



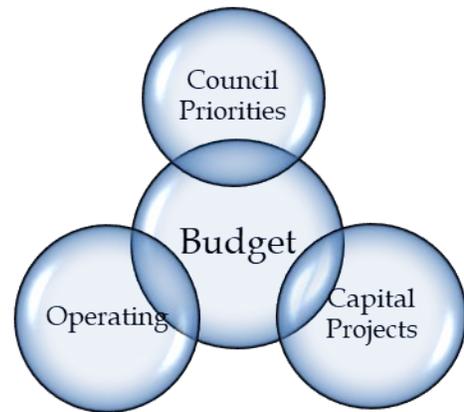
*Fiscal Year 2020-2021 Manager’s Budget Transmittal Letter
Executive Summary*

July 7, 2020

Mayor, Vice-Mayor and Council:

I am pleased to present the City of Flagstaff Fiscal Year 2020-2021 budget totaling \$450.7 million for your consideration. While we are required to prepare a budget annually per our City Charter, the annual budget is much greater than an articulation of the City’s financial resources. It is a comprehensive snapshot of the current City organization, informed by past trends and influences, while at the same time looking to emerging priorities and visions of the future. The budget formulation is an integration of policy and administration, bringing Council and staff together over numerous meetings and retreats that span several months.

In a very simplified and conventional description, the budget is comprised of three significant components – Council priorities, operating services and programs, and capital projects, as depicted in the model:



Priority Based Budgeting

In 2019, the City embarked upon a new budgeting concept that will be based upon priorities to guide resource allocation. Priority Based Budgeting (PBB) is a multi-year process and its implementation over time will significantly change conventional budgeting methodology. The City Council and staff members collaboratively created a map of the City’s priorities, staff created an inventory of programs, assigned costs to these programs and scored these programs against the City’s priorities.

In early 2020, the Budget Team worked with organizational divisions to incorporate PBB data into the City’s Increased Funding Request (IFR) process by asking divisions to link their requests to specific City priorities. This process allowed for a new lens that Council and the Budget Team used to analyze budgetary requests and served as a first step in incorporating PBB into the City’s budgeting process. As the budget process for the next fiscal year ensues, more emphasis will be placed upon costing and scoring of City programs to align with the stated priorities, as the organization continues in this multi-year implementation.



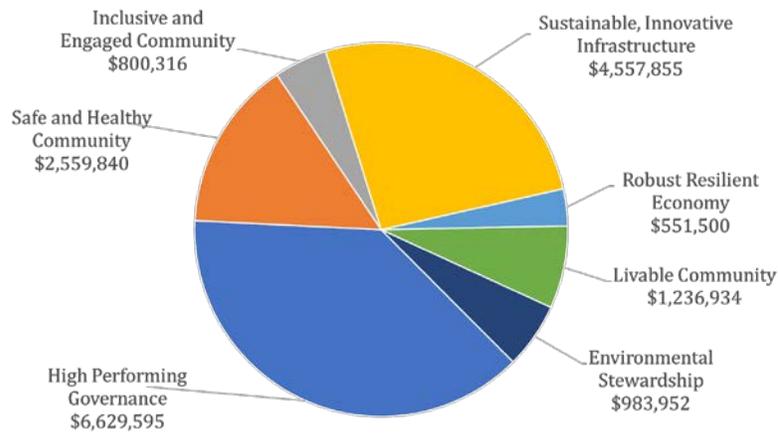


The Key Community Priorities are provided below. Further details related to Key Community Priorities and Objectives can be found in the final budget book. Additional public vetting of these and other emerging priorities will occur in the early stages of the budget process. Additional measures will include:

- Offering more communication and training throughout the organization to increase understanding of PBB
- Refine existing scoring processes to match City of Flagstaff context and needs
- Work to make PBB present and other data visualizations more user-friendly and accessible
- Simplify and enhance program scoring



The FY 2020-2021 budget includes the following proposed expenditures for the Key Community Priorities, totaling over \$17.1 million:





Economic Condition

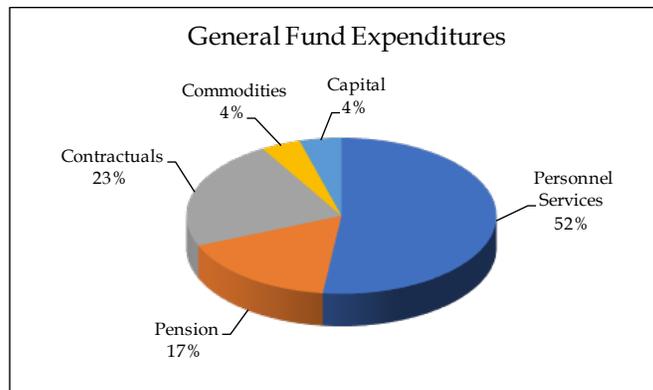
As a general comment, national, state and local economic conditions have shown several years of steady improvement since the “Great Recession”. The Flagstaff economy can perhaps best be measured by four indicators - sales tax, Bed, Board and Beverage (BBB) tax, state shared income tax and the construction industry. There are three types of sales taxes in Flagstaff. The first is a 1% tax on all general sales except food. Revenues from these sales support General Fund operations. As depicted in the below graph, the City has seen steady growth with a peak in FY 2017-2018.

What may be notable in the below graph is the decline of sales tax revenues in FY 2018-2019, and a somewhat flattening of the increase in subsequent years. This may be attributable to different factors, including more on-line auto sales, a fluctuating construction industry and the preemptive collection of sales taxes by the State, replacing that of local collection in 2017. In 2019, the Arizona Auditor General determined that the Department of Revenue was auditing significantly fewer businesses, and not consistently monitoring required business licenses. The City has recently budgeted for increased staffing to help backfill these reduced services, in hope to bring about better compliance.



The forecasted sales tax revenues for FY 2020-2021 were based upon these flattening trends, with conservative growth projections of 2.5%. For FY 2021-2022, revenues were forecasted with a 3.0% decline for an expected economic downturn. These forecasts preceded the COVID-19 pandemic and the resulting economic downturn which materialized in March 2020. The budget projections remained largely intact, with the City adopting a Recession Plan to address the downturn with quicker response time and more flexibility. The Recession Plan, consisting of five stages that correlate with increasing increments of revenue decline, is discussed in more detail below.

In terms of General Fund expenditures, the below pie chart illustrates the various components, with labor cost and pension liability constituting the larger expenditures.





In terms of revenue projections, an economic downturn commenced in March 2020, resulting from COVID-19 and the resulting stay-at-home directives that were implemented by Emergency Declarations at both the local and state level. Revenue projections for the remainder of FY 2019-2020 were revised downward accordingly. Specifically, in April 2020, a decrease of General Fund sales tax revenues by \$1.3 million was forecasted and an overall decline in revenues in excess of 3%. This projection has since been revised to approximately \$300,000.

In forecasting revenue declines for FY 2020-2021, a methodology was employed that averaged three different economic recovery scenarios:

- Scenario 1: Economy returns, but another COVID-19 surge brings additional impact; monthly revenues estimated at 70-100% for the first two months, with recovery, followed by similar reductions due to another COVID-19 outbreak
- Scenario 2: Economy weak early, then recovers stronger – monthly revenues estimated at 70-100% first two months
- Scenario 3: Economy weak longer and slow recovery – monthly tourism related revenues at 50% below prior year and slowly recover to only 90%, retail 5% down

Averaging the three scenarios yields a projected decline of 6.4% for FY 2020-2021. This is a reasonable and conservative estimate, and with the Recession Plan in place (see below discussion) the City can be adaptive to decreases that exceed this projection by implementing more stringent cost-saving measures.

Category	Budget Adoption	Economy Returns, Then Another COVID	Weak Economy Early, Stronger Recovery	Weak Economy, Slow Recovery	Average of 3 Scenarios
	FY 2020-2021 Budget	Scenario 1 FY 2020-2021	Scenario 2 FY 2020-2021	Scenario 3 FY 2020-2021	Scenario 4 FY 2020-2021
Sales Taxes Total	\$ 22,018,300	\$ 20,197,400	\$ 20,732,400	\$ 19,705,800	\$ 20,212,100
State Shared Revenues					
State Shared Sales Tax	\$ 7,486,400	\$ 7,389,100	\$ 7,116,400	\$ 6,905,000	\$ 7,136,800
State Shared Urban Revenue	10,669,600	10,700,000	10,700,000	10,700,000	10,700,000
Auto Lieu Tax	3,540,900	3,350,800	3,289,700	3,170,900	3,270,500
State Shared Total	\$ 21,696,900	\$ 21,439,900	\$ 21,106,100	\$ 20,775,900	\$ 21,107,300
Franchise Fees	\$ 2,471,500	\$ 2,357,100	\$ 2,414,100	\$ 2,414,100	\$ 2,395,000
Building Permits	1,702,500	1,650,000	1,500,000	1,250,000	1,466,700
Property Taxes	6,967,500	6,867,500	6,967,500	6,842,500	6,892,500
Other GF Revenues	10,439,932	9,168,900	9,808,712	7,931,647	8,969,800
	\$ 21,581,432	\$ 20,043,500	\$ 20,690,312	\$ 18,438,247	\$ 19,724,000
Total General Fund Revenues	\$ 65,296,632	\$ 61,680,800	\$ 62,528,812	\$ 58,919,947	\$ 61,043,400
\$ Change vs Prior Estimate		\$ (3,615,832)	\$ (2,767,820)	\$ (6,376,685)	\$ (4,253,232)
% Change vs Prior Estimate		-5.5%	-4.2%	-9.8%	-6.5%

Recession Plan

City staff endeavored to formulate a Recession Plan to help guide the City through future economic downturns in the Fall of 2019. The resulting Recession Plan was adopted and implemented in April 2020. Fortuitously, the plan was in effect at the time of the economic downturn resulting from COVID-19.

The plan is based upon five stages. Each stage represents an incremental severity in declining revenues – the first stage is relatively minor and is triggered by a decrease of up to 2%, while the fifth stage is quite severe and triggered by a decrease of greater than 20%. During the Great Recession, as one basis of measurement, the City of Flagstaff experienced a revenue decline of approximately 13%. Had the Recession Plan been in place, the fourth stage (major) would have been triggered.



Alert/Minor	Moderate	Significant*	Major*	Crisis*
<p>Trigger: Up to 2% Reduction in Revenues (Less than \$1.4 million)</p> <ul style="list-style-type: none"> - Expenditures reduced where reasonably possible - Postponing filling vacant positions 	<p>Trigger: 2%-4.99% Reduction in Revenues (\$1.4 - \$3.4 million)</p> <ul style="list-style-type: none"> - Limit non-essential services - Large purchases delayed and cancelling consulting services/contracts - Partial freeze on new hires - Travel and non-essential employee training postponed 	<p>Trigger: 5-9.99% Reduction in Revenues (\$3.4 - \$6.7 million)</p> <ul style="list-style-type: none"> - Strong justification for large purchases - Elimination of discretionary training, travel, meetings - Hiring freeze except for essential health, safety and welfare positions - Reduction in workforce (part-time, contract, temporary) 	<p>Trigger: 10-19.99% Reduction in Revenues (\$6.7 - \$13.3 million)</p> <ul style="list-style-type: none"> - Major service cuts - Suspend all salary increases - Consider employee reduction policies - Reduction in capital expenditures - Draw down on reserves - Closure of non-essential city facilities 	<p>Trigger: 20% Reduction in Revenues (More than \$13.3 Million)</p> <ul style="list-style-type: none"> - Reduction in workforce / employee costs reduction policies - Elimination of programs and services - Stops all capital improvement projects and purchasing - Reduction in reserves

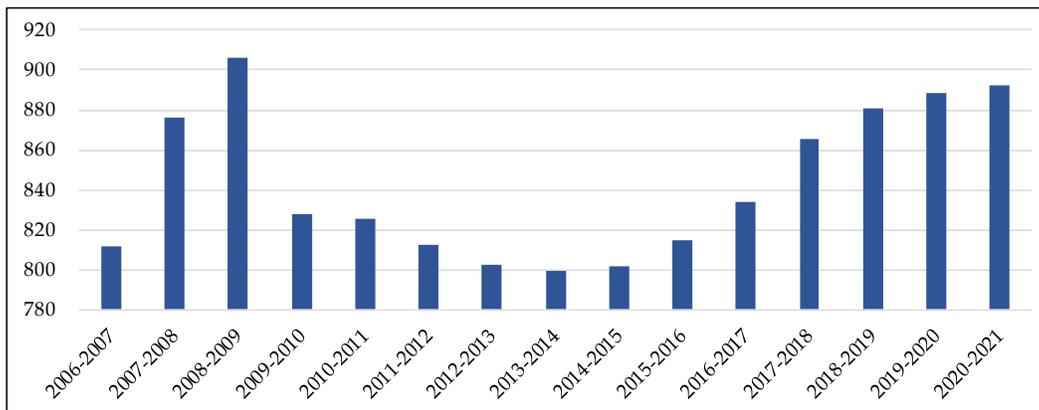
* Requires consent and resolution of Council
Source: City of Flagstaff

As summarized in the table, each stage has a series of increasingly stringent action measures to be pursued by the City in order to offset the revenue declines. In April 2020, the City was in the second stage (moderate). This correlated with such measures as a recruitment freeze, cessation of unnecessary travel and training, and some delay of large purchases. In June 2020, the City Council agreed to the recommendation to advance to the third stage (significant). This is premised upon expected revenue declines in FY 2020-2021 between 5-10%, as noted in the Economic Condition section above.

The Recession Plan is nimble and can be implemented with quick action, proving to be a more preferable approach than conventional budget adjustments and revised revenue projections. As noted at the outset of this budget message, the budget process is quite protracted, and the resulting budget is voluminous. Moreover, scaling back the budget to meet anticipated revenue declines would necessarily equate to greatly reduced expenditures and quite possibly the implementation of drastic actions such as labor reductions. This in turn could not be reversed should the economic landscape improve mid-fiscal year. The Recession Plan, conversely, allows the budget to remain intact, with resulting measures to reduce costs to be implemented 'on the fly' as conditions so dictate.

Organization

The City of Flagstaff currently employs approximately 888 full-time equivalent (FTE) employees. The following depicts the size of the organization in FTEs, prior to and subsequent to the Great Recession. As shown, the organization has remained relatively flat in terms of employee growth in recent years, and substantially less than the increase in staff that occurred prior to the Great Recession.

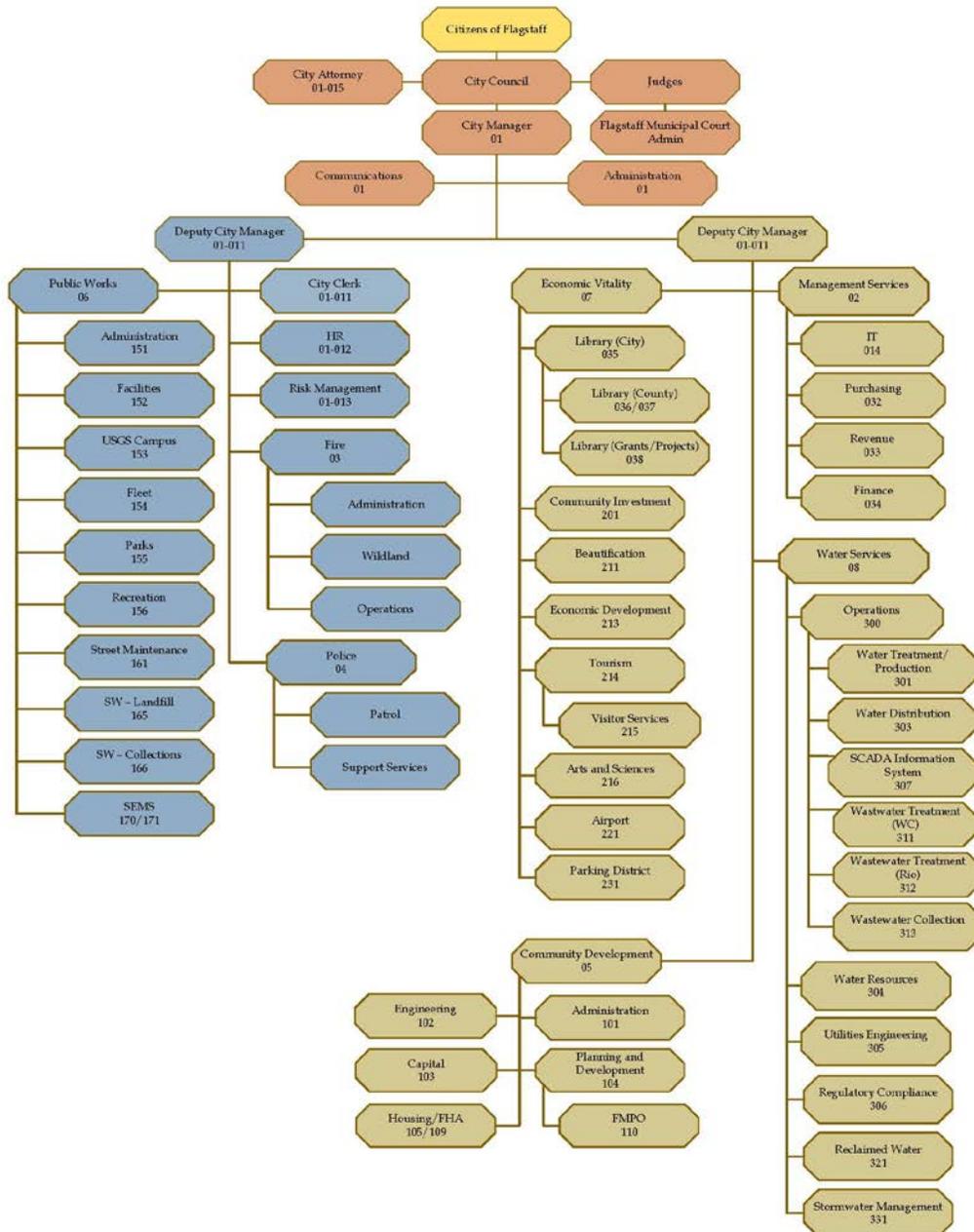




In terms of the reporting structure of the organization, and as depicted in the organizational chart provided in the FY2019-2020 budget, the City Council has three direct appointments - City Attorney, Presiding Magistrate, and the City Manager. The City Manager, pursuant to the City Charter, is responsible for the administration and oversight of the organization.

The oversight of the staff has been largely delegated to two Deputy City Managers, each responsible for supervision of six direct reports. The two deputies, in turn, directly report to the City Manager. The structure, as depicted below, is one premised largely upon vertical hierarchy.

City of Flagstaff





Issues and Updates

COVID -19

The first laboratory-confirmed case of the Coronavirus (COVID-19) occurred in late January 2020. The World Health Organization (WHO) declared a global health emergency on January 30th. The virus, with its origin believed to be in Wuhan, China, started to see local transmission in the United States (U.S.) in late February, with the first deaths reported in the U.S. on February 26th.

A national emergency was declared on March 13, 2020, and the Centers for Disease Control and Prevention (CDC) started to issue warnings against large gatherings two days later. By March 17th, there was presence of the virus in all fifty states, and local shelter-at-home orders began to emerge in some localities. By March 26th, the U.S. reported more COVID-19 cases than any other country.

The City of Flagstaff was the first local government in Arizona to issue a state of emergency and impose restrictions, limiting dining at restaurants and closing most gathering places to fight the spread of the new coronavirus. The action was followed by many other local governments in Arizona. City facilities largely remain closed at the beginning of FY 2020-2021, with many operations being performed remotely.

The City of Flagstaff was authorized by Governor Executive Order on June 17th, to implement face mask requirements. That requirement was put into place by Mayor Evan's Proclamation on June 19th.

As of July 5, 2020, COVID-19 has claimed the lives of 129,576 individuals in the U.S., with 2,841,906 cases being reported. In Coconino County, as of July 5th, there have been 1,503 confirmed cases and tests are producing an 11% positivity yield.

The City organization has generated a detailed Re-Entry Plan that is predicated upon four phases. The City is currently in Phase 2. The third phase, which will prompt the re-opening of most City facilities, will only occur after the following monitoring criteria is achieved:

Monitoring Criteria

Downward trajectory of the number of cases, hospitalizations and deaths over four or more weeks. During this same timeframe, the community members, business owners and visiting public have demonstrated the ability to follow CDC guidelines such as physical distancing, wearing masks when in close spaces and personal hygiene to help prevent serious illness and death. Healthcare facilities must have capacity to care for those who are seriously ill and the ability to provide testing, monitoring and contact tracing.

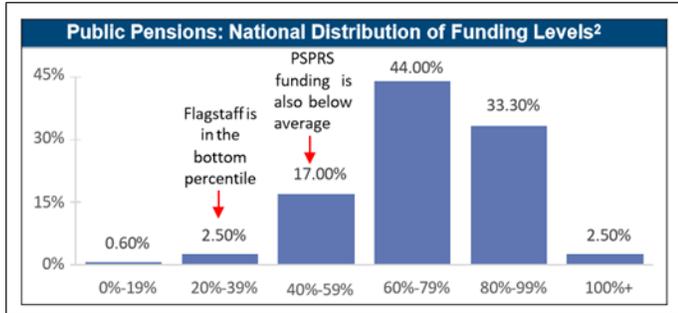
PSPRS Unfunded Liability

The Public Safety Personnel Retirement System (PSPRS) provides a statewide retirement system for public safety personnel. A board of trustees oversee the system's policies, operations and investments. Funding for PSPRS comes from employee contributions, employer contributions and net investment income. The equation is as follows:

$$\text{Contributions} + \text{Investment Earnings} = \text{Benefits Payments} + \text{Expenses in Administration}$$

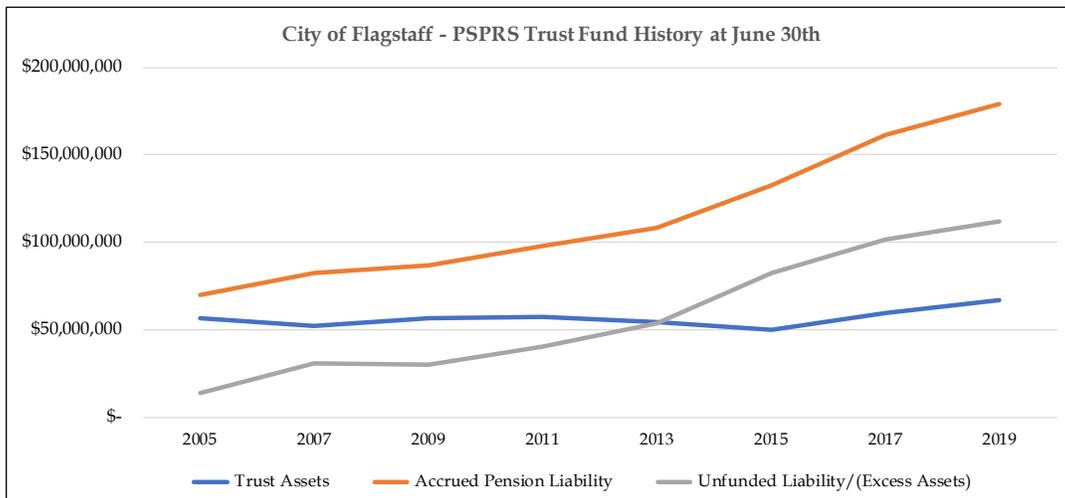


An employer's funding ratio indicates the amount of assets that are already available in the trust to present value of future benefits. For example, a funding ratio of 100% (commonly called being "fully funded") means there are enough assets in the trust to pay 100% of future expected benefits. Most employers participating in PSPRS within Arizona are not fully funded. The City of Flagstaff's Fire Department and Police Department are both funded below 40%. This places Flagstaff in the low percentile of funding levels for public pensions at the national level.



The City's unfunded liability is debt. In 2019, the debt was approximately \$112 million. Paying down unfunded liability amounts to increased contributions in the above equation. Some jurisdictions have successfully accomplished this to reach a higher funding ratio, enabling the realization of more investment earnings. Both City safety pension plans accrue at an assumed rate of 7.30%, well above what the City might pay on its debt (3% to 4%).

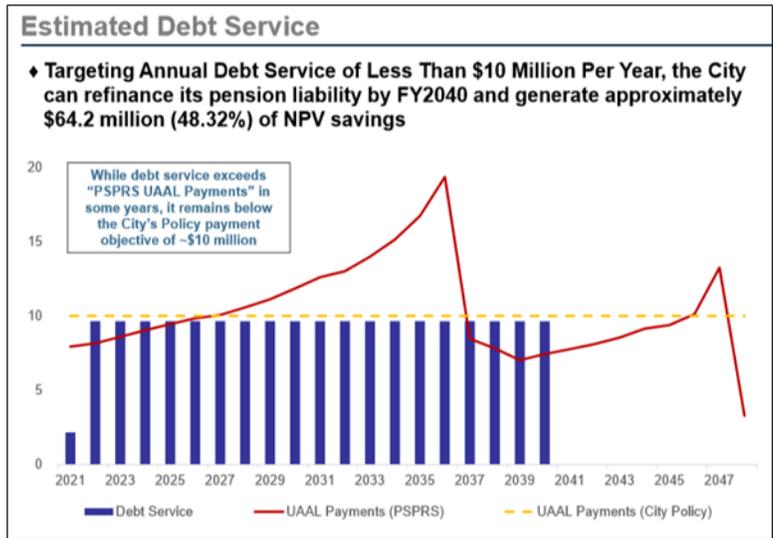
Toward this objective, the City Council has been pre-paying the annual contribution at the beginning of each fiscal year to maximize interest payments, and in 2019, use tax revenues were approved to be used as increased contribution, estimated to be \$850,000. However, the City is not making significant ground on reducing the unfunded liability, as evidenced by the below graph.





Paying down the unfunded liability will not only enable the City to gain from investment earnings, it will also significantly free up monies otherwise encumbered in the General Fund.

The City of Flagstaff's PSPRS employer contributions of \$11.3 million currently equal approximately 17% of total labor costs in the General Fund. Significantly, the amortization for both plans (Fire and Police) have spikes of upward near \$20 million in future years, as depicted by the red line in this graph. Leveling out the debt payments, shown by the yellow-dashed line, will ease the encumbrance upon the General Fund, and shorten the amortization by several years. This will save the City, and its taxpayers, approximately \$65 million net present value.



The City Council was presented a plan to issue Certificates of Participation in a strategy to pay off the unfunded liability at 100%. Through these ground lease and lease-back agreements, several City properties will be used to leverage an issuance of approximately \$132 million to pay the unfunded liability. With the City's excellent bond rating of AA-, the resulting low interest rate on this issuance will enable the realization of sizable investment earnings. Notably, the valuation of encumbered City properties will be a fraction of the \$132 million issuance. This issuance will occur in July/August 2020.

Local Recovery Plan

The City of Flagstaff created a plan that includes government relief, community development, economic development, arts and science, library, sustainability, airport transportation, housing, and tourism practices during and post COVID-19 pandemic. This plan helps guide our residents and businesses with government relief programs and shares economic development incentives that are being developed. It also shares grants, programs and business protocols that include our arts and science, library, sustainability, housing and airport sections. The City's messaging strategy is currently focused upon the COVID-19 pandemic, welcoming our visitors back to stay, play, distance and mask responsibly, while helping to drive overall economic impact for our city. Below is a link to the Local Recovery Plan digital flip book.

<https://www.calameo.com/read/00502074665b4f3bc385a>

Independent Revenue Streams

Several proprietary funds exist within the City's budget. These funds, referred to as enterprise funds, function as government-owned businesses where revenues generated within the respective operations sustain the operational costs over time. Municipal utilities are a prime example of enterprise funds. Existing enterprise funds include water services, airport, solid waste, sustainability and environment management, and the Flagstaff Housing Authority.

The Flagstaff Pulliam Airport has, however, seen increased costs related to growing capacity and enplanements. Transfers out of the General Fund to assist funding operations have been significant. The City of Flagstaff is taking measures to ensure that the Airport functions in a more sustainable manner and as a true enterprise fund.



Toward this objective, the City Council has approved the initial planning steps to see the development and leasing of the vacant 31.45-acre parcel that adjoins the Airport facility, as a long-term revenue generator. In a more immediate timeframe, the addition of a paid parking system will also contribute needed revenues. Finally, with the award of the \$18.1 million CARES grant, the City has generated a healthy five-year plan to address maintenance and upgrades to the terminal and hangars.

The watershed protection and wildfire risk reduction program was established in 1997 by City Council. Now recognized as a national model with proven success, the program is currently funded by General Fund transfers, grants and a voter-approved bond. The Flagstaff Watershed Protection Program (FWPP) bond - a project specific funding source - will be fully expended within the next several months. Recognizing the need for a sustainable ongoing program and some continued project specific funding, the Council was presented with a program whereby the needed revenues would be generated through a new fee integrated within the water billing structure.

The new utility fee structure has two significant components. First, the Environment Management Fee (EMF) has been revised to a use-based allocation whereby increased revenues are collected upon increased water consumption. This translates into a savings for residential consumption in the lower tier of consumption. Higher consumption will yield increased fee revenues. The second component is the institution of a Water Resource and Infrastructure Protection (WRIP) fee. The revenues from this new fee will sustain the continued function and staffing of the FWPP, although future funding for project-based capital will still be needed. The impact of the new fee structures is shown below, for residential consumers:

EMF/WRIP Residential Impact Summary	
Residential Consumption 3,500 gallons	Residential Consumption 10,000 gallons
<ul style="list-style-type: none"> • Environmental Management Fee = \$2.03 (\$1.97 decrease from current fee) • Water Resource and Infrastructure Protection Fee = \$1.82 • Total = \$3.85 per month <ul style="list-style-type: none"> • \$0.15 monthly savings • \$1.80 annual savings 	<ul style="list-style-type: none"> • Environmental Management Fee = \$4.77 (\$0.77 increase from current fee) • Water resource and Infrastructure Protection Fee = \$5.20 • Total = \$9.97 per month <ul style="list-style-type: none"> • \$5.97 monthly cost • \$71.64 annual cost

Employee Retention

Employee retention remains a growing concern for the organization, as compensation continues to be a concern with our employees. Merit-based increases have been sporadic through the years, and as a general comment, our employee compensation packages may be lagging behind market rates.

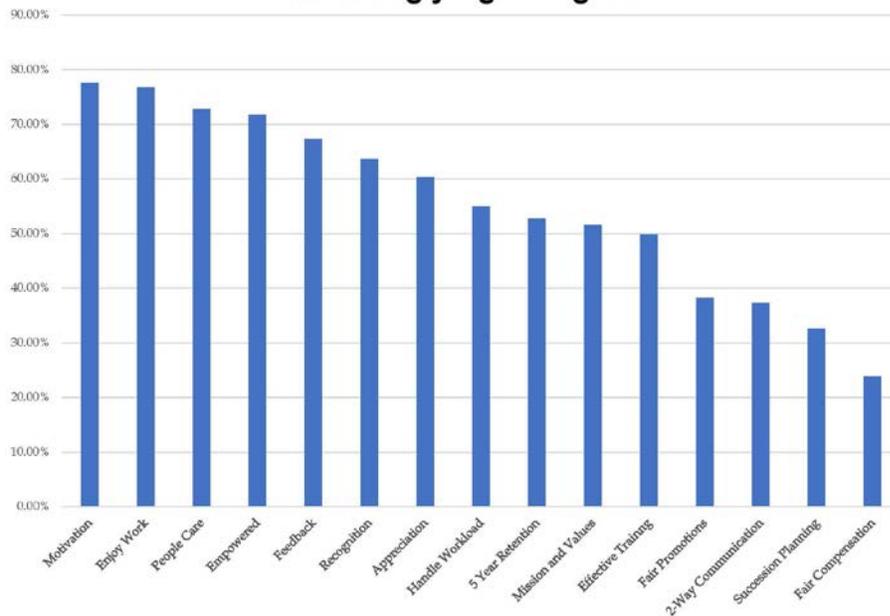
Achieving market-based pay is a continued Council goal and is supported by our Employee Advisory Committee (EAC). In FY 2019-2020, merit increases of up to 3% were funded with the intent of establishing an ongoing program. The FY 2020-2021 budget does not include this merit-based adjustment, and the 2% Cost of Living Adjustment (COLA) as approved by Council has been deferred pursuant to the Recession Plan.



The City is refreshing its market study to provide information on keeping City salaries competitive with both the local market and the statewide municipal market. It is imperative that we do so and establish an ongoing merit-based adjustment regiment that will improve our employee retention and overall morale. The 2019 Employee Survey, which saw participation by 461 employees, revealed that compensation is now the lowest ranking factor for the employees. This represented a drop by four percentage points from the previous survey in 2017.

2019 Overall Results

% Strongly Agree/Agree



Significant Projects

Rio De Flag

The Rio de Flag Flood Control Project is a cooperative project between the City of Flagstaff and the US Army Corps of Engineers. The goal of the project is to remove the 100-year flood plain from central Flagstaff, which will reduce flooding hazards, improve safety and encourage redevelopment. The project design is currently in the draft 100% status, with a final review and approval anticipated for late summer. In early 2020, the Army Corps was successful in securing \$52 million in federal funds, which combined with the City's contribution, provides full project funding. The City's current focus is on completing the environmental clearance and contract documents and acquiring the necessary property rights for the project. The project estimate is \$122 million (fully funded) and the City is responsible for 35% of the total project cost, which is provided by Stormwater fees.

Transportation

The FY 2020-2021 budget includes a number of important transportation projects. Design work will begin on the Lone Tree Overpass, a City capital project that will provide a grade-separated bridge crossing of the BNSF Railway corridor and the Rio de Flag. This new segment of Lone Tree Road will begin at Butler Avenue and end at Route 66 to the north. Project funding in the amount of \$73 million is provided by a 2018 approved Transportation bond. The City will be advertising a Request for Statements of Qualifications, which will be presented for Council award this fall. Design and construction completion are anticipated by 2026.



In partnership with the Arizona Department of Transportation, design work will begin on a new round-a-about intersection at Fourth Street and Cedar Avenue/Lockett Road. The project is funded with a \$1,928,366 Federal Highway Safety Improvement Program (HSIP) grant and \$60,813 in City transportation funds.

The City's funding portion of the bridge widening project on Fourth Street over I-40 was completed during last fiscal year, with construction work continuing through the 2020 construction season. The multimillion-dollar project was the result of a successful partnership between the Arizona Department of Transportation and the City of Flagstaff. Beyond the bridge work over I-40, improvements will continue on Fourth Street to Butler Avenue, with the eventual reconstruction of the Fourth Street and Butler intersection.

Airport Parking

The Flagstaff Airport has seen major success with the addition of its second airline, United Airlines. The Airport has also seen an uptick in service with American Airlines. With the new routes, the facility has experienced a substantial increase in enplanements and car rentals. Parking at the facility has been grossly over-capacity. Staff has taken measures to provide an interim overflow parking area which is now functioning. As a long-term measure, an additional surface parking lot with a minimum of 350 parking spaces will be constructed in FY 2020-2021. The City will add other infrastructure elements including fencing, lighting, pedestrian access to the terminal, bus pullouts and bike lanes. Both the existing parking lot and additional parking facility will incorporate a paid parking model. It is estimated that the entire project will cost approximately \$4 million and this has been funded in FY 2020-2021.

Respectfully Submitted,

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Greg Clifton
City Manager