Minutes
City Council Issue Review Session
June 11, 2009

Minutes of the Tempe City Council Issue Review Session held on Thursday, June 11, 2009, 6:00 p.m., in the City Council Chambers, Tempe City Hall, 31 E. Fifth Street, Tempe, Arizona.

COUNCIL PRESENT:
Mayor Hugh Hallman
Vice Mayor Shana Ellis
Councilmember P. Ben Arredondo
Councilmember Mark W. Mitchell
Councilmember Joel Navarro
Councilmember Onnie Shekerjian
Councilmember Corey D. Woods

Mayor Hallman called the meeting to order at 6:25 p.m.

Call to the Audience

No one came forward to speak.

Long Range Forecast Update

INFORMATIONAL BACKGROUND available in City Clerk's Office.

DISCUSSION – Presenter: City Manager Charlie Meyer; Financial Services Manager Jerry Hart

Charlie Meyer summarized that six months ago, the Council was provided with an economic forecast and at that time staff indicated that it should be updated periodically. At that time, staff stated that there is still great economic volatility and hoped that by this time, the bottom will have been reached, and by later in the calendar year, some recovery would begin. Things are a bit worse off than what was predicted six months ago, but it could be much worse. Previously we have focused on the general fund since that is the most critical fund for City operations, but staff will also provide forecast for the other funds.

Jerry Hart thanked the members of the budget team for their assistance. When staff came forward on February 19th during the special five-year planning meeting, the basis of the information in that budget balancing plan was the initial forecast for the City's general fund. Since that time, staff has been able to update the forecast for the general fund, but has also put together the forecast for the additional operating funds. Given the volatility in the economy and its impact on the general fund, it was necessary to make sure that the Council was fully informed that the economic impact was also affecting the other operating funds.

He summarized that the five-year forecast mainly serves as a planning tool to assist Council in its resource allocation decision-making process. This updated forecast covers all of the operating funds—general fund, transit fund, performing arts fund, transportation funds, Rio Salado/Community Facilities District funds, water/wastewater and solid waste funds, golf fund and cemetery fund. Certainly, overall economic conditions have not improved much since the original presentation in February.

The major revenue sources continue to be negatively impacted by the economic downturn. The latest tax statistical report for May shows there is still some slippage in terms of sales tax revenue and staff continues to monitor that. Along with the downturn in revenues, the pace of growth in expenditures has outpaced the growth in revenues, which has been the trend for a number of years. He outlined the key economic assumptions:

- This forecast shows flat sales tax revenue growth for FY 2009/10. Beginning in FY 2010/11, there might be some rebound of about 3% and in the next year, about 5%. The key emphasis is that we have built recovery into the forecast but the numbers still show a projected deficit of $3.7M.
- This forecast assumes no change in the state shared revenue formulas. The legislature has proposed certain items that would negatively impact the City's revenues, mainly vehicle license taxes which would have about a $1.3M impact to the general fund. There is also the provision of a moratorium on the impact fees which would primarily impact the water/wastewater funds of $6.2M over a three-year period. There was a proposal contained within the budget bill to reduce the assessment ratio for commercial property. Currently it is about 20% to 21% and the proposal was to reduce that to 10% beginning in FY 2009/10. That could potentially result in about a $6.5M to $7.M loss in secondary property tax revenue to the City.
- This forecast also reflects the anticipated impact of the 2010 census. The City's population as a relative share of the overall state population continues to decline each time a census is taken. Because of that, the City's share of the state shared revenue is expected to be impacted beginning in FY 2011/12.

He continued with the key budget balancing assumptions which are part of this forecast.

- It assumes a salary/wage freeze through FY 2011/12.
- The phased advanced funding of Other Post Employment Benefits (OPEB) is reflected.
- The budget for FY 2009/10 contains the elimination of 48 positions identified as part of the budget balancing plan and then beginning in FY 2010/11, approximately another 70 positions that were identified as part of the budget balancing plan will also be eliminated.
- The enterprise funds, namely water/wastewater and solid waste funds will continue programmed planned rate increases.

He summarized each fund.

- <u>General Fund</u>.
  - The major revenue sources are primarily sales taxes and state shared revenue, which is identified in the forecast as "local taxes" and "intergovernmental." Included in the local taxes is also the primary property tax.

  - The general fund forecasts deficits through FY 2012/13 which are primarily due to the economic downturn and its impact on the sales taxes, as well as development revenue.
  - The reduced collection of sales tax revenues, combined with the projected spin-down of the fund balances, have an impact on interest revenue.
  - Intergovernmental revenue forecasts a $2.5M to $3M impact to the state shared revenue simply because of

the City's relative share of the population. Even though Tempe might be growing at a slow rate, other cities are still growing at a much faster rate, so the relative share of population falls.

- The original budget balancing plan projected about a $2.6M shortfall in FY 2010/11 in the general fund and by FY 2011/12, it would be balanced. This forecast reflects an additional $3.7M shortfall, and from that point forward, it shows that the general fund is not balanced. That will mean that the City will have to do some additional work in terms of finding ways to close this new projected budgetary gap.
- At the end of FY 2009/10, staff anticipates the fund balance would be drawn down about 21%. At the beginning of this fiscal year, about $72M had been accumulated in fund balances to help address the economic shortfalls. Staff anticipates that by the end of FY 2009/10, that could be cut to more than half.

Mayor Hallman added that that would be with the assumptions provided, which were salary/wage freezes through FY 2011/12, the OPEB piece and the elimination of the 118 positions.

- Transit Fund.
  - This fund also relies heavily on sales tax.
  - Deficits are anticipated beginning in the operating fund in FY 2010/11 and throughout the balance of the forecast period.
  - We have begun receiving over the past couple of years a federal reimbursement for the City's investment in the light rail system. Those federal reimbursements will be received through FY 2011/12, at which time they will cease.
  - At this point it is anticipated that by FY 2012/13, the fund reserves would be exhausted.

Mayor Hallman asked if this includes the implementation of the Phoenix-driven increase in fares. He was concerned about how that increase may impact ridership and he suggested monitoring that closely.

Mr. Hart responded that it does include that.

- Performing Arts Fund.
  - Like the general fund and transit fund, this fund's major revenue source is sales tax revenues.
  - The forecast shows slippage.
  - It had always been the plan for the performing arts fund that annual revenues, combined with fund balances that had been built up in earlier years while the TCA was under construction, would provide sources of funding to help offset the operating costs of the TCA through the expiration of the tax.
  - The plan was that by the time the tax expired there would be a sufficient level built up to annually offset or provide for the operating costs.

Mayor Hallman clarified that the original enactment by Council was that there would be a sufficient amount left in the fund so that the cost of the center would be controlled to allow for an endowment left over to serve to operate the center forever. The cost of the center doubled, however, and it looks like it will burn up the balance by 2014. The fund would have $1,467,000 left at the end of 2013, and by 2014, depleted. Unless this problem is fixed, The Arts Center will be drawing off the general fund after that.

Mr. Hart added that staff has begun preliminary discussions not only on the performing arts fund, but on the transit fund to determine potential ways to address these budgetary shortfalls.

Mr. Hallman added that he was particularly concerned with the facility revenue, which was shown in FY 2007/08 as actual, and in FY 2009/09 was projected at $540K. He would like to see an actual number.

Mr. Hart added that the tax will expire in January of 2021, so future operating costs of the TCA will need to be addressed.

- Transportation Funds.
  - This fund relies most heavily on another state shared revenue source, the Highway User Revenue Tax.
  - One negative impact is our declining population relative to the state shared revenue.
  - Another negative impact is the fact that gasoline consumption is down from previous years.
  - Deficits are predicted through the forecast period.

Mayor Hallman asked about the possibility of the state taking the lottery proceeds as well.

Mr. Hart responded that staff has been monitoring that, but he wasn't aware of any provision contained in the proposed legislative bill. In previous years, substantial balances have built up in the fund that will help over the next few years. Once again, the transportation fund, unlike the general fund, relies on this one revenue source, and because of our declining share of state population, we will continue to see declines unless gasoline consumption increases or the state revenue picture changes.

- Rio Salado/Community Facilities District Funds.
  - Previous Council action established the Rio Salado operating reserve with the idea that while the Town Lake area developed, there would be a source of funding to help offset the operating costs.
  - The Council's direction was to take the interest earnings from the payment stream to help offset the operating costs of the Rio Salado Community Facilities District area.

Mayor Hallman added that if that disappears for any particular reason, we will see that we won't actually be balancing that budget either. The operating deficits in prior years were being made up by general fund.

Mr. Hart added that the major significant infusion of funding into that reserve was about $5M from the sale of the Rio West property.

- Water/Wastewater Fund and Solid Waste Fund.
  - Comparatively, these funds are doing rather well. The Water/Wastewater Fund and the Solid Waste Fund have their primary source of revenue as the user fees.
  - At the Issue Review Session on May 28, staff presented Council with the proposed rate increases for the water utilities that would go into effect, assuming Council approval, in November of this year. This forecast reflects the series of increases that have been brought to Council's attention.

Mayor Hallman clarified that it does not currently reflect the moratorium that has been proposed in the legislature. He explained that in the proposed state budget, there is a moratorium on impact fees, with the argument that cities can't be trusted not to increase these fees outrageously on home builders and developers when the legislature takes the vehicle license tax from cities and other sources of revenue. They propose a moratorium on impact fees, meaning the City cannot charge impact fees for new development. The City takes the policy that growth pays for itself. The current estimated impact of this moratorium on the City is about $6.2M. The reality of this is that it has nothing to do with the legislature balancing its own budget, because it has no impact on the legislature's budget, but rather that it is a special interest effort to provide a specific narrow interest group with a tax holiday so they can avoid paying the costs of infrastructure. Everyone else would have to pay the cost of the infrastructure for new projects. It hurts cities on the outskirts more than Tempe, because anyone who is

developing flat dirt housing will avoid all of those impact fees and all the residents of the community get to make up the difference. In Tempe, the hit of $6.2M means that in order to pay for the cost of waterline and sewer line rebuilds and other new infrastructure, we would have to charge more for water and sewer. What the legislature has done by giving a special favor to a very narrow group of people is that every city will face the obligation to increase its water and sewer fees. That has nothing more to do with balancing the budget than property tax assessment ratios have to do with balancing the budget.

Vice Mayor Ellis clarified that this is all based on the financial policy reserve requirement. It says 100%, and she asked if that is being changed.

Mr. Hart responded that one of the recommendations from the Red Oak Consultants is that we take a look at that.

Vice Mayor Ellis clarified that it would go from 80% down to 40% within four years, and then the reserve requirement for Solid Waste says 10% of revenue, yet we are approaching 30%.

Mayor Hallman clarified that the Red Oak memorandum shows that because we are building in the appropriate amount of costs recovery, that we can go ahead and spend down our reserve. We did this about 10 years ago when an original proposal came forward to increase water/wastewater fees by $1 per household on average each year for eight years so that by the end of the eighth year it would be an $8 increase. The Council, instead, recommended that we would go to an 80 cent model and reduce the amount of reserve, and the Red Oak memorandum stated that it was viewed as a responsible way to go. We can reduce our reserve requirement for water/wastewater because our cost recovery is viewed as responsible.

Mr. Meyer added that a good portion of that is really being used because of the substantial investment being made in capital improvements in the system for compliance and performance reasons. It's not so much that we are building in reliance upon that reserve, but we are investing in the system and we are also investing a lot of bonding to upgrade both our sewer and water systems.

Mayor Hallman added that the market is viewing this as a use of those reserves for one-time expenditures on capital that is reinvested in the system. Our residents need to understand that a lot of what we are having to do is spending down reserves to keep increases in fees at a minimum, but we still have to increase fees because the amount of regulation that has been imposed on us by the federal government for both water and wastewater.

Mr. Hart added that even with the anticipated increase, the City's rates will continue to remain very competitive and among the lowest in the Valley.

- <u>Golf Fund and Cemetery Fund</u>.
  - In the Golf Fund, as in previous years, there is a general decline in play.
  - Staff has taken steps over the last few years to try to mitigate the costs of maintaining the golf courses, while maintaining the courses in excellent condition.
  - There is only so much we can do on the cost side. This is a challenge not only in Tempe, but across the country.

Mayor Hallman asked if the Ken McDonald Course is carrying itself and the Rolling Hills Course is the one losing money.

Mr. Hart agreed.

Councilmember Shekerjian asked for clarification as to where the money comes from when the fund balances in the various funds, such as the golf fund, are depleted,

Mr. Hart responded that the only thing to turn to is the general fund.

Councilmember Shekerjian clarified that to keep the golf fund where it needs to be in order to support it; it draws away from other services.

Mr. Hart added that any time resources have to be deferred out of the City's general fund to support other funds, it has a negative impact.

Vice Mayor Ellis had understood that the three funds that are projected to run at a large deficit are transit, golf and cemetery funds and that it would be taken out of fund balance. If we add those three funds together, that is over $10M projected to lose. Where is that reflected in the forecast on the general fund?

Mr. Hart responded that it is not reflected there.

Vice Mayor Ellis clarified that the ending fund balance for the general fund shows $18M, but it would be a lot less than that if we follow this. We are not subtracting it from the general fund, although theoretically that's what would happen.

Mayor Hallman clarified that staff went forward with updates on all of the funds because now we have to go through a budget balancing program for every fund, like we did with the general fund, and we have to remember that we now have to find $3.7M more in general fund reductions in order to get the general fund from bleeding on its own. If we get everything into balance, then we will still have general fund balances, but each fund needs to balance. We are, however, doing things now that other cities have not yet even thought about. We started our budget balancing process in December for the 2009/2010 year and we are down to about a $3.7M problem looking at the new projections. Other cities haven't even pulled together the new projections yet. We need to look at all of these things and recognize that when the golf fund loses $136K in 2010/2011 or $103K in 2009/2010, it has to come out of the general fund. It is important to keep in mind that the opposite doesn't happen. We can't take surpluses out of these enterprise funds and use them for the general fund. We have to balance the general fund because we don't have another place to get money. These other funds will hit the general fund if we don't get them balanced and we have to figure these things out in 2009/2010.

Councilmember Shekerjian asked if staff has looked at what will happen if we did nothing different in terms of those other funds, that is, if we just used our general fund balance to pay for those funds. When would we run out of our general fund balance?

Mr. Hart responded that he hadn't looked at that. Just based on the numbers we have discussed here, he would expect that within three to four years beyond this forecast the general fund balance would be exhausted.

Councilmember Shekerjian clarified that in 2013/2014, the general fund balance would be exhausted. As these other funds start to draw down, if we did nothing else and we just hold money from our general fund balance to support those deficits, at what point would we run out of money? This is assuming we are going to come out of this slump. Many forecasters are saying this will be another depression and we're not going to come out of it in a couple of years.

Mr. Hart responded that with respect to the general fund, and the transit and the performing arts funds in particular, we have already built into these numbers an economic recovery and despite that, projections still show deficits.

Mr. Meyer suggested that this is probably an appropriate point in which to transition this discussion. We cannot sit back and allow these other funds to run deficits to the point where they have to drain the general fund because the general fund is not that flush. We have to take action in the general fund to correct this. He proposed that staff look at the general fund and develop a series of solutions so that the $3.7M never happens. He has begun discussions with staff about approaches to take. For example, the other day the Transportation Commission met. Carlos de Leon gave a great presentation on this and Mr. Hart was there to talk to the commission about the seriousness of the transit fund and actions that need to be taken. The Transportation Commission agreed to, in concert with staff, spend their summer working on the transit fund so that by September, we will be in a position to return with some recommendations to the Council on how to address issues with the transit fund. In most of the funds, there are oftentimes both staff and constituent groups that can help us deal with that.

Mayor Hallman added that in some ways, each of the constituent groups is already forming with staff their own ad hoc budget and finance committees.

Mr. Meyer added that there are a lot of cities throughout the country who maintain cemeteries as city expense. There isn't a revenue source that exists any more because a cemetery is no longer drawing revenue in.

Mayor Hallman suggesting combining the golf operation with the cemetery operation and maybe it could work.

Mr. Meyer added there is some potential there, but the cemetery fund is not a huge dollar amount and obviously we would do whatever we can to both maintain that cemetery and also look at the prospect of revenue.

Mayor Hallman stated that before Mr. Meyer's tenure, the City went through consideration of off-loading the cemetery and it was a disaster. That is a location where everyone matters to somebody in the community, and we probably don't want to repeat that experience.

Mr. Meyer clarified that it is staff's intent to bring to Council within the next few months plans to address all of these funds. We must take action. Council understands that not taking action is the most disastrous choice even if we just look at the general fund. To draw down general fund at $3.7M per year would mean that after three or four years, we have drawn down about $11M off the fund balance. That is not an option. Staff will present an action plan for dealing with that, and it will probably be different than what we have done previously. Last fall, when staff was looking at $34M, that was a different prospect and a lot of decisions had to be made fast. We have had suggestions from employees and employee groups, and there are other items we just didn't have the latitude to look at earlier, but we can look at those things now. We need to take a second look at vacancies that are occurring and whether there are ways to wrestle down cost in those kinds of areas. Given the parameters Council has given previously, it would be his intention to develop a plan to address the $3.7M before we start the budget process again. This is not a prediction of our future, but is a forecast so that the future doesn't occur in the way the finance department has predicted.

Mayor Hallman stated that the forecast does show a recovery, however. It predicts a 3% increase in revenues in 2010/2011 and a 5% to 6% increase in 2011/2012. If that doesn't happen, then there's another series of problems. Let's not think this is trying to make it look worse than it is. He is concerned that the economy might

not recover quite as strong and it could be worse.

Councilmember Shekerjian clarified that her point in asking her question about the outcome was because it was apparent to her that we have to do something. Doing nothing would be unacceptable and all services would be put at risk.

Councilmember Arredondo recognized that staff spent much time to prepare this forecast.

CONSENSUS
- Staff to continue to provide updates to Council.
- Staff to work with constituent groups to look at action plans to address shortfalls.

Follow-up Responsibility: Charlie Meyer

Formal Council Agenda Items
None.

Future Agenda Items
None.

Mayor's Announcements/Manager's Announcements
Charlie Meyer acknowledged two important people who for the last three decades have provided strong leadership to the City. Gene Obis has been the Information Technology Department Manager and has been with the City for 30 years. He is retiring and he will be greatly missed. Dave Heck, current Deputy Manager of Information Technology Department, will be serving as the interim manager during the recruitment process. This will also be the last Council meeting for Tom Canasi who has served the city in a very able way for 29 years, and for the last part of his tenure has been Manager of the Community Services Department. He has much to be proud of. The city will miss both of those individuals.

Meeting adjourned at 7:20 p.m.

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Jan Hort
City Clerk