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**Minutes  
Tempe City Council  
Special Budget Session  
March 20, 2008**

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Minutes of the Tempe City Council Special Budget Meeting of Thursday, March 20, 2008, held at 6:00 p.m. in the Harry E. Mitchell Government Center, Municipal Building, City Council Chambers, 31 E. Fifth Street, Tempe, Arizona.

**COUNCIL PRESENT:**

Mayor Hugh Hallman  
Vice Mayor Hut Hutson  
Councilmember P. Ben Arredondo  
Councilmember Barbara J. Carter  
Councilmember Shana Ellis  
Councilmember Mark W. Mitchell  
Councilmember Onnie Shekerjian

*Mayor Hallman called the meeting to order at 6:20 p.m.*

## **CIP Work Session**

Presenters: City Manager Charlie Meyer; Financial Services Manager Jerry Hart

Jerry Hart summarized that staff has reviewed of all the CIP requests submitted this year and the proposed five-year Capital Improvement Program reflects staff's judgment of the needs to be considered for funding.

Mayor Hallman clarified that the CIP budget represents where capital dollars will be spent. Staff will return in later months to discuss the operations budget of the City. Under State law, the cities have strict requirements on how they spend their money. There are certain things within the CIP that require revenue from certain sources and the revenue must be spent only for the capital within those areas. General money is also available and can be spent on anything that is capital, and in some instances moved over to the operating budget. The new budget document that has been prepared by finance staff takes the CIP summary and all of the detail and ties it back to the sources of the funds.

Charlie Meyer added that department managers met several times and pulled this budget together as a group. However, in light of the financial conditions, Staff wanted to set some parameters in going forward that were consistent with typical financial times. Staff carried forward projects that had been previously authorized by the Council, and built in whatever necessary increases were needed in order to get those projects accomplished. These projects would have had impact beyond the year in which they were started. Projects ensuring maintenance of the City's infrastructure were added, as well as projects that

would be irresponsible not to add.

He added that the plan also includes a listing of projects of merit noted as “unfunded.” All the revenue sources are identified to be applied toward these capital needs. Staff has also evaluated the needs for a bond election. Every dollar identified has not been used and some sources have not been identified because they carried forward only those existing projects involving basic maintenance of infrastructure. Staff would seek direction as to whether the right mix of projects is presented and whether Council wishes to address a bond election.

Mayor Hallman clarified that assumptions were made to determine how much money is available to determine the size of this budget. Projects were added to the list, based on the criteria provided by carrying forward projects, adding dollars to make up for any shortfalls given the increases in construction, for example, and whatever new information would be required, maintenance and infrastructure additions that were necessary, and finally projects staff felt would be irresponsible not to bring forward. All of that totaled \$471,958,407, leaving about \$19M from two sources (\$7.7M in bonding capacity, including bonds with current authority and bonds that would require a bond election, as well as approximately \$12.7M in East Rio proceeds). He added that detail is also included about the operating impact (what it would cost to operate the facility after construction), and that number is shown as \$42.4M in operational costs. There are really three elements in this process: (1) start on the budget process, and from that, (2) determine what a bond election would need to be to fund the five-year plan and when that could occur, and (3) what, if anything, to do with the \$20M out of the \$471M.

Mayor Hallman added that the City does a five-year plan to know where we’re headed, in part because projects that we start today may take several years to complete, but also so that we are planning far into future about what our costs and needs will be.

Mr. Meyer began with the Water Program (page 9) that comprises a very large part of the entire CIP with very capital-intensive needs. The rates that the City Council ultimately sets for water and sewer will be determined by the kind of projects included. He suggested that some of what is listed in the Water and Wastewater Programs is as a result of regulatory requirements with specific timelines by which to meet them. Some of it is for replacement of aging infrastructure. There is also a small amount that allows for a little capacity expansion, in particular, areas where the City is redeveloping and lines need to be replaced. Very little of this would constitute expansion of the system. Water conservation, the balancing of water needs from one place to another, ground water systems vs. Central Arizona Project and the Salt River Project all have to be balanced. There is an element, for example, to include an additional ground well which would provide stability in times of drought or other reasons why water would be cut off.

Mayor Hallman clarified that this is the “New Production Well” on page 12, scheduled out for 2012/2013. This reflects priorities in terms of what is funded and what is unfunded, and things that are funded today, tomorrow, and further into the future because they are less important immediately.

Councilmember Carter asked about “Water Line Replacement and Repair.”

Don Hawkes responded that in the original budget document that came to Council in January, there was a portion of that particular project that was unfunded and there was a portion that was funded, and the total

shown is the difference between unfunded and funded.

Mayor Hallman explained that when Council was first introduced to the CIP, the consensus was that it didn't make any sense to have on the unfunded list costs associated with a project on the funded list. As a first step, staff was to identify where costs had gotten higher on a project since the last CIP. Council's consensus direction was to bring this all together and determine what a project will actually cost. There was essentially a full page of unfunded programs totaling \$93M in the Water Program, with only \$27M funded. Everything on the Water Program's unfunded and funded lists have been moved up to a funded program on the view that we need to recognize that this is infrastructure that is first necessary, but also much of it is now federally mandated coming forward. Water/Wastewater doesn't come out of the General Fund or the CIP, but comes out of the water and sewer fees.

Councilmember Carter noted page 9, "Financial Services – Customer Services Utility Billing System Upgrade." She asked if that has an IT impact.

Mr. Hart responded by referring to page 37 which shows an operating impact of approximately \$110K per year.

Mayor Hallman clarified that it will have a \$440K impact over five years and that has to be paid for in the O&M budget out of Water/Wastewater. It is not a general fund hit. Every capital item is analyzed for future operating impact and most of those impacts, with the exception of \$1.8M, come out of these enterprise funds.

Mayor Hallman continued that the bond election is a generalized document statement that has \$111,765,000 of currently authorized bonds with a need of \$339M in future bonds to fund this program. He would like to have this broken out by the different categories of bonds because water/sewer improvement bonds will be funded with the fees collected from water and sewer. The storm drains are shown as a GO bond item. It would be helpful for Council to know for its next meeting how these bonds are being floated by which set of revenues and even to schedule out the cash flow analyses for these. In the past, we have tried to have bond elections that have enough bonding authority so that it stretches for three or four years. In the bond election in 2006, he had to push staff very hard to increase the size of that bond election from the proposed \$157M to \$227M so we don't have to keep having elections about bonding. It would be helpful to have that cash flow analysis based on the current five-year CIP when we discuss when those bonds are needed, how much, and from what source of income they are being paid. People need to understand that the water/wastewater bonds are paid for only out of the water and wastewater fees and those fees are not being used for anything except to fund the water/wastewater companies that the City runs.

Mr. Hart added that in looking at page 41, except for water/wastewater, the debt service is borne by secondary property tax, GO bond funded. Additionally, any bonding issued for our transit are excise tax bonds. GO bonds are not issued and those bonds do not require voter authorization.

Mayor Hallman asked why we are not still showing the source of funding as a bond. They are excise tax bonds. We have revenue (sales tax) that we can also use to create a bond stream, and that was done for the Town Lake. The bonds for the Lake (\$.8M in bonds) were an excise tax bond. We used our sales tax

to support those bonds so residents weren't asked whether or not they wanted to have a bond election. Why do we not include that because it does eventually hit our balance sheet and shows up as bond indebtedness?

Mr. Hart responded that the purpose of this schedule was to focus on the GO bonds. Certainly, in this five-year plan, staff wasn't assuming any additional issue of transit tax bonds. That is still being assessed as we continue to analyze the timing of the federal reimbursement. In this plan tonight, with respect to the transit program, we are not identifying the need to issue more bonds.

Mayor Hallman suggested creation of a spreadsheet that breaks these out as GO bonds vs. water/wastewater improvement bonds, but also breaks it out over the five-year period. It would also be helpful to see all of the other sources of revenue and when that revenue will come in vs. when you are proposing to spend it. For example, scheduled payments for the East Rio sale are coming in and that can be pre-paid. In addition, there are deferred payment fees that are charged on that, which is really more like an income, not a capital flow. Over the last several years, we have talked about that as a source of funding that could be used for operating budget, particularly to pay for the operation and maintenance of the Lake. He would like to see more detail on all of those sources of funds and when they are actually coming in, as well as when they will be spent. We can look at any surplus amounts that are developing from those sources as well. We could move those monies around as part of the analysis of when we go to a bond election and what to fund with it. He thought the reason Mr. Hawkes had unfunded and funded projects was the assessment of how much money is coming into the water and wastewater companies through the fees. The discussion we had six or seven years ago was that we need to look at the capital surpluses that are within that budget as one of these items to see how much of it we should spend. We've set protocols for how large that surplus should be. We need to look at the impact of what we need to do for our fees. The assumption is set out here that our fees will increase over time based on the costs of running the water department, and that our residents can rest assured that we aren't trying to make some sort of profit here. We are charging just what we think it will take to build the water company and meet the needs of this community and to meet federal obligations. The surprise we've had since creating one of the most impressive master plans ever done (by the Water department back in 1999/2000) is that there have been huge changes in federal law that have imposed massive additional costs.

Mr. Hawkes added that the most critical item is called "Stage 2 Disinfection By-Products" and that is a regulation that comes into effect in 2012. We have to meet the minimum contaminant level of NCL and it is a very different structured way than we are currently doing.

Mayor Hallman clarified that we are currently meeting it, but they want us to do it another way. How much will that cost?

Mr. Hawkes responded that the two biggest projects on the water side are the Johnny G. Martinez Water Treatment Plant upgrades (page 9), \$45.5M in the next two years. The other is the South Tempe Water Treatment Plant Water Quality Improvement, another \$22.1M.

Mayor Hallman clarified that by federal mandate, we now have to spend in the next three years \$67M and now we have to make sure we get the funds to pay for that. The only way we can do that is by having our water and sewer fees cover those costs. The reason we bond for these kinds of things is because we

aren't going to turn around and ask our residents to pay \$67M in the next three years to cover these costs. We will borrow the money and schedule the payments of those bonds from this process. The public needs to recognize that if this Council goes forward with this project plan as proposed, most of the expense is being driven by a federal mandate that didn't exist six years ago. What is our current surplus capital reserve in Water and Wastewater and what are our current reserve requirements, based on our decision about what we need to keep in reserve to cover bonds?

Mr. Hart responded that the current reserve is approximately \$60M (both Water and Wastewater) and also the current reserve requirement is 100% of revenues. Revenues are currently running at about \$50M.

Mayor Hallman clarified that there is an excess reserve of about \$10M. Has that been built into this program?

Mr. Meyer responded that as we look at the rates over the period, we would be looking for rate proposals that would gradually increase so that we would be using up a portion of that fund balance in order to achieve this capital program with the added objective of bringing to Council. We now have the lowest water rates in the Valley and we want to stay competitive. We are trying to accomplish those multiple objectives in spending down the fund balance to accomplish this capital program and smooth those rates.

Mayor Hallman clarified that at this stage, staff is looking at this reserve and trying to mask the fact that as costs increase, the revenue line will increase, so that the reserve amount required will increase. At some point, revenues will be at \$60M and we will need \$60M, and so if we spend it today, we would just have to make it up in later years anyway. We want to smooth the rate adjustments. Keep in mind, that while we are still the lowest cost provider in the Valley, the other cities haven't gone through this analysis yet. This department has moved so quickly on these mandates that we are probably first in line addressing these. As the other cities catch up, their rates will have to change significantly to catch up to us.

Mayor Hallman summarized that on the five-year Water Program, there's consensus that this is acceptable. Before final adoption, it would be useful to see what the proposed rate adjustments will need to be. We put that in place several years ago based on the five-year capital plan, but it got stalled in one year, and then it had to be made up in the second year, so there was a double-year hit on our residents. It would be good for us to look at that and make sure we recognize we are comfortable with what those rates have to be to fund this program. Rates are set because of the cost of running the department, not the other way around.

Mr. Hart added that tentative adoption of the CIP is scheduled for May 22. Water/Wastewater and Financial Services are tentatively scheduled to come before Council with the rate proposals on June 5.

Mayor Hallman asked if the information could be provided sooner.

Mr. Hawkes responded that he will supply the information.

Mayor Hallman continued with the Wastewater Program. There is an unfunded list and a funded list, and this is an instance when we decided that sewer projects had to be funded upfront more than the Water projects in the initial cut. There were \$77.5M in funded and only \$11.3M in unfunded over five years. These have been rolled up into \$88M for that program.

Mr. Hawkes summarized that this is driven by three basic things: growth, regulation, and infrastructure repair and replacement.

Mayor Hallman added that the same issue exists here. The 91<sup>st</sup> Avenue Waste Water Treatment Plant (WWTP) represents a multi-city organization that recognized that the sewage should flow downhill to the west side of Phoenix at 91<sup>st</sup> Avenue.

Mr. Hawkes explained that additional capacity is currently being purchased to meet with the growth needs for the City. There is a significant rehabilitation effort on the two major interceptor sewer lines (the Salt River Outfall and the Southern Avenue Interceptor). They are capacity-constrained and there's a lot of money involved in fixing the capacity constraints on those two conveyance facilities.

Mayor Hallman asked that the information be broken out.

Mr. Hawkes agreed to provide that information.

Mayor Hallman asked where else do the federal mandates on the Clean Water Act appear.

Mr. Hawkes responded that it the only place. The rest of this is primarily infrastructure-related. The other big ticket item is the Southern Avenue Interceptor (SAI) Rehabilitation. That is the interceptor on the border of Mesa all the way through Tempe and is jointly owned by the City of Mesa and City of Tempe.

Mayor Hallman asked if that is the one that keeps causing problems at Southern and Priest.

Mr. Hawkes responded that the problem has basically been fixed. This item involves the sewer line that was installed with enough concrete on the line so it would last forever. In reality, that generated high levels of sulfite gases which turns into sulfuric acid which has eaten the line down to the point that some of the rebar is showing. This project will do cured-in-place lining. Some of the sections have already been done and this will complete the line.

Mayor Hallman added that on both of these, there is a significant amount of infrastructure replacement. Many portions of our City have thirty to forty-year-old infrastructure so there is a lot of effort to rebuild infrastructure. He asked for the proportion of this that is making up for lost time.

Mr. Hawkes responded that there are some specific replacement projects, primarily on the Water side. On page 9, some specific projects have been identified, such as Orange/Lemon, Margo/Geneva, 22<sup>nd</sup>/24<sup>th</sup> (Hardy/Roosevelt). These are all projects where the infrastructure is very old and undersized.

Mayor Hallman summarized that subject to getting the information on how we are going to schedule the fees and costs associated with it, the Wastewater portion is acceptable. He asked about the development fees. This is important to identify because we have to buy some additional capacity at the 91<sup>st</sup> Avenue facility because of growth, and this shows \$5.6M in development fees. He asked Mr. Hawkes to describe that revenue source.

Mr. Hawkes responded that development fees are collected from all new developments, and those fees were raised through Council action last year. It is staff's intention to come back on an annual basis to make sure those are adjusted so that growth is paying for growth.

Mayor Hallman asked if it is his sense that the \$5.6M pays for cost of growth that we've had and are going to have at the 91<sup>st</sup> Avenue Wastewater Treatment Plant?

Mr. Hawkes responded that per their development fee study, it is scheduled to do that. Sometime later this year staff will come back to look at that.

Mayor Hallman added that this Council has worked very hard to identify and make sure that new projects and growth pay for themselves and that our current residents aren't expected to do that.

Mayor Hallman addressed the Golf portion. Golf Course Improvements are shown on pages 15 and 16. We have a peculiar problem with Rolling Hills because it needs about \$2M to rework the water system to use canal water rather than treated water. The system needs to be rebuilt and the difficulty is that Rolling Hills is increasingly losing money. It is hard to justify making anyone else pay for Rolling Hills' golf needs.

Councilmember Carter asked Mr. Hart to review the cost of that project and if we bonded for it, how long it would take to pay for it, and would it then be cost effective or do we need to look at privatizing that course.

Mayor Hallman added that there might also be an option to find a public partnership. Phoenix has gone to a charitable organization to help operate a course, and we certainly have our partnership with Papago and we have ASU that might be a good partner on golf.

Councilmember Carter suggested scheduling a CCD COW meeting to discuss this.

Mayor Hallman agreed that after the budget cycle might be a good time to discuss the Papago Park piece as well and how we could deal with Rolling Hills in particular. Ken MacDonald has a similar issue. For years we've wanted to see replacement of the club house. The Golf Committee has again said their highest priority item would be a new clubhouse operation at Ken MacDonald and that's about a \$5M to \$6M problem, except that Ken MacDonald is breaking even and carrying its cost, but it has no way to generate enough money to pay bonds to build that clubhouse.

Mr. Hart added that approximately four to five years ago as a part of the CIP budget that Council adopted, it appropriations were included for irrigation system replacement at Rolling Hills in the amount of about \$2M. Ken MacDonald clubhouse renovation was also in the budget, but given the significant financial challenges facing the golf fund at that time and since then, we did not receive that. In the analysis on the debt service cost associated with going forward with both of those projects and declining revenues in the golf fund, it was clear that the golf fund on its own would not be able to support current operations, as well as the debt service associated with those projects.

Mayor Hallman directed staff to plan for a CCD COW meeting in the Fall and start analyzing the golf course operations and see what kind of opportunities we might have to get them in a better position, not only to operate effectively, but maybe drive the capital that could get them back up to speed. Phoenix has been

faced with a spiraling problem with Papago and that's why they finally put it out for RFP to find someone else to operate it, and put in some capital and make it work. What does the \$50K per year get us?

Mark Richwine responded that it is really there for emergency purposes. If there was some unanticipated expense, it provides the ability to finance that over the long term so we can absorb some minor costs on an annual basis in the Golf operating fund.

Mayor Hallman clarified that this is not a GO bond, for example, or bonded item. It would be coming out of that enterprise fund. Would this be treated as an excise bond?

Mr. Hart responded that historically, we have financed the golf improvements with excise tax bonding. That is why this is listed here. With \$50K per year, we aren't talking about a lot of money. More than likely, he would explore with the City manager some opportunities to do some internal financing much like what we did with the old Performing Arts Center rather than going to bond for this small amount.

Mayor Hallman added that Councilmember Mitchell asked if we could fund things for the Golf enterprise with GO bonds. We can always take secondary property tax bonds and spend them on any capital item. It has to be capital. The property tax can only be used to pay the bonds. We can't even save up secondary property tax and then pay directly. You have to sell the bonds, take the proceeds, and pay the bond back with the secondary property tax.

Mr. Hart added that Council policy for all of the enterprise funds, including Golf, is that the user fees recover 100% of the cost, including any associated debt service.

Mr. Meyer added that in looking at the five-year plan, it needs to be obvious that the concept of the Golf Fund funding itself through user fees is not going to work. We're not making the kind of capital investments that are needed and we recognize that if we make the capital investment, it's not going to increase rounds of golf sufficiently to pay those back. We have to look at some other concept. We will either have to be subsidizing golf from some other source or go to some other kind of plan.

Mayor Hallman added that what we do know from the income spreadsheets that we get is that Rolling Hills is losing money, so right now Ken MacDonald Golf Course is subsidizing Rolling Hills to a fairly significant amount, \$200K, so it's not that Ken MacDonald couldn't generate the capital that would fund a clubhouse, it's that it is currently paying for the operations of Rolling Hills at the expense of Ken MacDonald. That's part of the conversation that we should have. We need to break them apart and let Ken MacDonald achieve its level of success, but we need to solve the bigger problem of Rolling Hills.

Mayor Hallman asked if there were further questions that would help in our next meeting in dealing with Transit, and the Rio Salado program funded out of a combination of the fund generated from the Rio Salado, as well as the general fund.

Councilmember Mitchell noted that Mr. Meyer asked if Council wished to direct staff to prepare a recommendation for bond election.

Mayor Hallman responded that it is necessary to find out what our programs are before we decide about



the bond election.

Councilmember Shekerjian added that when she looked over the CIP project descriptions, she noticed there were technology requests embedded in different departments. She is concerned about paying debt on something longer than the item will exist. In terms of bonds, are there shorter term bonds that we could be using?

Mayor Hallman asked if there is a way to take all of this data and stratify it and show us which things in here are not 20-year items, and should we be looking at different ways to fund those things so they are not funded with capital. If we split those out, do we have cash flow to fund those without using a bond? Moving bond money to longer term items and taking the cash we have and funding cash items with that and at some point getting out of the capital program things which really are cash replacement items which should be on the O&M side.

Mr. Hart agreed to do that.

Mayor Hallman added that it would be useful to see all the different sources of funding and how that is scheduled to come in over the five years. We know there is \$42.5M coming in on the Rio East sale. There's not \$42.5M total in this budget. His sense would be that some of that money has already been identified and spent in the current year. He would like to know what that was spent on and anything that is a long term project. For example, Council took action to go forward with the parking garage and pay for it. That's nowhere in the CIP and yet it is more than a one-year program. He would like to know any other project that has more than one year cost associated with it.

Mr. Hart responded that concerning the parking garage, it was fully funded this year.

Mayor Hallman added that the money was identified, and it is sitting in an account, but it is not something we are buying over one year. We are paying for it over a couple of years.

Mr. Hart responded that the parking garage is not in this five-year plan. From the current year, there were \$7M of appropriations given to the project, but on February 21<sup>st</sup>, there was an additional \$14M given to the project and appropriations have been given all in this year. That's why you don't see any further appropriation to the project.

Mayor Hallman clarified that we schedule the payments in the five-year CIP to reflect that this is when the money will come in and when it will be spent. In this case, you are treating it as fully funded even though the payments will be made over more than one year. He didn't know why we didn't treat that action as a precursor of this five-year CIP, that whatever money will be spent this year is spent this year, and some can be spent next year and it was really a two-year CIP on that one item. He would like to get the information on that and any other project that is a multi-year project. He would like that in a spreadsheet. Mondrian is another example. It shows up in this spreadsheet at \$10.8M, but the contract has a bigger amount associated with it.

Mr. Hart responded that those payments will be received over a 15-year period with a lump sum of about \$3.5M at the end. What you see here is the funding source that represents the net present value as we

calculate it. We are using our current discount rate.

Mayor Hallman stated that he would like to see what those Mondrian payments as a cash flow item are scheduled out as and any other source of net income we have.

Mayor Hallman further directed that enough CIP time be scheduled to finish these items.

*Meeting adjourned at 7:30 p.m.*

I, Jan Hort, the duly-appointed City Clerk of the City of Tempe, Maricopa County, Arizona, do hereby certify the above to be the minutes of the City Council budget meeting of March 20, 2008, by the Tempe City Council, Tempe, Arizona.

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Hugh Hallman, Mayor

ATTEST:

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Jan Hort, City Clerk

Dated this \_\_\_\_\_ day of \_\_\_\_\_, 2008.