Memorandum

Finance and Technology Department

Tempe

Date: February 2, 2012

To: Mayor and Councilmembers

Through: Charlie Meyer, City Manager

From: Ken Jones, Finance and Technology Director

Subject: Long-Range Financial Forecast

During the February 2, 2012 City Council Issue Review Session, I will present the City's Long-range Financial Forecast. I have attached a copy of the Powerpoint presentation that will be used. This memo provides a summary of the topics to be covered during that presentation, as well as a page containing the assumptions that are built into our forecast models.

In addition, this week's Friday Packet includes the Budget Office's Quarterly Financial Performance Report, which provides information on financial trends that prove helpful in gauging current performance as well as providing context for adjustments to future growth projections.

As always, please feel free to contact me prior to the City Council meeting if you have any questions about the information provided.

Purpose of the Last Long-range Forecast

The Long-range Financial Forecast is an integral part of the annual budget process. It provides context for current budget decisions by presenting 5-year projections for all major operating funds, based on current policies and anticipated conditions throughout the forecast period. Councilmembers are encouraged to provide broad fiscal direction, which will be incorporated into the City Manager's recommended operating and capital budgets for fiscal year 2012-13. More specific City Council direction is welcomed during the formal reviews of the Proposed Operating Budget and Proposed Capital Improvement Program Budget.

Fund Analyses

During the presentation of the Long-range Financial Forecast, I will review summaries of each fund's 5-year revenue and expenditure projections, as well as the anticipated fund balances. The following pages contain some commentary on significant issues that have had, or are expected to have, an impact on each fund. These same notes are contained on the notes pages of each Powerpoint slide for your reference.

General Fund:
Our budget-balancing approach for the General Fund has not changed since we updated the City Council on September 8, 2011. Based on current projections, we should be able to eliminate the current structural deficit and overcome the June 2014 expiration of the .2% temporary sales tax by making recurring 3% adjustments to the projected annual budgets for each of the next four years.

However, as we discussed previously, in order to maintain a stable budget going forward, the required budget adjustments should include limits to the growth of personnel costs, which are projected to outpace revenue growth in the future, based on current City personnel policies. Therefore, the City Manager has been working with representatives from the Six-sided Partnership to examine our current policies and recommend changes for the 2013-14 budget, when current employee group MOU's expire.

For 2012-13, the senior management team has been working with the City Manager to identify inefficiencies in our current General Fund budget in order to make the necessary 3% adjustments. So far, adjustments totaling $3.2 million have been identified without impacting service delivery. We expect to identify the remaining $2 million in adjustments before the City Manager presents his proposed budget to you in April.

Following are adjustments that have been made to the General Fund forecast since our September 2011 update:

- We have maintained the forecast for local sales taxes , which are performing very close to budget in the current year;
- Revenue from public safety fines/fees have been revised downward, mainly due to the elimination of the City's photo enforcement contract;
- Cultural and recreational and engineering revenues have been revised upward due to better-than-expected performance in the first half of the current fiscal year;
- Interest revenue projections have been reduced throughout the forecast period, based on the recent Federal Reserve commitment to maintain the Federal Funds Rate at 0% to .25% until late 2014;
- Employer contributions to the Public Safety Personnel Retirement System (PSPRS) have been increased slightly for fiscal year 2012-13, based on recently-updated actuarial reports provided by PSPRS staff;
- Retiree health insurance growth rates have been increased based on plan changes approved earlier this fiscal year.

Transit Fund:
In fiscal year 2010-11 the City Council approved a 3-year budget-balancing plan for the Transit Special Revenue Fund that called for approximately $14 million in recurring adjustments. A pay-down of approximately $50 million in outstanding bonds is already planned for 2012-13, which will reduce annual debt service payments by approximately $1.5 million. We have identified, in our long-range model, a need to make a final adjustment of approximately $3 million in order to stabilize the fund. Public Works Transit management will be presenting their plans for adjusting the Transit Fund to the City Council later this fiscal year.

Highway User Revenue Fund (HURF):
The main source of revenue for the HURF Special Revenue Fund is the diminishing Highway User Tax, distributed by the State of Arizona, which can only be used by the City for street/highway costs. In fiscal years 2008-09 and 2009-10, the HURF Fund was experiencing deficits of almost $3 million per year. Public Works management began making expenditure cuts in 2010-11. In 2011-12, we began phasing-out the annual $2.77 million transfer that was being made from the HURF Fund to the Debt Service Fund. The transfer was reduced to $1.55 million this year and will be reduced to $.5 million in 2012-13 before being completely eliminated in 2013-14.

By eliminating these transfers to the Debt Service Fund, we are moving to a more appropriate model of having true streets-related capital projects funded with bonds, repaid by secondary property taxes from the Debt Service Fund, and paying for street-related costs that can more reasonably be categorized as operations and maintenance from the HURF Fund, which is projected to be healthy again.

Golf Fund:
After undergoing a complete change in its operating model in 2011-12, the Golf Enterprise Fund is expected to overcome the anticipated short-term expenditure increases necessary to implement the new model, and move toward stability in 2012-13. Staff will be closely monitoring golf operations to ensure continued stabilization of this fund.

Water/Wastewater Fund:
The Water/Wastewater Enterprise Fund model included in the Long-Range Financial Forecast assumes the continuation of planned rate increases that were approved as part of a long-term strategy to comply with water quality regulations being imposed by State and Federal Agencies on all water utilities. Rate increases have been kept to a minimum by spending-down the fund balance in a measured fashion to reduce the balance to approximately 6 months of operating revenues from what was once equivalent to a full year's revenue. Applying this strategy, the Water Division of Public Works has maintained user fees at or near the lowest in the Valley, while complying with all State and Federal standards.

Solid Waste Fund:
The Public Works Department is in the process of conducting a rate study for solid waste user fees in conjunction with efforts to reduce costs. The model displayed in our Long-Range Forecast does not include any rate changes or expenditure reductions because there is no City Council-approved plan at this point. The forecast shows the Solid Waste Enterprise Fund suffering a slight deficit in 2012-13 if no changes were made. We anticipate the Public Works Department presenting the cost of service and rate design study to the City Council in the spring of 2012.

Cemetery Fund:
In recent years the costs of Public Works' efforts to maintain the City's cemetery were moved to the General Fund for accounting purposes. Because this is considered an Enterprise Fund, we have moved those costs back into the fund. An enterprise fund doesn't necessarily need to be self-supporting, but we are required to account for revenues and expenses of the fund correctly.

Besides the $60,000 to $70,000 annual cost of maintaining the cemetery, the fund also has a debt service payment of approximately $190,000, which will expire at the end of fiscal year 2025. Since the operating revenues are not expected to generate more than about one-half of the annual operating costs, we should consider two alternatives:

- Continue to operate the cemetery as an enterprise and budget a transfer from the General Fund to cover the annual deficit until new revenue streams can be identified; or,
- Absorb the operations of the cemetery into the General Fund and eliminate the enterprise fund.

Performing Arts Fund:
Over 90% of the revenue deposited in Performing Arts Special Revenue Fund is from the City's .1% Arts Sales Tax. The remainder of the revenue is generated by users of the Tempe Center for the Arts.

Revenues are not sufficient to cover current expenditures and the fund balance is expected to be depleted by 2013-14. A cumulative deficit of approximately $2.5 million is expected to build through 2016/17, when a partial debt payoff will result in a $2.5 million reduction to annual debt service costs, generating an annual surplus of approximately $1.5 million through December of 2020, when the Arts Tax expires and the remaining debt is paid-off.

Financial Services staff members are working with Community Services management to explore alternatives for the Performing Arts Fund.

Debt Service Fund:
The Debt Service Fund is used to account for payments of tax-supported debt from Secondary Property Taxes, in support of the City's Capital Improvement Program. As a result of last year's implementation of the Property Tax Stabilization Plan, we are gradually spending-down the fund balance in the Debt Service Fund to between 4% and 8% of outstanding tax-supported debt, as approved by the City Council.

A detailed analysis of this fund and the City's debt policies is planned for a future presentation to the City Council as part of our Capital Improvement Program Budget (CIP).

Forecast Growth Rates - February 2, 2012

Revenues	**FY 11/12**	**FY 12/13**	**FY 13/14**	**FY 14/15**	**FY 15/16**
Sales Tax Revenue Base Growth	1.9%	3.4%	4.4%	5.4%	4.6%
Total Sales Tax Rate	2.0%	2.0%	2.0%	1.8%	1.8%
General Fund	1.4%	1.4%	1.4%	1.2%	1.2%
Transit Fund	0.5%	0.5%	0.5%	0.5%	0.5%
Performing Arts Fund	0.1%	0.1%	0.1%	0.1%	0.1%
Property Tax Levy Growth	2.5%	2.6%	2.8%	2.8%	2.8%
Property Tax Rate	$1.79	$2.01	$2.06	$2.07	$2.06
Bed Tax Taxable Sales Growth	2.9%	3.8%	3.8%	3.7%	3.6%
Bed Tax Rate	5.0%	5.0%	5.0%	5.0%	5.0%
City Population Growth	0.2%	0.2%	0.2%	0.2%	0.2%
State Population Growth	0.5%	1.0%	1.6%	2.0%	2.1%
State Shared Income Tax Growth	-15.3%	21.0%	7.6%	6.3%	7.5%
State Shared Sales Tax Growth	-3.3%	4.7%	6.3%	8.0%	6.8%
State Vehicle License Tax Growth	-7.7%	2.1%	1.7%	1.9%	2.3%
Building and Trades Growth	16.4%	-25.1%	12.4%	20.0%	15.0%
Cultural and Recreational Growth	46.7%	2.2%	2.6%	2.4%	2.1%
Fees, Fines, Forfeitures Growth	-5.6%	2.2%	2.6%	2.4%	2.1%
Business Licenses Growth	0.2%	0.2%	0.2%	0.2%	0.20%

Expenditures	**FY 11/12**	**FY 12/13**	**FY 13/14**	**FY 14/15**	**FY 15/16**
Salary Growth	0.00%	4.50%	4.00%	4.00%	4.00%
FICA (% of payroll)	7.65%	7.65%	7.65%	7.65%	7.65%
State Retirement (% of payroll)	10.1%	10.5%	10.9%	11.0%	11.3%
Police Retirement (% of payroll)	24.2%	29.9%	32.1%	37.0%	37.0%
Fire Retirement (% of payroll)	27.2%	32.9%	36.1%	41.5%	41.5%
Health, Dental, Life Actives	3.9%	10.0%	10.0%	10.0%	10.0%
Health, Dental, Life Retirees	37.0%	19.0%	10.0%	14.0%	16.0%
Mediflex growth	0%	0%	0%	0%	0%
Other Fringe Benefits Growth	0%	0%	0%	0%	0%
General Inflation	1.3%	2.0%	2.4%	2.2%	1.9%
Electricity Inflation	3.3%	3.3%	3.3%	3.3%	3.3%
Water & Sewer Inflation	7.0%	7.0%	7.0%	7.0%	7.0%
Gasoline Inflation	2.7%	-3.8%	4.1%	2.4%	0.3%
Private Employment Cost Index -CY Basis	1.9%	2.0%	2.2%	2.3%	2.4%

Other Assumptions:

Property Tax Levy growth includes new construction

OPEB Advance Funding and HRA deposits are suspended through FY 2011/12.

Legislative implementation of Public Safety Retirement Board proposal in FY 12/13-FY 15/16.

No Legislative change to General Fund state shared revenue sharing percentages

Assumes future electricity budgets will not exceed growth rate in APS-ES proposal