POLICIES AND PROCEDURES

FISCAL POLICIES

The City balances current revenues against current expenditures (balanced budget approach) in all funds on an annual basis. Additionally, all City funds must balance these funds on an on-going basis for a minimum of five years. Both operational and capital efforts must be sustainable to assure continuity of service to citizens.

A five-year Capital Improvement Plan is updated annually and includes anticipated funding sources. The City's accounting records for General Government operations (General, Special Revenue, Debt Service and Capital Projects Funds) are maintained on a basis consistent with Generally Accepted Accounting Principles (GAAP) with measurable revenues recorded when they become available to finance expenditures in the current fiscal year. "Available" is defined as collectible within the current period or soon enough, thereafter, to be used to pay liabilities of the current period. Expenditures, other than principal and interest on debt, are recognized in the accounting period in which the liability arises. State statute allows for encumbrances to be recognized for a 60-day period following the end of the prior fiscal year as uses of prior year appropriations. To ensure that appropriations do not lapse, departments are directed to re-budget for all items that are expected to be delivered after June 30.

For the Enterprise Funds, the annual budget is prepared on a basis that differs from GAAP because state law requires capital purchases and debt service payments to be budgeted as expenses, and bond proceeds and grants that are to be utilized are to be budgeted as revenues.

As a matter of general policy, the City of Flagstaff attempts to realize the following goals and objectives:

GENERAL

The City maintains a moderate property tax rate. The secondary property tax rate relates directly to voter-approved debt. General Obligation (G.O.) debt, supported by property tax revenues, may change based on one or both of the following factors: 1) assessed valuation; or 2) property tax rate changes commensurate with community consensus. Additionally, debt service requirements are repaid through a specified revenue stream whenever possible, e.g., water and sewer G.O. bond debt service requirements are built into utility rate structure.

The City's general sales tax is used to meet the general operating needs of the City. An additional two percent BBB tax has been levied on lodging, restaurant, and bar services. This latter tax has been designated for enhancing the quality of life through Beautification projects, Economic Development, Tourism efforts, Arts & Science contributions, and Recreation operations and projects. The City has dedicated ($.00721) sales tax for transportation purposes, which will expire in 2020.

The City's goal is to maintain a minimum general fund balance of 15% of operating revenues. During difficult budget times, the city may reduce fund balance to 12%. The projected fund balance for FY 2012 is 42%, for FY 2013 is 19%, and for FY 2014 is 17%.

Current revenues will be sufficient to support current operations. Grant funds are considered to leverage City funds. Inconsistent and/or fluctuating grants are not used to fund ongoing programs.

ENTERPRISE FUNDS

The City has a policy of utilizing a systematic methodology to determine the rate increase in water and wastewater charges and fees based on the philosophy of "cost of service." All Water and Wastewater Fund, Environmental Services Fund, and Stormwater Fund operations are managed on the basis that they must be self-sustaining operations. The rate models include all capital costs and routine maintenance items. The water and wastewater fund has been approved for a rate increase effective January 1, 2011 with planned increases for five years. The Environmental Services fund implemented a rate increase for FY 2008 and has a 5% annual escalator for commercial and residential refuse, commercial and curbside recycling, and tipping fees thru FY 2013. As a matter of policy, the City will raise the landfill fee to an amount higher than the tipping fee at the Material Recovery Facility (MRF) to encourage recycling. The stormwater program had a rate increase June 2010 and there is no increase planned. Airport revenues generally have a CPI increase and several services are competitively bid.

An Environmental Services reserve will be determined and evaluated annually to provide funding for costs of landfill closure.

The City’s goal is to maintain enterprise fund balances in excess of 10% of operating revenues due to the fluctuations of usage not in the control of the departments.

REAL ESTATE PROCEEDS FUND

The disposition of funds from real estate proceeds is governed by ordinance. Proceeds from the sale of real property assets will only be used for costs of acquisition or sale of real property.

DEBT PERFORMANCE

To ensure that the City's debt position and bond ratings remain favorable, the City's borrowing program strives to meet the following general debt performance goals:

- The City will limit long-term debt to only those capital improvements that cannot be financed from current revenues.
- The terms of repayment for any debt will not exceed the estimated useful life of the project or asset acquired nor will debt be used for recurring expenditures normally considered operational and maintenance expenditures.
- Minimize the impact of debt obligation on the general taxpayer, by:
  - Using Special Improvement Districts (SID), revenue bonds (street projects), or user charges (water and sewer bonds) whenever possible.
  - Determining if BBB funds (Beautification, Economic Development, Tourism, Recreation, and Arts & Science) should underwrite all or part of a proposed project.
  - Creating sinking funds when possible to provide for expansion or replacement of capital items.
  - Seeking out grant support to the maximum extent possible as well as other lower interest debt options such as state revolving loan funds or redevelopment district designation.
  - Collaborating with the City's financial advisors to structure debt in such a way the debt load is explicitly related to the operating budget and the ability to handle debt will not impair operating needs. General obligation debt load will not exceed 15% to 20% of the operating budget and debt expenditures to allow sufficient resources to meet ongoing needs without placing an undue burden on the taxpayer.
  - Preparing an Official Statement on all bond offerings and notes, including Certificates of Participation.
  - Maintaining good relations with its financial advisor, bond rating agencies and insurance carriers, and providing full and open disclosure on all financial reports and prospectuses.

DEBT MANAGEMENT

The City will not pledge General Fund taxing authority to secure long-term debt except when marketability can be significantly enhanced.

At least 25% of capital outlay (including capital equipment acquisition) will be funded on a pay-as-you go basis. The City will fund on a pay-as-you-go basis as much as possible rather than using debt financing.

A feasibility analysis will be undertaken in-house for proposed long-term financing to determine current and future budgetary impact and reliability of revenue stream to support both debt service requirements and operations. Council will review the financing program annually.

Financing will not exceed the useful life of the infrastructure improvement.

Debt financing will be on a competitive basis. Private placements (negotiated financing) may be used when the market is highly volatile or the debt structure is highly unusual and complex as to financing structure or security structure.

Debt schedules will be prepared and included in the Annual Budget and Financial Plan (budget document) as well as the Five-Year Capital Improvement Plan with an annual update.

The City will diligently monitor compliance with all bond covenants as well as strict adherence to federal arbitrage regulations.

FUND BALANCES AND RESERVES

The City will strive to maintain fund balances of at least fifteen percent (15%) in the General Fund and ten percent (10%) in the Special Revenue and Enterprise Operating funds. Twelve percent (12% of General Fund revenues and five percent (5%) of other funds is considered the minimum level necessary to maintain the City's credit worthiness (bond rating). However, a more stringent level is recommended so as to provide for:

- Economic uncertainties
- Assurance against vagaries and uncertainties in the bond market
- Cash flow requirements (60 days operating revenues)
- Adequate contingencies

A Landfill Sinking Fund has been established to provide for future closure and environmental regulation requirements and equipment needs. For closure costs, amounts are legally designated for future construction needs in order to insure financial compliance. The landfill rates include an allocation to the sinking fund.

EXPENDITURE LIMITATION CONTROL

The State of Arizona provides for several options regarding expenditure control limitations. State statute determines the allowable expenditure limits for each municipality. There can be a one-time adjustment, a permanent adjustment, or charter cities have a homerule option. The City operates under the state expenditure limitation rather than the home rule option allowed to Arizona municipalities, which requires voter approval every four years. The City has a permanent adjustment to the base as a result of the BBB tax approved by voters in FY 1988, which allows the City to increase the expenditure level base by the amount of the additional revenues generated by the tax.

The City received voter approval for a second permanent base adjustment in the May 2006 general election. The adjustment was necessary to align previous citizen approved expenditures with the maximum allowable amount per the Economic Estimates Commission.

Expenditure Limitation is presented as the basis of accounting presented by the uniform expenditure reporting system, which excludes expenditures of certain revenues specified in the Arizona Constitution.

BUDGET POLICIES

Budget Basis of Accounting – The accounting and budgeting systems for the City are in accordance with Generally Accepted Accounting Principles (GAAP) format, with minimal variances between the two systems. Budget basis for enterprise funds differ primarily due to state laws. The major differences are as follows:

- Encumbrances (contractual commitments) are considered the equivalent of expenditures. Encumbrances at year-end for goods or services, which are not received prior to the end of the fiscal year, are cancelled.
- Fund balances reserved to inventory and bonded debts are not included in the budget.
- Certain expenditures, such as depreciation and landfill closure and post closure accrual, are not included in the budget.
- All funds except the Internal Service Fund are budgeted.
- Enterprise funds budget capital expenditures and debt service payments as expenses.
- Enterprise funds budget bond proceeds and grants as revenues.

The City will utilize a number of different fund types to segregate the financial activity within the City either due to regulatory reasons or as designated internally. The fund classifications are Governmental funds, Proprietary funds and Fiduciary funds.

Governmental funds are typically those that account for the tax supported activity within the City. Within governmental funds, the sub-classifications utilized by the City are:

- General Fund - The chief operating fund that accounts for all activity not accounted for somewhere else. The General Fund currently encompasses the activities of General Administration, Management Services, Community Development, Public Safety, and Non-Departmental expenditures.
- Special Revenue Funds – Accounts for certain revenue sources that are set-aside for a specific purpose. Special Revenue Funds currently in existence are the Library, Highway User Revenue, Transportation, Beautification, Economic Development, Tourism, Art's and Sciences, BBB Recreation, Real Estate Proceeds, Housing and Community Services, and Metropolitan Planning Organization.
- Debt Service Funds – Established to set aside the resources needed to meet current and future debt service requirements on general long-term debt. The City has established the General Obligation Bond Fund, the Secondary Property

Tax Fund, and the Special Assessment Fund in this category.

- Capital Projects Fund – Established to separately reflect major capital acquisitions and/or construction from other ongoing operating activity. The City of Flagstaff has established a Capital Project Fund.

Proprietary funds are used to account for those activities that are expected to be self-supporting through user fees in whole or in part. Proprietary funds encompass Enterprise funds.

- Enterprise Funds – May be utilized for any activity in which a fee is charged. An Enterprise Fund is required to be utilized if the debt is backed solely by fees or charges, if there is a legal requirement to recover cost through fees and charges, or there is a policy decision to recover cost. The City has four Enterprise Funds in the form of Utilities (Waste and Wastewater), Airport, Environmental Services, and Stormwater.

Fiduciary funds are used when the City holds resources while acting as an agent for a party outside the government. The City has no fiduciary funds.

Budgetary control accounts are maintained in the general ledger system at a line item level to track estimated revenues, appropriations, and encumbrances.

The Comprehensive Annual Financial Report (CAFR) Statement of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual, reflect how well the City met its budget plan at the legal level of control which, is at the department level. In addition, while individually budgeted, the City combines the BBB funds for CAFR presentation. These include Beautification, Economic Development, Tourism, Arts & Science, and Recreation. Conversely, the City presents the Internal Service fund in the CAFR as unbudgeted.

REVENUE DISTRIBUTION

Highway Users Revenue Funds (HURF) will be used to fund a portion of the Annual Streets Maintenance Program (overlay, chip seal, reconstruction) at a level of effort that will strive to maintain the streets system based on availability of funding. A portion of HURF funds will also be appropriated each year for street and sidewalk improvements, streetlights, and Americans Disability Act (ADA) compliance.

Local Transportation Assistance Funds (LTAF) funding was eliminated for FY 2011 by the State budget process which in turn will eliminate funding of a portion of the annual streets maintenance program. We do not currently see this funding being restored in the near future.

Debt service requirements for General Obligation Water and Sewer bonds will be built into the respective rate models so that sufficient revenues are generated from user charges to cover annual debt service.

BBB Funds are restricted to Beautification, Economic Development, Tourism, Arts & Science, and Recreation projects and programs. The Beautification Fund will finance major beautification projects including an urban trail system, bikeways, pocket parks, streetscape, rehabilitation, area redevelopment enhancements, and related maintenance expenditures. As determined at the April 1996 Council retreat, funds for recreation will serve to improve, maintain, and enhance park facilities.

Annual funding for Economic Development opportunities $125,000 and Open Space $150,000 shall be allocated on a priority basis from excess revenues over expenditures.

Transportation funds benefit four major categories: Fourth Street overpass, Street Improvements, Safety Improvements, and Transit. The Street and Safety projects include Safe-To-School Projects, urban links, streets widening, and gateway development.

OPERATING BUDGET IMPACT

The impact of capital improvements on the respective fund operating budgets is required for all capital projects. Costs are developed for first-year start-up costs as well as an annual operating cost estimate. For Enterprise Fund capital projects, debt service requirements are included in the rate projections.

Balanced revenue and expenditure forecasts will be prepared to examine the City's ability to absorb operating costs due to possible changes in the economy, service demands and capital improvements. The forecast will encompass five years and will be updated annually.

An analysis of impact on cost-of-service will also be undertaken by the City staff to determine if any changes to fees and charges should be recommended to Council.

MINIMUM LEVELS OF CAPITAL INVESTMENT

The Street Improvement Program will strive to commit $1.5 million for annual capital maintenance of the street system which includes ADA compliance in the street system.

The Water and Sewer system will undertake sufficient capital improvements considered routine operations and maintenance to prevent system degradation. Additionally, the inner basin waterline will be improved over a 20-year period.

Sinking funds have been established for future landfill closure costs. Currently, it is estimated that $16 million will be needed over 30 years starting in the year of closure to finance the closure and environmental regulatory compliance costs for the landfill. Landfill requirements are built into the Environmental Services rate structure.

NON-RECURRING REVENUES

The City will balance operating revenues against operating expenditures. Any non-recurring revenues are budgeted for other one-time and/or non-recurring expenditures. Should any non-recurring revenue source have ongoing operating implications, those considerations will be evaluated before the acceptance of such funding.

Inner Basin Pipeline Reconstruction - May 2012