

CITY COUNCIL REPORT  
PUBLIC

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TO: Mayor and Council Members

FROM: Brandi Suda, Finance Director

CC: Josh Copley, Shane Dille, Barbara Goodrich, Leadership Team

SUBJECT: FY2012 BUDGET BALANCING

This CCR is in response to a council member's request information on FY2012 Budget and the City's responsibility to adopt a balanced budget.

Discussion

The FY2012 adopted budget was balanced and absent of a structural deficit. The FY2012 total budget appropriation (i.e. expenditures) exceeded total budget revenues by \$7.0 million. The \$7.0 million difference was funded with available fund balance to fund one-time, capital and carryover items. Budgeted appropriations in excess of budgeted revenues do not constitute a budget deficit. The FY2012 City Manager's transmittal letter is included which discusses the specific measures taken to balance the City's budget for that fiscal year. The City Manager prepares this overview for every budget year. The City budgets dating back to 2003 can be found on the City website at this address <http://www.flagstaff.az.gov/index.aspx?nid=164>.

The City is required by state statutes to adopt a balanced budget each year. The City balances current available resources (revenues, other financing sources and fund balance) against current expenditures in all funds on an annual basis. Additionally, all City funds must balance these funds on an on-going basis for a minimum of a five year look into the future. Both operational and capital efforts must be sustainable to assure continuity of service to citizens.

RECOMMENDATION / CONCLUSION

This report is for information only.



# City of Flagstaff

July 11, 2011

To the Honorable Flagstaff Mayor and Council,

How we spend the public's money is our most important business. With this letter, I am transmitting the Final Approved Budget for Fiscal Year 2012.

The past three fiscal years have been extremely difficult as we have watched resources shrink dramatically. The City has become far leaner with many sacrifices by city personnel and difficult decisions by the City Council. Despite this, Flagstaff service levels are nearly unchanged.

Fiscal Year 2012 represents one of the most difficult budgeting years I have faced. Not because of the dramatic cuts, but in the absolute unpredictability of our revenue sources. In our November Budget Retreat, I characterized our financial situation as being on the fulcrum of a teeter-totter. A number of our revenue sources have been trending upward. An equal number of revenue sources had been trending downward. It was uncertain where this would leave us. We did not have the 2010 Census numbers available to us when developing the Recommended Budget. Moreover, the State Budget was not adopted until April 1, 2011, after we had sent the April recommended budget to print for the April Council Retreat. Therefore, this transmittal letter will explain the evolution of the Final Adopted Budget with these component parts.

## The Base Budget

The Flagstaff budget is divided into funds. Think of each fund as its own business but all part of a larger corporation (sort of a holding company model). The reason for this is that many revenue sources are restricted. For example, revenue from utilities can only be spent on expenditures related to utilities. Therefore, we put those revenues and expenditures in their own "fund." The General Fund is the fund with mostly unrestricted revenues primarily from taxes. The General Fund has many of our core functions and administrative overhead. These include Police, Fire, Parks, Recreation, Community Development, Courts, Finance, Human Resources, Information Technology, City Manager, etc. Here is a brief synopsis of some of our funds.

The revenue sources for the Environmental Services Fund (Solid Waste and Sustainability and Environmental Management Section), Utilities Fund, Storm Water Fund, Bed Board and Beverage Funds are increasing. This breaks a downward trend from previous years. It also means that service levels associated with these funds will be holding steady or in some cases increasing. Examples of increases include:

Utilities – As a result of water and sewer utility rate increases that took effect January 1, the restoration of various maintenance and service programs is possible. These include: restoration of the Conservation Manager to a part-time basis and \$15,000 towards various conservation incentives; restoration of the meter replacement program; restoration of overtime budgets for our 24/7 operations; resumption of our infrastructure replacement program; and \$85,000 to pay for our share of the Arizona Department of Water Resources per the State Budget. The FY2012 budget also includes the elimination of the Project Manager position.

Environmental Services – This includes our Solid Waste program and our Sustainability and Environmental Management Section (SEMS). New services include: development of a wood pallet collection program; exploration of same day collection of trash and recycling; full year's operation of a fee-for-service glass collection service; as well as, money for a comprehensive Solid Waste Management Plan for the landfill. This study will include handling methane gas, alternative daily covers, etc.

BBB – Bed Board and Beverage revenue is earmarked into five different funds—Tourism/CVB, Economic Development, Beautification, Parks and Recreation, and Arts & Sciences. The BBB budget is predicting an approximate 8% increase in revenues versus the FY2011 Budget which translates into about a 1% over FY2011 estimates. This enables the substitution of a \$100,000 in marketing dollars that was originally earmarked from the Incentive Fund, to be paid for out of BBB revenues within the CVB portion. It also allows for the City to Fund Riordan Mansion at \$20,000 for another Fiscal Year from the Arts and Sciences portion of BBB. Community Investment (a section in Economic Vitality) is able to continue funding of Science Foundation, SEDI and ECONA in FY2012 as well as conduct its own retention, redevelopment and attraction programs.

The Capital Improvement Program (CIP) is not a fund, but a tracking mechanism of all our capital projects. The CIP will take another hit this year due to the continued reallocation of HURF funds by the State. Fortunately, the recently passed bond issue for streets and utility infrastructure maintenance and replacement will commence and we have several projects slated for FY2012. It is also important to note that due to a decrease in workload, the Capital Improvements delivery workgroup continued to make layoffs and did not fill vacancies.

The Library Fund is a complicated fund because it consists of revenue transferred from the General Fund to cover the City's portion of services, as well as revenue from property taxes collected in the County and transferred to the City to pay for County residents' use of Library facilities and libraries in the County. The revenue from property taxes will drop significantly in FY2012 due to a drop in real estate values. We are anticipating approximately a 10% drop in revenue to parallel a 10% decrease in property

values. Fortunately, this drop in revenue is mitigated by good planning. A drop was anticipated and therefore, 1) expenditures were not allowed to increase when revenues were increasing; and 2) additional reserves have been built up over time. So the Library Fund can absorb a 5% decrease in revenues without noticeably affecting services. The second 5% drop accessed reserves and the City continues planning for service decreases in FY2013.

The General Fund was far more complicated. Despite our principal revenue source, sales tax, trending upward at 1% versus this fiscal year, there was predicted a deficit in the General Fund of approximately \$1 million dollars. However, we also had \$1 million in carry-over money from FY 2010 that could have offset that deficit. This presented a policy choice: A) use the carry-over and hold service levels relatively constant; or B) adjust expenditures to match ongoing revenues and use the one-time dollars towards other purposes such as replenishing the General Fund Balance to 15%. Both had great merit, however, when we looked forward at future expenditures (rising health care and pension costs) and future revenue sources (grants expiring, future State deficits) our best prediction was further deficits; therefore, this budget addresses our current deficit immediately.

First, it is important to recognize, by self-imposed policy, we maintain a 15% Fund Balance in the General Fund. Fund Balance is a sort of savings or contingency account. Having a healthy savings account is critical to our bond rating. Having a good bond rating means we pay less in interest on our borrowing. In other words, we generally borrow our money for large projects through bonds. Outside agencies rate our credit worthiness based upon our financial health. One of the key components to that rating is how much money we have in our Fund Balance to make sure we can make the annual principal and interest payments to bond holders. Having a 15% Fund Balance is generally seen as a very good measure of credit worthiness. The Fund Balance also provides money in cases of emergencies, disaster, or significant recessions. The latter is the reason we reduced the General Fund Balance from 15% to 12% in FY2010. This provided \$500,000 a year for three years to offset some of the service and personnel impacts of the Great Recession. The third year of this program is FY2012. The use of Fund Balance dollars is one-time money (meaning, it does not come from a recurring source and once it is spent, it goes away unless a new source of revenue is available to replace it). Therefore, it was anticipated that in FY2013 we would need to restore that Fund Balance to 15%. [As an important side note, our Financial Advisor advised us in 2009 that reducing the fund balance from 15% to 12% would not affect our credit rating because we were still so much healthier than others during the recession]. Fortunately, or unfortunately, the last three years of revenue and expenditure reductions means restoring the fund balance to 15% is a smaller actual number. By the end of FY2012, the Fund Balance will be at 15%. Therefore, it is not necessary to redirect one time carryover dollars from FY2010 to return the Fund Balance to 15%

Before tackling the \$1 million deficit, it is important to know that our service levels are impacted by the numerous positions that were funded with one-time money used in the FY2011 budget that expires for FY2012. These include (with their personnel status in parenthesis):

- 11 Fire positions (10 operational and one Wildland Specialist)
- A Call Taker for dispatch (vacant)

- A Court Judicial Specialist (occupied)
- Reduction of a meter reader position (retiring)
- Assistant City Attorney (vacant)
- Code Enforcement Officer (occupied, but the supervisor position is vacant)
- Management Intern (occupied)
- Reduction of the Deputy City Clerk position 5 hours/week (occupied)

Additionally, Community Development has had numerous mid-year staffing reductions due to reduced workload and/or capital funding:

- Building Plan Reviewer
- Engineering Inspector
- Capital Improvements Engineer
- Capital Project Manager

With these personnel reductions in mind, we tackled the General Fund. Dissecting the \$1,000,000 deficit for FY2012, our health care and pension contribution expenditures have increased approximately \$500,000. Revenue was also expected to decrease \$500,000 due to reduced revenue from State shared income tax. On the positive side, personnel costs (primarily associated with turnover in which the new employee was less expensive than the retiring or outgoing employee and lower workers compensation insurance rates) were reduced by \$450,000. This left a \$550,000 structural deficit. To mitigate the expenditures, we have reduced health benefits, used a premium holiday and instituted a \$20 per month employee fee on health insurance. In other words, the City would no longer pay 100% of an employee's (separate from an employee plus dependent arrangement) health insurance. This resulted in a \$250,000 decrease.

The remaining \$300,000 in cuts is the equivalent of about 1% cut from other divisions in the General Fund. With the exception of Fire and Courts, every division in the General Fund made some cuts—Community Development made more than one percent. The impact of this includes, but not limited to the following:

- Elimination of 2 police officers (vacant)
- Elimination of part time Real Estate Assistant (vacant)
- Reduction of an Administrative Assistant in prosecution from 0.75 FTE to 0.50FTE
- \$30,000 from Recreation associated with Aquaplex utilities
- Many other cuts in contractual and commodities such as training and street sweeping.

Combined with the loss of one-time funded positions, some of these cuts have a very serious impact on services. For Fire, of the 11 positions, we had three retirements and once vacancy. This leaves 7 unfunded positions. The Wildland Specialist is preserved for a year by shifting its costs to a grant. Of the remaining 6 positions, three are saved by reorganization and shifting of salary. This leaves three positions scheduled for lay-off/elimination. The resulting change in service levels is a reduction from 6 engines and 1 rescue/engine (depending upon daily staff availability) in FY2011 to 6 engines and a

rescue operated only 25% of the time. The reduction of two police officers would eliminate the DARE program. Elimination of the Court Judicial Specialist would delay when a person would get a hearing for a civil traffic violation, parking ticket and/or code violation. For these reasons, we are proposing the following:

- Use \$140,000 of the one-time dollars carried over from FY10 to preserve 2 of the positions in Fire. Additionally, reduce the number of scheduled leave slots in peak months. Combined, this would enable us to operate the rescue 24/7 365 days a year.
- Transfer one fire operations person to the Fire Marshall position to avoid a layoff.
- Use of \$10,000 in one-time money to preserve street sweeping downtown on a daily basis.
- Restore one of the police positions permanently with the institution of a Use Tax that Council consented to adopt.
- Use \$30,000 in on-going dollars from a reorganization of CD-positions to hire a part-time planning technician to assist with front desk activities and the installation of a new permit tracking software.

These would offset the cuts with the greatest service impacts but creates a \$150,000 structural deficit in FY13. It also does not address the reduced level of service in courts.

This leaves \$850,000 in one-time money carried forward from FY2010. Council has allocated this money to prepare the organization for the future. It is broken down as follows:

- \$450,000 set-aside to fulfill the grant obligation of maintaining 6 police-officers for one full year after their grant expires. This will occur in mid FY2013 and carry through mid FY2014.
- \$70,000 to pay the General Fund's portion of increased utility costs over the next several years associated with the Power Purchase Agreement (PPA). If we can offset any expenses above anticipated electrical increases, this saves money immediately.
- \$100,000 toward outside legal fees.
- \$100,000 toward facility improvements that were deferred during the recession;
- \$47,000 toward United Way and Rural Policy Institute to offset one-time funding that was set to expire in FY2012;
- \$10,000 toward Council Travel. Otherwise there is no budget for travel.
- \$3,000 for participation in community events such as Annual Chamber luncheon, annual economic forecast, Flagstaff Cultural Partners Viola awards, Back to Flagstaff and similar functions.
- \$5,000 toward the Regional Plan Community Advisory Committee meetings;
- \$8,000 toward the restoration of a 0.25 FTE in the City Attorney's office
- \$10,000 toward the development of a Regional Plan
- \$47,000 toward the City's share of Auto Park taxes.

Most of these expenses are operational expenses that may re-occur (particularly the police officers). Using this carry-over money in this capacity; however, allows us more time to either recover our revenues or plan for the reduced expenditure.

There is another significant one-time revenue/expenditure line item in the FY2012 budget that is unpredictable—Sawmill South bond payments. The municipal corporation inherited the improved parcels when the developer defaulted on their bond payments. These bond payments are estimated at approximately \$700,000 per year. We made the December 2010 and June 2011 payments using budgeted contingency funds in the current fiscal year. The goal was to eliminate this burden by selling the properties for what is owed on the bond. In July 2011, this property closed to a developer of campus housing. With this sale to Campus Crest, the City will recoup the \$700,000 spent in FY2011 and allow us to reallocate the \$700,000 budgeted in contingency for bond payments in FY2012. That is a \$1.4 million dollar swing. During the Council budget review, the Council agreed to use this money to further position ourselves for the future should it become available.

One of the principal unfunded expenditures in the future is the replacement of vehicles including fire engines (please reference the issue paper on this topic in the 'Issues and Updates' section). We have historically paid for replacement vehicles each year as money was available. With the recession, funds have not been available and most vehicle replacements were deferred. Therefore, the vast majority of the Sawmill dollars will provide a solid foundation for building a replacement fund for vehicles as they reach their useful life and must be replaced. It will provide greater planning and predictability. The other portion of the Sawmill funds would go toward election costs associated with various local elections in FY2012.

As I noted in my Budget Transmittal Letter last year, it is only possible to maintain the same level of services long term if we can address equipment, facilities, infrastructure and personnel. With the use of one-time money (such as FY2010 carry-over and Sawmill offset) towards these functions rather than operating costs, we are helping equipment and facilities. Another difficult policy choice we will need to look at is reducing facilities to a level we can maintain long-term. Parks fit this category. As we continue to decrease maintenance levels in parks, we tend to reach a decision point where it is preferred to have fewer parks with green grass and safe amenities than a lot of parks with spotty grass and dilapidated or closed amenities. Another issue paper on this topic can be found in the 'Issues & Updates' section of the budget book.

In terms of maintaining our infrastructure for the future, the November 2010 bond issue helps address infrastructure. This is a \$16 million dollar one-time effort, but it does reduce the bleeding associated with deferring the maintenance of existing infrastructure. Lastly, as soon as possible, we need to start directing resources towards personnel. Municipal services are principally provided by people. If we are not able to maintain quality workers and/or suffer continual turnover due to non-competitive wages, service levels will suffer. The recession has been long and severe enough to limit employee choices; however, if we don't set the stage for addressing their needs, they will move as soon as the market bears. We must prepare the organization to make those adjustments and remain competitive.

## Property Taxes

An important aspect of this year's budget is the status of property taxes. As expected, assessed values have dropped significantly. Recall that there are two types of property taxes with two formulas for determining assessed value (the value upon which the tax rate is applied). I'll start with secondary property taxes because they are easier to understand.

Secondary property taxes are used for the purposes of paying down general obligation debt. In Flagstaff's case, all of the debt is associated with voter approved projects such as the Aquaplex, the Fire Station relocation program, and Open Space projects. The assessed value for secondary property tax is based upon the "full cash value" (or appraised value) of the property. The full cash value most closely reflects the market value of a property. As we know, the market value for property has declined notably during this recession. On average, property values used for this fiscal year have dropped an average of 8.5%. Holding the property tax rate constant at \$0.8366 per \$100 in value, the City will see an approximately \$600,000 decrease in revenue. Despite this decrease in revenue, we are able to meet all debt obligations. Therefore, the average taxpayer will see an approximate 8.5% decrease in their secondary property tax levy (a.k.a. tax bill) from the City.

The revenue from primary property taxes goes to the General Fund and pays for public safety, administration and various municipal services such as parks, recreation and community development. The assessed value for primary property taxes is taken from a "limited cash value" formula. In other words, when values of homes were rising significantly, a formula was created to limit that rise so as to limit the increase in property taxes when the property tax rate remained the same. Therefore, the value of your house, for primary property tax purposes, is less than the "full cash value" (or appraised value). The limited increase is restricted to 2% increase in revenue on existing property plus new construction. For FY2012, the limited cash value of most property is still below the full cash value despite a drop in property values. In order to minimize further cuts in the General Fund, primary property tax revenues will be increased by 2% plus new construction. This will increase revenue from approximately \$5,000,000 to \$5,125,000.

The net change in property taxes between primary and secondary will be a decrease in the amount paid for a majority of taxpayers. The only exception would be where the full cash value of a property actually increased. This is pretty rare in this market.

## Census Data and State Budget

In mid-March 2011, we received the Census data from April 2010. That data indicated that Flagstaff population had grown by approximately 24%. This growth rate mirrored the state of Arizona growth rate for the last decade. This was unexpected. State-shared revenue is based upon population. It was anticipated that Flagstaff, as a percentage of the State's population, would decrease. In reality, our

percentage increased. We believe this is largely attributable to the undercount from the 2000 Census rather than an actual growth rate comparable to the State.

State shared revenue comes in four forms: sales tax, income tax, gas tax (HURF), and vehicle license tax (VLT). Based upon the Arizona League of Cities and Towns estimates, the City of Flagstaff should receive \$987,000 more than was anticipated when we put the Recommended Budget together. State shared revenue is considered on-going (as opposed to one-time) revenue for budgeting purposes.

This extremely good news was tempered by the State adopted budget. The State of Arizona continues to suffer significant losses in revenues. In order to balance their budget, they have made significant expenditure cuts or shifts. The legislature adopted a budget on April 1, 2011, after the City Manager's recommended budget to Council in April was prepared. The following outline changes to the final budget. In that budget, the State reduced the amount of money provided to Flagstaff by reducing HURF funds by approximately \$750,000. We had anticipated a \$250,000 cut to HURF funds when preparing the budget so \$500,000 of this was unanticipated.

We reduced the amount of new revenue sharing associated with the Census data by the \$500,000 cut associated with the State budget, so we had approximately \$487,000 in on-going revenue to work with. Council allocated that money as follows:

- Shift the 2 firefighter funded with one-time money to on-going money (\$120,000);
- Offset the increase in health insurance premiums to employees (\$20 per month/per employee) (\$182,000) [for at least FY12].
- Restore the Call Taker position in dispatch (\$45,000);
- Restore the Court Judicial Specialist position (\$50,000);

These changes are focused on the City Manager's top fiscal policy of preserving FY10/11 service levels. Within that fiscal policy I have focused on maintaining service levels within public safety. This leaves about \$90,000 in ongoing revenue.

Also in the State budget, they changed the Arizona State Retirement System (ASRS) contribution formula from 50% employer and 50% employee to 47% employer and 53% employee. This reduces the amount of take-home pay for an employee as they must now make a larger contribution to their retirement (in addition to an overall increase in premiums) for the same benefits. For the employer (in this case the City of Flagstaff), our expenditure is decreased by approximately \$160,000. As noted above, we must position ourselves to remain competitive for employees. Therefore, Council agreed to offset this compensation decrease in the General Fund (including PSRS employees) by utilizing the \$160,000 savings plus the \$90,000 in unallocated on-going revenue associated with the Census.

As a further act of looking forward and planning, Council has created a "trigger" to restore between 0.6% and 1.2% of the 1.2% pay-cut employees took in May 2009 to help balance the budget. This

“trigger” means that if City sales tax revenues (minus construction and autos) is trending to come in \$425,000 to \$850,000 (twice as much as the 0.6% to 1.2% pay increase costs) more than budget when looking at receipts through December 2011, a portion of the pay-cut could be restored on the first paycheck after April 1, 2012.

Summary

The FY2012 Adopted Budget is balanced and absent of a structural deficit. Furthermore, we are using one-time dollars to prepare the municipal corporation for financial challenges of the future. This planning and preparation will lead to greater stability as we proceed forward.

Sincerely,



Kevin Burke  
City Manager