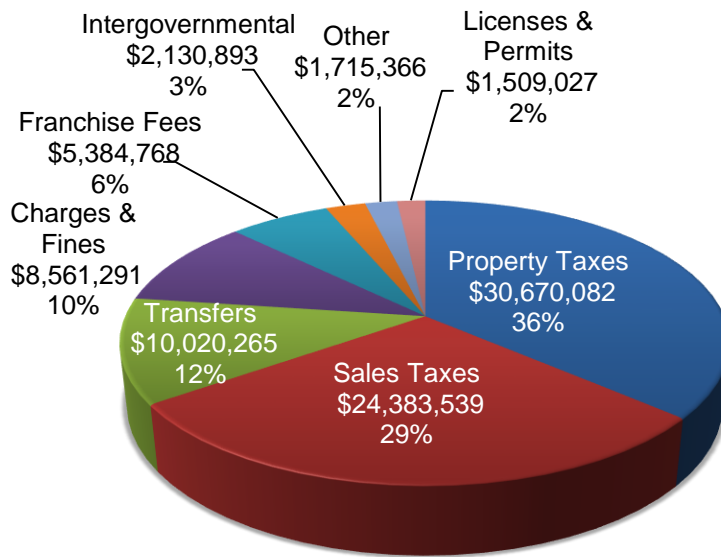
Operating expenditures are budgeted to be \$1.6 million more than revenues. This is due to the use of fund balance in the Debt Service Fund and Aviation as shown in the chart below.

Fund	Revenues FY 2019	Expenditures FY 2019	Fund Balance FY 2019
General	\$84,375,230	\$84,375,230	\$0
Water & Sewer	41,656,366	41,656,366	0
Solid Waste	18,768,780	18,768,780	0
Debt Service	14,116,274	15,866,274	(1,750,000)
Internal Service Funds	5,861,085	5,861,085	0
Special Revenue	7,708,338	7,394,667	313,671
Drainage	4,335,691	4,335,691	0
Aviation	3,034,539	3,219,124	(184,585)
Total	\$179,856,303	\$181,477,217	(\$1,620,914)

The citywide budget includes 1,281.5 full time equivalents (FTE), which is a slight decrease from the FY 2018 adopted budget. The ratio of employees to 1,000 residents continues a downward trend, declining from 8.7 in FY 2018 to 8.5 in FY 2019. For perspective, the ratio was 9.8 in FY 2008. This decline presents a growing challenge to provide the same level of services to our citizens. Even though there is a reduction in the number of FTEs per population, there will be no material service reductions.

General Fund

The General Fund is the general operating fund of the City. It accounts for all financial resources except those required to be accounted for in other funds. It is primarily supported by taxes. General Fund revenues are expected to total \$84.4 million, a \$2.2



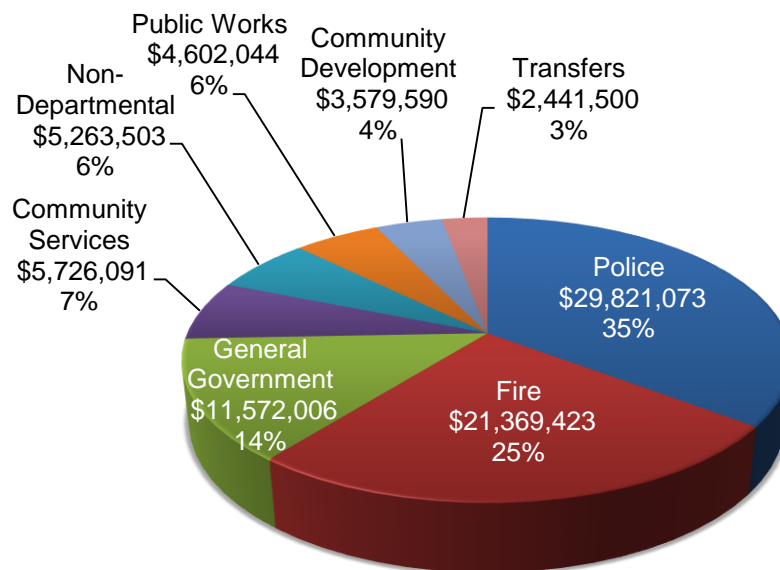
Fiscal Year 2019 General Fund Revenues: \$84,375,230

million or 2.7% increase over the FY 2018 adopted budget. The increase in revenue is attributable to increased property valuations, projected sales tax growth, and a shift in the tax rate from debt to operations

due to the use of accumulated fund balance in the Debt Service Fund. The budget as proposed assumes the property tax rate will remain the same at 74.98¢ per \$100 of property valuation.

General Fund expenditures for Fiscal Year 2019 are budgeted at \$84.4 million, which is a \$2.2 million or 2.7% increase over the FY 2018 adopted budget. This increase is primarily attributable to increasing operating budgets by the projected 2.6% increase in inflation. This

increase will allow the departments to not lose ground in their ability to provide services, as well as prevent the compensation of City employees from losing further ground to the market.



Fiscal Year 2019 General Fund Expenditures: \$84,375,230

Killeen experienced growth in assessed property valuation. According to the Bell County Appraisal District, the 2018 certified freeze adjusted taxable value for the City of Killeen is \$5.56 billion. This represents a \$63 million or 1.2% increase over the 2017 certified taxable value. There was a total of \$130.7 million of new taxable value added to the roll. This increase in value was nearly erased due to the increase in the disabled veterans' exemption.

As previously mentioned, the loss of taxable value as a result of this exemption continues to be an area of concern. The taxable value of properties that qualify for the exemption increased \$123.9 million or 21.3% from the 2017 to 2018 certified tax roll.

Utility Rates

Water and wastewater rates will remain the same for all customers. The average residential household water rate is \$28.55 per month. The average residential wastewater rate is \$33.96 per month.

The solid waste rate will remain the same for all customers. The average residential solid waste rate is \$19.78 per month. This includes refuse collection, disposal, and up to 300 pounds of bulk waste disposal per month.

Storm water rates will also remain the same for all customers. The average residential storm water rate is \$6.00 per month. The combined average residential utility bill (water, wastewater, solid waste, and storm water) is \$88.29 per month.

The FY 2019 budget offers the citizens of Killeen a sound financial plan. As the City continues to grow, we must focus on our long-range financial planning to ensure the financial health and sustainability of Killeen. I want to thank the City Council, boards and commissions, citizens, and City staff for their time and effort through this point of the budget process and for their continued commitment to the success of our City.

Respectfully submitted,



Ronald L. Olson
City Manager