



# City of Flagstaff

June 30, 2010

Dear Mayor and Council:

How we spend the public's money is our most important business. How we spend it during the most severe recession since the Great Depression is even more critical. While there is a degree of desperation in preserving municipal services, there is also an opportunity for change. Some change is imperative as we must balance expenditures to projected revenues. Other changes represent a policy choice and this letter will help outline that choice for Council consideration. By charter, I am required to provide my professional recommendation to you as to how to meet your goals and objectives with the financial resources available. This document will provide that recommendation.

## PROBLEM STATEMENT

As we budget for Fiscal Year 2011 (July, 1 2010 through June 30, 2011), we find ourselves in the midst of 26 straight months of declining sales tax revenue. The State operated almost the entirety of FY 2010 without an adopted balanced budget--instead operating in the red by over a billion dollars. Their inability to arrive at an adopted budget has meant continued uncertainty to the status of State Shared Revenue with cities. While they entertain various proposals that redirect voter approved percentage of State income tax and sales tax to cities, both revenue sources continue to contract at unprecedented rates further impacting the City's ability to maintain programs and services.

FY 2011's budget challenges, State and locally, are compounded with the budget challenges from the previous years. To give you an idea of this compounding effect, take a look at the five year General Fund revenues that were budgeted in FY 2008 versus actual and current projections (excludes grants and miscellaneous revenues):

<b>General Fund</b>	<b>FY2008 Act</b>	<b>FY2009 Act</b>	<b>FY2010 Est</b>	<b>FY2011 Est</b>	<b>% Change</b>
As Budgeted in FY2008	\$49,451,345	\$51,507,304	\$53,442,383	\$55,563,423	12%
Current Actuals and Estimates	\$47,058,511	\$45,454,464	\$41,800,614	\$40,481,610	-14%
Change	(\$2,392,834)	(\$6,052,840)	(\$11,641,769)	(\$15,081,813)	(\$35,169,256)

As you can see from the chart above, the decreases projected for FY 2011 are stacked upon decreases from previous years. This cumulative effect results in a decrease of \$35 million compared to what was expected or a 14% decline versus where we were just three years ago. Yet, if you look at: 1) the services the City provides, they have not changed noticeably; and 2) the level of service provided within these services, that has not changed noticeably either. This is because we have focused on preserving the aspects that are most visible to the public, while cutting those that are less visible. This makes logical sense, but as I will explain, it is not sustainable.

## **FY2011 BUDGET**

The Council Adopted Budget largely follows the discussions we had at the City Council retreat and follow-up in February. Moreover, each division consulted with their associated Boards or Commission for feedback. In the end, the final budget summarizes as follows:

- Revenue increases were minimal and took the form of increases in the cost to non-residents for fire services; increase to developers for lab fees; and the previously adopted increase in Solid Waste fees (2007).
- We will see approximately 26 positions eliminated in this budget, but only six of those will come in the form of layoffs.
- Public Safety services are largely in-tact.
  - All seven Fire Stations will be operating, but Station Seven (by the Furniture Barn) will run a rescue rather than an engine depending upon daily staffing.
  - Wildland Fire Management services continue through the use of grant funds and contracted labor but reduced 3 FTE.
  - All Police programs and staffing remains in-tact.
  - Animal Control services remain in place.
- Recreation services experienced no cuts.
- Community Development has taken above average cuts in-line with the decrease in work-load.
- Reorganizations occurred in Management Services, Public Works, IT, and Courts to accommodate personnel reductions.
- CVB maintains marketing levels despite personnel cut.
- Riordan Mansion maintenance is funded with in-kind city labor funded by BBB Beautification dollars.
- J. Lively will be rebuilt and possibly expanded.
- Power costs increased yet power consumption remained flat to falling.
- Created one time savings using Smartworks program.
- Restored United Way funding by \$70,000 to \$270,000.
- Restored the EcoPass, \$7,600 for Council Travel, and \$53,000 for Heritage Square maintenance and Downtown Street Sweeping
- Restored Arts and Science grant funding

While we were able to hold compensation flat for FY 2011, health benefits were decreased through the use of plan changes. Health insurance rates were proposed to increase by approximately 11% for FY 2011. As you know, we are part of a Trust which includes the County, FUSD, CCC, and NAIPTA. Collectively, the increase in health insurance could not be absorbed by the employers. So the benefits were reduced to lessen the increase in premiums. In anticipation of a large increase in health insurance, the Budget Team had set aside \$300,000 in its initial planning to deal with any increases in benefit costs. Since the collective was not able to absorb the increase, we have used the \$300,000 to restore six positions throughout the City for FY 2011.

Unfortunately, I could not foresee a way that we could fully implement the new Property Maintenance Ordinance (PMO) program in FY 2011. We will certainly develop the ordinance; develop the court procedures to prosecute these offenders; and begin writing tickets; but we are down to two code enforcers in Community Development and one code enforcer in Sustainability and Environmental Management Services. Moreover, we have no increase in prosecutors or court staff to process these tickets and quite frankly went the opposite direction of reducing staff in these areas in FY 2010. So while we can, and will, put the PMO infrastructure in place, we must manage expectations that there will be a significant difference in service delivery because the personnel are not available.

Similarly, we continue to be exposed to the interconnectedness of criminal justice activities. This recession has hit all governmental functions hard. The County Attorney's office continues to face budget cuts and as a result they are redirecting some Class 6 felonies to Municipal Court (about 150-200 cases). This will result in increased case load for prosecutors, public defenders, and municipal court staff. Additionally, while we lost a total of 13 positions in the Police Department in FY 2010, Patrol was largely unchanged and in fact increased citations by 36% (from 11,203 to 15,271). This ripple effect was felt in the aforementioned agencies plus the county jail who are again facing decreases of their own.

Also included in this budget is a redirection of stimulus dollars that were allocated to the auto industry in the form of waiving the 1% sales tax on the purchase of new or used vehicles to the construction industry to help incentivize new construction. We had previously allocated \$100,000 to pay for the auto sales tax waiver. As of March, 2010 approximately 46 people had taken advantage of the program at a cost of approximately \$8,000. Assuming another \$2,000 gets used in the transition, we will redirect \$90,000 to the construction stimulus program outlined at the budget retreat last year. The construction stimulus program originally did not take effect because we never had an adopted balanced State budget. This stimulus is intended to get projects that have already been reviewed by Community Development (and therefore our costs are already spent) to be picked up and started. If these incentives are enough to push a project over the hump, then the whole Flagstaff economy will benefit.

The budget preserves most programs with minimal decreases in service levels; addresses some unique situations (J. Lively and Riordan Mansion); and balances the budget. It is, however, not sustainable past FY 2011 if revenues decline or even remain constant.

### **A STRATEGIC CHOICE**

We know we must cut from FY 2010 base in order to operate with a budget that balances expenditures to revenues. But there are two distinct ways we can accomplish this. The most typical way is to reduce expenditures that have minimal short-term impacts and leave programs and services largely intact. This is the most typical because politically it is the most acceptable and has the least personnel impact. Each City program or service has a constituency (with the exception of overhead related functions). Any attempt to eliminate or reduce a program usually activates those constituents who use that service and would have their lives affected. Consequently, it is typical to make only those cuts that are absolutely necessary to keep the program or service alive until next year, when "hopefully" revenues will improve.

This is what I term, the "hold your breath and hope" approach. As you saw above, this is how I have crafted the budget thus far. We, as a municipal corporation, do this all the time. We hold a position vacant and spread out the work assuming that when times get better we will fill that position. Or we agree to defer replacing a piece of equipment recognizing we'd rather be in the business operating an old piece of equipment versus being out of the business completely. The problem is, what happens when the revenue doesn't return? How long before the maintenance costs on the equipment become more than the replacement costs? How long before a roof fails? How long can staff run at this higher pace with less pay? In short, we must look past the immediate fiscal year and say how do we build a sustainable ship for the longer haul?

In this budget year, each Division Director and Section Head was asked to cut anywhere from 6.5% to 34% over the previous year budget which saw cuts as high as 22%. When asked if the budget they had developed was sustainable over the next three to five years if they got no more revenue, the answer was consistently "yes...with the exception of:"

- ❖ Equipment – vehicles, tractors, graders, etc
- ❖ Facilities – roofs, HVAC, custodial services, etc.
- ❖ Infrastructure – streets, water lines, pumps, sewer lines, parks
- ❖ Personnel – training, compensation (if other markets increase), uniforms, etc.

In other words, we can continue to provide this level of service from a workload standpoint, so long as the tools we rely upon don't break. Moreover, in the short term, we believe the breakdown's will be unremarkable in the first year (which was FY 2010) and stressed in the second year (FY 2011), but will come due in the third year and beyond. In the end, it is my determination that **we cannot sustain the proposed level of programs and services for the long-run.**

So we have a choice to make: 1) do we budget at a level that minimizes visible impacts to programs and services and then re-evaluate next year and either cut deeper if needed or look at new revenue sources to accomplish the structural support (equipment, facilities, compensation) necessary to sustain that level of service; or 2) do we cut deeper now affecting services and increasing layoffs, but know that we are able to sustain that level of service for the long run? To answer this question, you need to know what the future looks like. Of course the degree of accuracy when looking into a crystal ball is murky at best. Very few saw the degree of decline that the State of Arizona and City of Flagstaff would experience starting in the fall of 2008, three months in advance let alone 3-5 years in advance. But we need to look out 3-5 years.

Recognizing the limitations of my Bachelors degree in economics (the Master's was in Public Administration), I will defer to others to provide predictions and use my knowledge to interpret the impacts of the forecast on this budget. Forecasts by the Federal Open Market Committee predict the national economy will grow around 2.8-3.5 percent during 2010 and between 3.5 and 4.5 percent in 2011 and 2012. Arizona economists consistently predict the State will grow slower than the national economy, but will still grow in calendar year 2010. Meanwhile, NAU economist Ron Gunderson's forecast in November 2009 was no signs of the local economy recovery in 2010. NAU economist Dennis Foster at the same conference projected a local recovery could take as long as 5 years.

This provides an interesting outlook for our municipal corporation. From a contractals and commodities standpoint (equipment, fuel, computer hardware and software, etc), a growing national economy will insert a degree of price inflation back into expenditures; however, if the local economy remains flat, it becomes difficult to even keep up with 1-2% inflation. As a result, the cost of providing the same level of services for Flagstaff is not possible and cuts must be made. From a personnel standpoint, which is our most significant resource and expense, there is a question about worker mobility. Mobility within the state of Arizona is pretty high as demonstrated by the quick departure of police officers to Valley communities when pay differentials are minimal, but add in cost of living between Flagstaff and the Valley and the differential is more significant and more attractive to leave this area. But if the State economy continues to suffer, those in-state employment options become limited. However, if the national economy is rebounding much faster, the compensation and cost of living differential may become great enough to entice workers to move out of State. When this happens, our corporation struggles significantly as we are in a perpetual state of training new hires, which in turns means lower levels of customer service and in turn poorer performance. Maintaining competitive wages (that retain and attract quality workers) is the single most important structural element to a sustainable ship. No matter how small we might get; no matter how few programs we might offer; if we don't have a quality workforce to deliver it, there will be continual dissatisfaction with the organization which will lead to constant turnover (including elected officials). These arguments would seem to lead us towards the obvious choice of #2: keep cutting and make the ship sustainable for the next 3-5 years. But what would that take?

Looking at the categories outlined above, here are some estimates to “maintain what we’ve got:”

**Equipment –**

- Fleet (General Fund w/o fire engines)-\$500,000/yr (FY11 Budget = \$250,000)
- Fire Engines - \$400,000/yr (FY11 Budget = \$0)
- Solid Waste Equipment - \$2 million/yr (FY11 Budget= \$1.8 million)
- Utilities (vehicles and plants) - \$1million per year (FY11 Budget = \$0)
- IT Capital - \$700,000/yr (FY11 Budget = \$470,000)

**Infrastructure –**

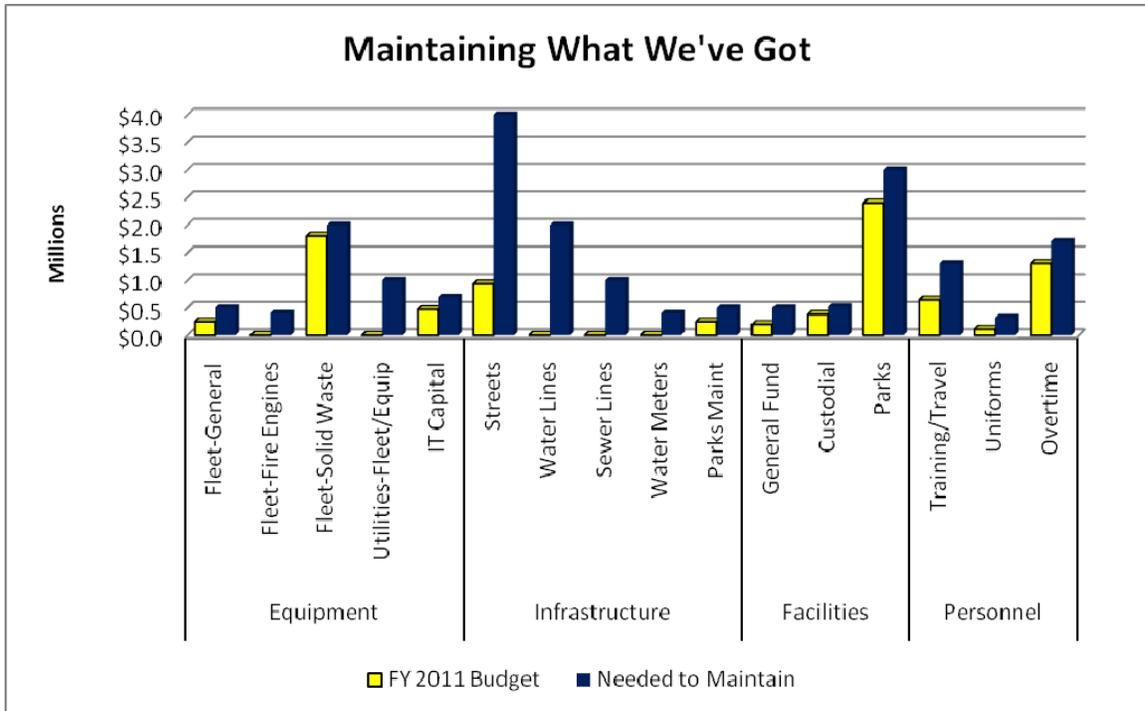
- Street preservation - \$4 million/yr (FY11 Budget = \$937,000)
- Water lines - \$2 million/yr (FY11 Budget = \$0)
- Sewer lines - \$1 million/yr (FY11 Budget = \$0)
- Water meters - \$400,000/yr (FY11 Budget = \$0)
- Future water supply for build-out - \$200M - \$600M
- Parks capital - \$500,000/yr (FY11 budget = \$250,000)

**Facilities –**

- General Fund - \$500,000/yr (FY11 Budget = \$200,000)
- Custodial - \$525,000/yr (FY11 Budget = \$383,000)
- Parks Maintenance - \$3 million/yr (FY11 Budget = \$2.4 million)

**Personnel –**

- Training and Travel - \$1.3 million/yr (FY11 Budget = \$647,619)
- Compensation (average 19% below market) - \$6.3 million/yr to catch up
- Uniforms - Police \$1,200 /person/yr - \$224,000 (FY11 Budget = \$112,000)
- Fire \$1,000/pers/yr (not including safety gear) - \$100,000 (FY11 Budget = \$0)
- Overtime (primarily Police, Fire and Snow removal) - \$1.7M/year (FY11 Budget = \$1.3M)



The total deficit of these ongoing needs (not including future water supply or compensation) is approximately \$11 million per year. For just the General Fund & BBB (Park Maintenance) it is approximately \$6.5 million. To meet these ongoing structural support expenditures would take significant and severe expenditure cuts. If we look back at the items added back to the proposed budget during the February council retreat, deleting those items would save \$1.7 million and have significant program and service impacts. To get to this larger number we would need to consider a cut equivalent to a half cent sales tax.

To expound, our 1¢ sales currently generates about \$13 million. This is equal to 27% of all the revenue in the General Fund. We know that if that went away today, we would be faced with eliminating about 3 out of every 10 jobs in the General Fund. The structural support expenses are equivalent to half these amounts. This would mean significant reductions in programs and service levels in core services such as Police, Fire, and Courts. Remember that just \$1.7 million in cuts meant closing 2 fire stations, eliminating all police liaison positions, and no funding for warrants or public defenders in the Municipal Court. This is almost 4 times as severe a cut.

Of course, the alternative is revenue enhancement. The decision between cuts and revenue enhancements (once efficiencies have been achieved) always comes back to the level of service debate. If the public demand for certain services are quite low, then the cuts may be acceptable. If the demand is high, the cuts become less acceptable and revenue enhancement becomes more viable.

Given that the City Council has created a Budget Advisory Task Force to help provide guidance for the FY 2012 budget, it makes sense to defer these questions and these choices until that committee has had an opportunity to weigh in on them and provide their advice to Council and staff. Therefore, my recommendation on how to spend city dollars in FY 2011 is to stay with lesser cuts now and address the long term sustainability of this level of service with the Budget Task Force during this upcoming fiscal year. The details of the Council Adopted Budget are captured in the pages that follow.

Sincerely,



Kevin Burke  
City Manager



# The City of Flagstaff Service At A Higher Elevation

## **Mission**

The Mission of the City of Flagstaff is to enhance the quality of life of its citizens while protecting the values of our community.

## **Vision**

The City of Flagstaff will be a sustainable, safe and vibrant community retaining the character, high quality of life and charm of a small town.

Flagstaff will offer economic opportunities, educational choices, attainable housing, a protected environment and cultural and career opportunities to a diverse population

## **Values**

### *Our Values*

As employees we hold ourselves accountable to these values:

#### *Accountability*

We value accountability.

#### *Responsiveness*

We value addressing our customers' concerns.

#### *Quality*

We provide high-quality customer service

#### *Professionalism*

We are honest, responsible, accountable, highly-trained, and cost conscious.

#### *Teamwork*

We are a team in partnership with citizens and other agencies for a better Flagstaff.

#### *Problem Solving*

We solve problems in a creative, open-minded, and professional manner.

