

Prioritizing Your Values

Avoiding Slash and Burn in an Economic Downturn

■ BY JENNIFER CARLSON

Budgeting is just as much about values and priorities as it is about dollars. In times of fiscal distress, however, we often ignore those principles in favor of just getting the budget balanced. But in times of fiscal stress, it's even more important for governments to communicate their priorities and values to improve budget transparency, demonstrate fairness, and help justify difficult decisions. In this section, we will look at practical strategies to help you prioritize your organization's values and develop a framework to make those tough decisions and communicate them to those who are most affected.



Priority Based Budgeting Creates Community Alignment in Duluth

The City of Duluth, Minnesota, is a beautiful, long city built narrowly on a hillside next to the world's largest freshwater lake, Lake Superior. Because of its dramatic landscape and geographic location, Duluth experiences a lot of weather extremes from heavy snowfalls to powerful storms. Duluth's scenic location and 23-mile length make it challenging to provide core government services (public safety) and operate utilities (water, natural gas, stormwater, sewer, and steam), and to manage other community assets (two public golf courses and one public ski hill).

Exhibit 1, which shows Duluth's eight fire stations, makes the logistical challenge clear. The hurdle this creates for staffing is obvious. Similarly, the extreme weather often dictates the city's activities and services such as snow removal and street repair, as well as golfing and skiing, two very weather-dependent activities with revenue uncertainty. Finally, in addition to the geography and weather extremes, the city also operates within a union environment with six collective bargaining units and an expensive employee benefit program.

EXHIBIT 1

A LONG CITY NEEDS A LOT OF FIRE STATIONS

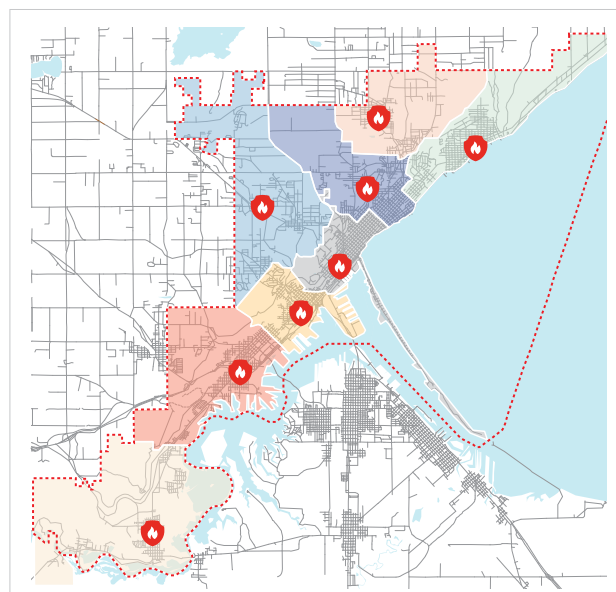
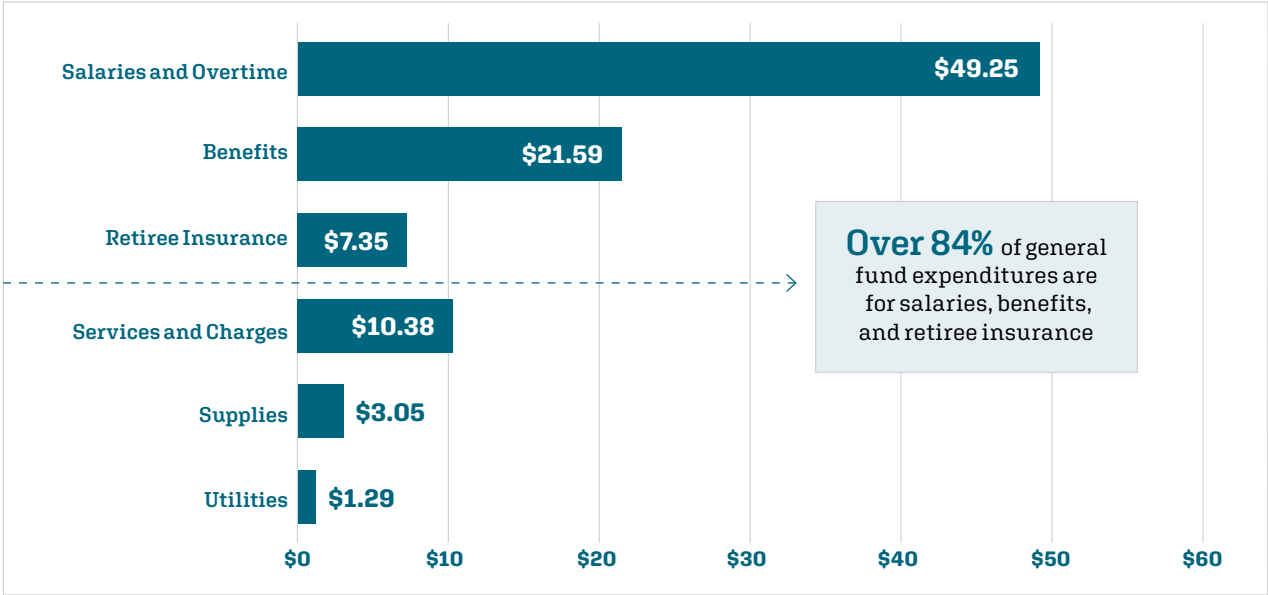


EXHIBIT 2
2020 PROPOSED GENERAL FUND EXPENDITURES BY SOURCE (\$ IN MILLIONS)



The City of Duluth, MN faced structural challenges in its budget, given some of the city's particular needs and obligations. Priority based budgeting helped the city align its revenues, expenditures, and values.



The city's 2020 budget was approximately \$330 million, and the general fund budget was approximately \$92.9 million. Exhibit 2 shows the city's general fund budgeted expenditures, which are probably similar to those of most entities in that more than 84% of the expenditures are people-related: salaries, benefits, and retiree insurance.

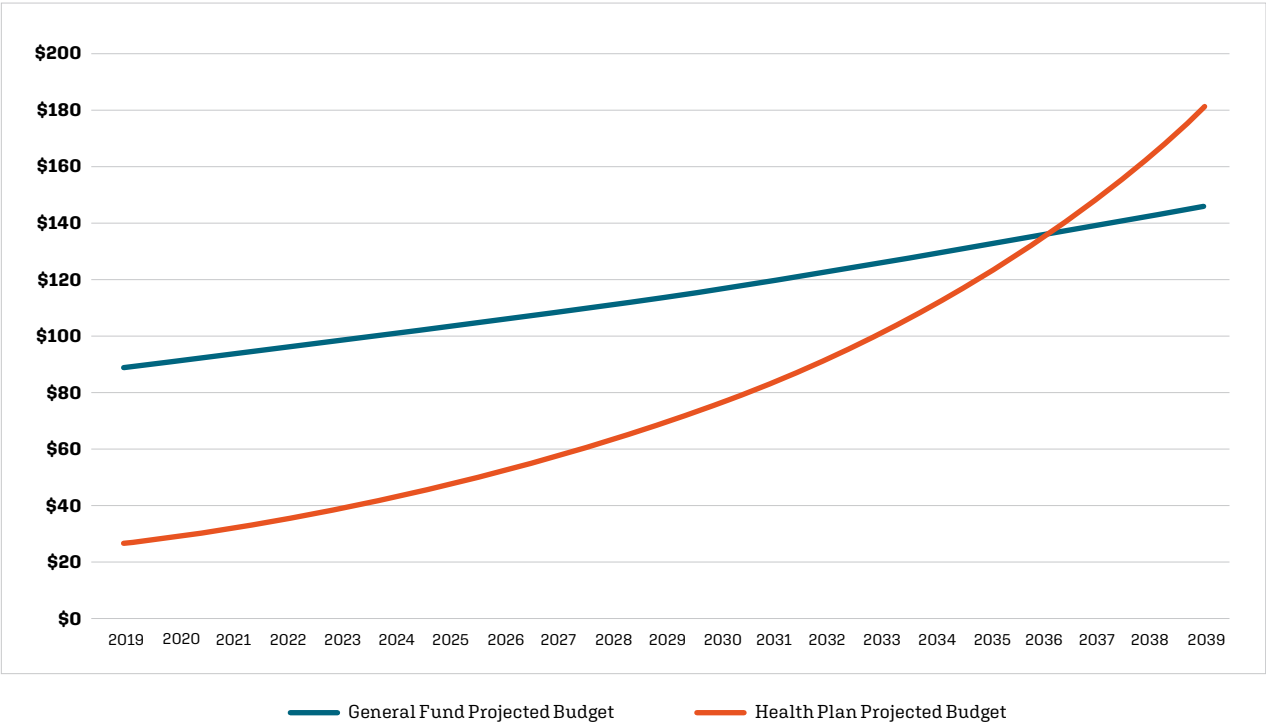
One of the largest and fastest-growing personnel expenditures is the city's health plan. Exhibit 3 shows that if the general fund grows at the rate of inflation—2.5%—and the health plan continues to grow at 10% a year (as it has for four consecutive years), in 2036, the cost for employee and retiree health care will exceed costs for all other general fund expenditures. This obviously creates a financial challenge, and Duluth has been working with its medical provider and bargaining units to find solutions.

More than 70% of the city's general fund revenues comes from three sources, the largest of which is local government aid from the State of Minnesota—approximately a third of the city's budget. The

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formula for local government aid is determined by the state, and it compares the city's spending needs to its ability to fund services. The amount of local government aid is relatively fixed, with no growth factor built in. Property tax is the city's second-largest revenue source, followed by sales tax. These three sources make up 70% of general fund revenues, and costs of services have a higher rate of appreciation than their revenue increases. The only revenue source Duluth can control is property tax, which we try to keep as low as possible. The challenge is that while 70% of its revenues aren't projected to keep pace with inflation, over 84% of Duluth's expenditures are, creating a structural imbalance and a budget gap.

EXHIBIT 3
GROWTH OF HEALTH PLAN VERSUS GENERAL FUND (\$ IN MILLIONS)



The city works to close the budget gap (see Exhibit 4) every year, especially during budget time. For many years, Duluth had a status quo, line-item budget with no new initiatives and no additional staff; in short, it was built on continuing to do things the way they had always been done. When the city had a deficit, it would hold positions vacant, ask for volunteer cuts, or make cuts across the board.

Duluth's 2018 budget was an example of this strategy in action. It was titled "Shared Sacrifice," and we needed to cut \$1.7 million out of the general fund budget. We cut across the board and most of the departments had to come up with reductions. Amounts were assigned to each department, and they decided what they would cut. These reductions were not tied to the city's priorities. Duluth used line-item budgeting at that time, so there was a limited amount of information available about the programs that would be affected or how the programs aligned with the city's priorities. We looked at line items, whether it was salaries or FTEs, office supplies, or technology, and decided which line items to reduce.

As we were working to solve the 2018 budget deficit, we had recently adopted a land use plan called *Imagine Duluth 2035: Forward Together. Imagine*

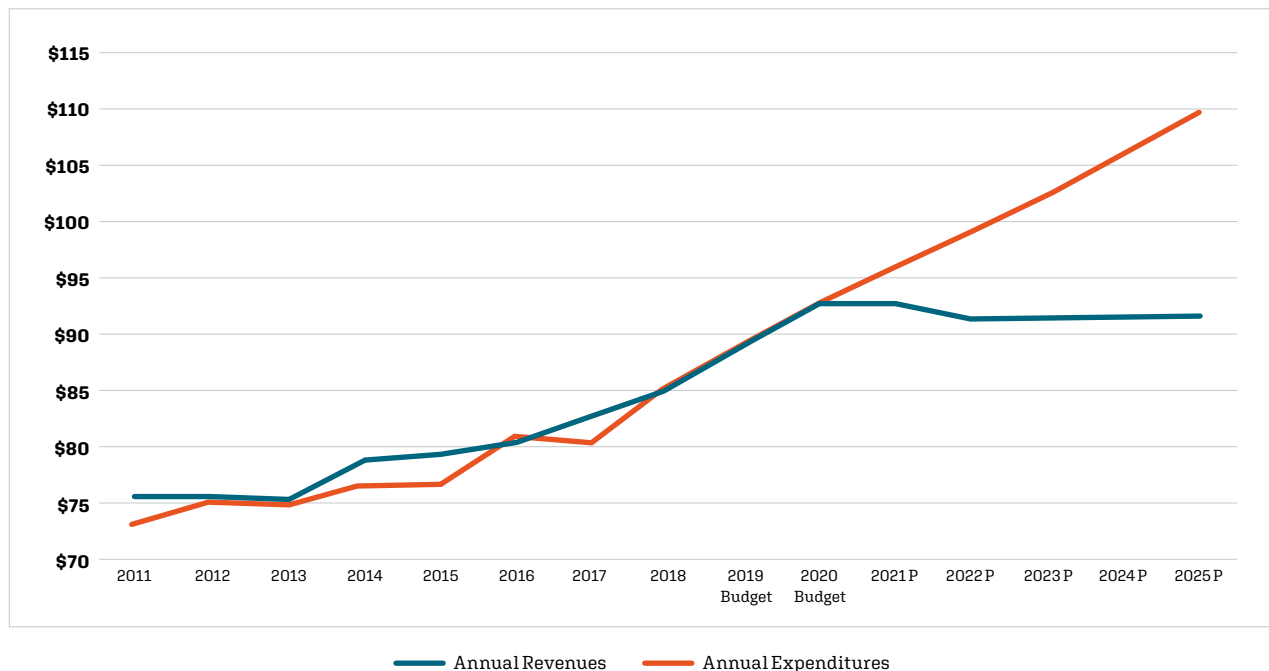
Duluth 2035 was a very community-oriented process. The community's priorities outlined in the land use plan included economic development, energy and conservation, housing, open space, and transportation. While we had a land use plan, we didn't have a way to align the budget and resources to the plan. We had two options: shelve the *Imagine Duluth 2035* plan or start putting it into action. But what would putting it into action look like with the city's level of financial structural imbalance?

During the formation of the *Imagine Duluth 2035* plan, we asked community members about their visions and priorities for the city. We made a real effort to engage all areas of Duluth, and over the two years of the program, thousands of people from all neighborhoods in the city participated. Our staff used many forms of media to reach out to community members. A webpage developed for the *Imagine Duluth* plan had 33,000 views. A Facebook page was also developed, and it had 1,000 followers.

If people weren't able to get to any of the community engagement and planning sessions, the city tried to reach them via social media. We created an online community survey, which ran for four months and had more than 3,500 respondents. We held more

EXHIBIT 4

REVENUES NOT PROJECTED TO KEEP PACE WITH INFLATION (\$ IN MILLIONS)



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than 50 public events and reached out to more than 70 area businesses and nonprofits. We tracked the ages and gender of respondents. We worked hard to engage all community members and make sure the city's priorities reflected the priorities of the entire city and not just certain groups.

We learned that people lived, worked, and visited Duluth because of the city's proximity to Lake Superior, the natural scenery and great views, the parks and open space, and the trails. When asked what the City of Duluth's highest priorities over the next 20 years should be, the three most common responses were: attract new employers, improve the road network (we are known as the City of Potholes thanks to our extreme weather), and preserve the city's natural resources and open spaces.

Duluth had a line-item budget and a land use plan that clearly listed the community's priorities. But how were we going to be able to point the city's resources toward those priorities? We didn't have a tool or a mechanism to get us where we needed to be.

A new compass

The city decided that the answer was to implement Priority Based Budgeting (PBB). A large part of PBB is determining a community's priorities. We had already done that work, having just spent two years asking residents what they envisioned the City of Duluth looking like over the next 20 years. We knew that our focus should be on culture and recreation, infrastructure, the economy, livable neighborhoods and affordable housing, and green space and energy conservation. The city also added building a safe and secure community as an important priority.

We knew that implementing PBB was going to take time (see Exhibit 5 for the city's implementation timeline). There was an understandable concern among staff when they were told the city would be taking the next eight months to start forming a priority-based budget when staff was already being pulled in so many directions. It wasn't that they were unhappy with the concept; they just didn't have any time to spare.

On top of this, we had just gone through reductions, so there were also fewer employees, and this was going to be an all-hands-on-deck, organization-wide effort. But we weren't going to achieve the community's priorities with our status quo line-item budget, so we kicked off the process in December 2017. We created programs, allocated costs to the programs, and scored the programs in accordance with the program's alignment with the city's priorities. We also had a peer review process, and finally, in August, we were able to look at opportunities and decide how we were going to move forward with this information.

EXHIBIT 5 IMPLEMENTATION TIMELINE

2017	2018						Annually	2018-present
December PBB Boot Camp	January Program Creation	Feb/March Cost and Revenue Allocations	May Departmental Scoring Process	June Peer Review Scoring	August Departmental Opportunities	Nov/Dec Internal Program Mapping	Clean Up Programs and Costs	Use PBB for Decision-Making

A closer look at the process

How were we able to complete this demanding project? The road to success started with a strong tone at the top. We found that a third of the people involved were on board from the beginning and knew this is what we needed to do, a third were neutral, and a third were resistant.

Duluth's mayor was absolutely foundational in pushing PBB through. She made it clear that this was the direction the city was going in. She understood the process was going to take time and effort, but it needed to happen. We had just spent two years on a land use plan that we now needed to implement. Failing to act on the plan would mean shelving years of hard work. The city's chief administrative officer and finance director joined the mayor in supporting the effort. PBB was implemented for all city funds, and it took a significant amount of time.

The city's line-item, status-quo budgeting process made it difficult for departments to understand the programs and services that were being provided by other areas of the organization. For PBB to be successful, we needed to bring staff together to learn about programs and services provided by departments throughout

The more we started looking at what we were spending time on, the more ideas we generated for making improvements.

the city. Because staff are passionate about their work, it can be difficult to objectively evaluate other departments' work.

Departments worked together and formulated programs that expressed the services they provide to the community. We identified 497 programs. Some of the programs serve internal customers, like payroll and budget office programs. Other programs are community-facing, like investigations, pothole patching, and election administration.

The next step was allocating costs and revenues to the 497 programs. We allocated both personnel and non-personnel costs from the line-item budgets to the department programs based on how much time and resources are spent on the programs. To assist with allocating personnel costs, we created

A COMMUNITY-ORIENTED PROCESS

The *Imagine Duluth 2035* plan engaged community members from all areas of Duluth to determine their budget priorities.

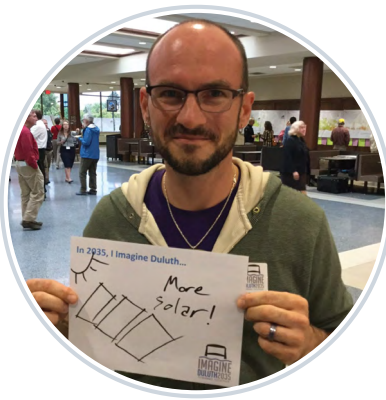
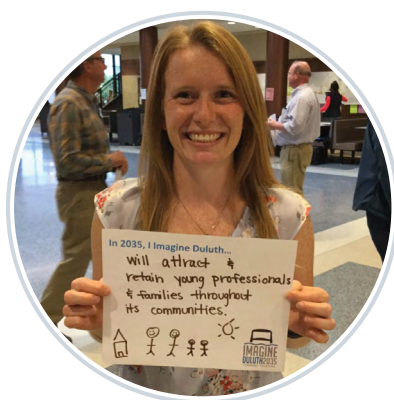
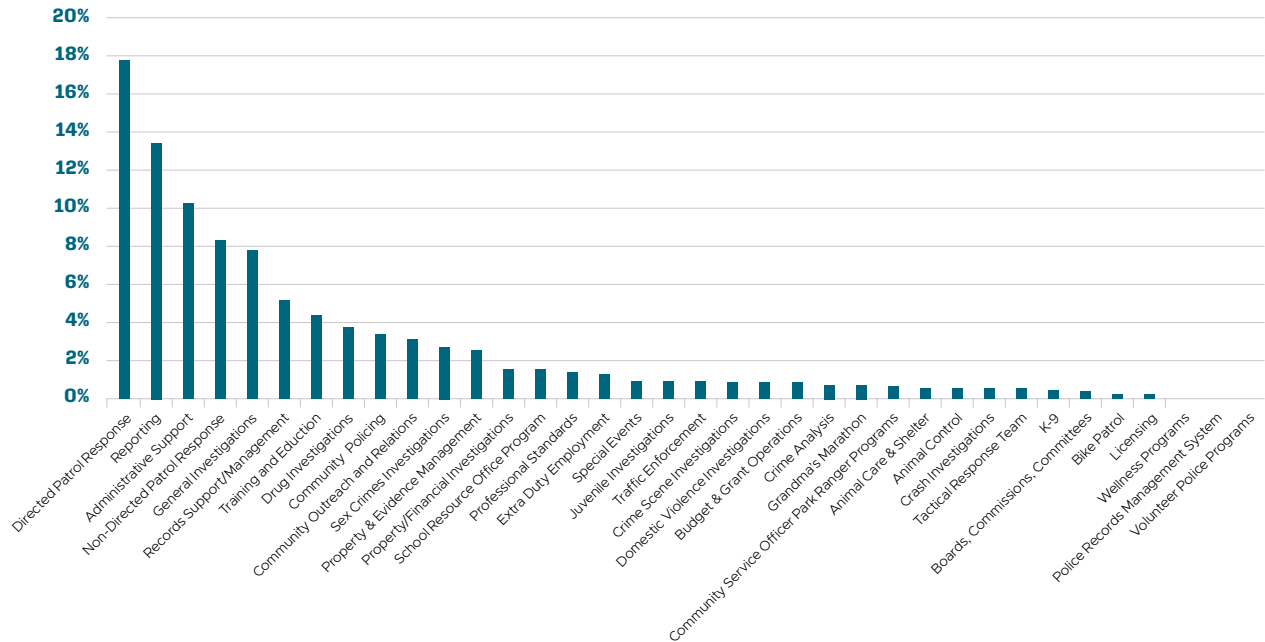


EXHIBIT 6**EVALUATING DULUTH'S POLICE DEPARTMENT BUDGET AFTER IMPLEMENTING PBB**

templates with the department's programs and asked every staff member to write the percentage of time they spend working on each of the programs. This was a sizable undertaking (the city has 868 FTEs) and required the involvement of a lot of people. The process was enlightening for a lot of managers and directors because they didn't realize how much time was being spent on programs. This marked the beginning of management starting to look at how things could be done differently and how they wanted people spending their time.

Exhibit 6 shows how the city's decision-making tool changed after implementing PBB. Before, we would make decisions by reducing lines. The new method provided a tool that clearly showed exactly what our departments were working on and how much our programs cost. We could look at police department spending, for example, and see that nearly 14% of its time was spent on reporting. We could then ask whether there were opportunities for more automation. The more we started looking at what we were spending time on, the more ideas we generated for making improvements.

With all the programs determined and priorities identified, it was time to start scoring the programs based on their alignment with city priorities. Part of the scoring process involved scoring programs based on basic program attributes, which included mandate, cost recovery, reliance, demand, and population served. Scoring programs using basic program attributes was valuable in showing:

- How much of our programs' costs are recovered
- The degree to which the program is mandated (federal or state level, local level, best practice)
- How much of the population is being served by the program
- Change in demand for the program and
- The reliance of the community on the program.

Every program in the city received a score for each of the basic program attributes. Then, programs were scored based on their alignment with internal or external priorities. The external-facing community priorities are infrastructure, dynamic and diverse economy, green space and energy conservation,

livable neighborhoods and affordable housing, culture and recreation, and safe and secure community. The internal governance priorities (for instance, payroll and budget office) are high-performing organization, customer service, trust and engagement, long-range planning, workforce, fiscal responsibility, and compliance. The departments scored each of their 497 programs on a scale from one to four, with four indicating that the program was highly aligned with the city's priorities and one indicating that the program had a relatively low alignment with priorities.

We created peer review teams to provide objectivity to the departments' scores. Because every department is passionate about its programs, we needed another level of scoring review to look at the scores the departments had assigned to their programs. The peer review teams were voluntary; people were asked to participate if they felt inclined to do so.

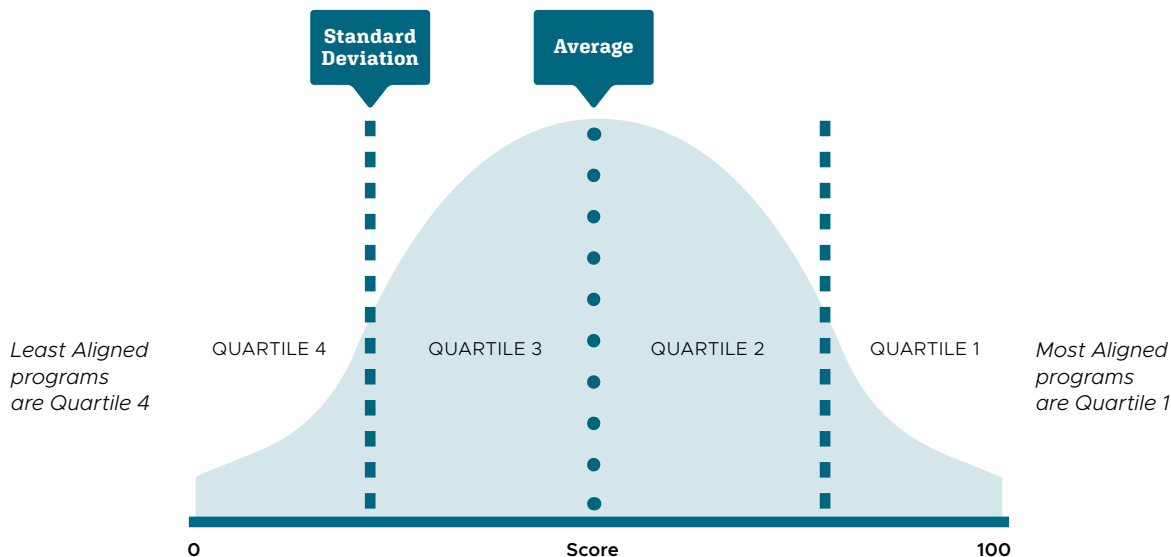
Fifty people volunteered, demonstrating a great deal of staff engagement in this process. There were groups for each of the priorities and each of the basic program attributes. We formed the peer review teams to include one expert in the priority,

Discussions of the city's capital plan no longer just talk through what will be purchased or replaced; they now center on why.

and staff members with less experience with the priority. For example, on the peer review team for the culture and recreation priority, we included the fire chief and the police chief to expose them to the importance of culture and recreation programs and to learn about programs that other city departments were providing. Based on the score the programs received, they fell into one of four quartiles, forming a bell curve (see Exhibit 7).

The programs in quartile one were most aligned with the city's priorities, and the programs in quartile four were least aligned with the city's priorities. Instead of referring to quartiles three and four as low-alignment quartiles, we called them our opportunity quartiles.

EXHIBIT 7
SCORING QUARTILES





With an average snowfall of 70 inches a year, the Duluth's snow removal program is highly aligned with the city's priorities.

It made sense to start analyzing programs in the opportunity quartiles. Each department was asked to identify opportunities for up to five programs. Opportunities they could identify included one-time technology investments, internal partnerships to reduce redundancy, external partnerships, cost recovery through grants, increasing fees, and so on. Staff started thinking about ways we could work together to either start reducing service levels of the least-aligned programs or looking at different ways to fund programs.

To assist with the analysis of opportunities with city programs, we asked policy questions, including: Are we over-providing mandated services? Should we be reexamining what we consider to be a mandate? Are there public-private partnership opportunities? What is the impact of the program?

The city also stressed that we weren't just going through the motions of this process; we were going to implement PBB in everything we do. We were going to start looking at things through the PBB lens. One example of this is in hiring. In the past, a manager or director would replace a position simply because that position was already part of their department, regardless of the programs the position works on and the programs' alignment with city priorities. Now, instead of automatically replacing the present position, they look at ways to transition to a different position that can work on programs with high alignment.

Performance measurements were also redone to better reflect the city's priorities. Exhibit 8 shows the planning and development team's objectives, strategies, and measurements to achieve high

EXHIBIT 8**REVISED PERFORMANCE MEASURES**

PLANNING & DEVELOPMENT					
City Priority: Livable Neighborhoods and Affordable Housing					
Objective	Strategy/Measure	2017 Actual	2018 Actual	2019 Estimated	2020 Projected
Development/Redevelopment: <i>Encourage and support strategically planned, well-designed and uniformly regulated mixed-use development and redevelopment, enhancing its desirability as a great place to live and work</i>	Number of plan reviews performed, including shoreland permits	173	225	257	280
	Number of land use applications processed by Planning Commission or Heritage Preservation Commission	195	161	195	205
Community Involvement: <i>Instill a sense of community pride through proactive communication, engagement, outreach, participation, and volunteerism.</i>	Total number of community development applications evaluated for funding	28	34	33	35
City Priority: Safe and Secure Community					
Objective	Strategy/Measure	2017 Actual	2018 Actual	2019 Estimated	2020 Projected
Livable Community: <i>Ensure regulatory compliance in order to provide clean and well-maintained neighborhoods, to protect property, the environment, and the lives and health of residents and visitors</i>	Number of predevelopment meetings facilitated	256	243	164	175
	Number of formal compliance actions	31	62	37	45

alignment with the city's priorities of livable neighborhoods and affordable housing, and safe and secure community.

Discussions of the city's capital plan no longer just talk through what will be purchased or replaced; they now center on why. We consider what priorities the purchase helps to achieve. Plow trucks are a good example. Duluth gets a lot of snow, and these trucks haul approximately 20 million cubic feet of snow every year. Snow removal is a city program that highly aligns with the safe and secure priority of the city.

Changes in action

The city used PBB for its 2020 budget. We were able to capitalize on a partnership with AmeriCorps for city-wide, year-round recreation staff (culture and

recreation priority programs), a partnership with the Duluth Library Foundation for an early literacy initiative (culture and recreation priority programs), a partnership with the Housing and Redevelopment Authority to fund a full-time housing developer (livable neighborhoods and affordable housing priority programs), and a full-time sustainability officer to leverage internal and external cost and energy savings (green space and energy conservation priority programs).

The city is also addressing COVID-19. If the pandemic had hit before Duluth adopted PBB, we would have cut line items regardless of the services affected. Instead, we have reduced service levels of programs that we are unable to safely provide. Instead of reducing positions based on vacancies, regardless of the program impact, we restructured



PBB has aided the city in introducing new initiatives, like a partnership with the Duluth Library Foundation to promote early literacy.

staff based on program alignment. For example, because the city is unable to safely resume all library programs, some library staff were moved to the Parks division to assist with high-priority programs there.

When we used line-item budgeting, we struggled to provide new initiatives. Now, the city introduces new initiatives every year and throughout the year, using existing funds, cost recovery, and partnerships. In the past, we did things the same way we'd always done them, and now we are continually pointing and restructuring our programs and services to align with the priorities of the city.

Conclusion

All of this has taken a lot of work, and there was some resistance at the beginning. The city had just reduced personnel and spending, and it seemed overzealous to jump with both feet into such a long and complicated process. But now that PBB has been integrated into city planning and spending, all the city's departments have started to see why this is so important. It has been an excellent tool to provide agility and to better align resources to get the city where the community wants to see it by 2035.

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