

MEMORANDUM

TO: Mayor and Council
THROUGH: Andrew Ching, City Manager
FROM: Mark Day, Municipal Budget Office Director
Rosa Inchausti, Strategic Management and Diversity Office Director
Ken Jones, Deputy City Manager, CFO
DATE: February 21, 2019
SUBJECT: Long-Range Financial Forecast Update, Strategy Tool for Aligning Resources for Tempe (S.T.A.R.T) Prioritization Results, and Performance Measures Update



PURPOSE:

To provide an update to the City's long-range financial forecast and to review the results of the Strategy Tool for Aligning Resources for Tempe (START), both of which will be presented during the 2/21/2019 Work Study Session.

RECOMMENDATION OR DIRECTION REQUESTED:

The City Council should provide comments and suggestions regarding the City's long-range financial strategies. Also, the City Council will be asked to provide consensus on the performance measures that should be accelerated in upcoming budgets, both operating and capital (CIP), based on the results of the input provided by the City Council using the START tool.

CITY COUNCIL STRATEGIC PRIORITY:

Maintaining a long-range financial forecast and eliciting City Council feedback on financial policies relate directly to City Council priority #5 – *Financial Stability and Vitality* and are critical strategies to achieving the following performance measures:

- 5.4 – Maintain the highest general obligation bond (credit) rating
- 5.5 – Maintain a General Fund unassigned fund balance at a minimum of 20% and maximum of 30% of General Fund revenue.

BACKGROUND INFORMATION:

The last long-range financial forecast was presented to the City Council on November 1, 2018. The START tool was introduced to the City Council on November 1, 2018 with the results of the input provided in a December 14, 2018 Friday packet memo.

FISCAL IMPACT or IMPACT TO CURRENT RESOURCES:

No financial commitments will be made during this presentation to the City Council; only direction for budget development and long-term financial planning will be elicited.

ATTACHMENTS:

PowerPoint Presentation
START Tool Input Memo and Results
Strategic Priorities Performance Measures Update

Introduction

This is the final update to the long-range financial forecast for the City's major operating funds before the development of the FY 2019/20 budget. We will use the projections contained in this forecast to establish parameters for current budget decisions and to plan for future operating and capital needs. Although projections of future revenues and service costs can never be exact, the models utilized by our Budget Office are constantly improving and have proven to be good indicators of potential resources and costs.

General Economic Conditions and Projections

The City's overall financial condition continues to be strong and stable. Our five-year forecast for revenues remains positive, anticipating moderate growth in taxable sales and other revenue sources. Commercial and residential development activity has provided a big boost to construction sales tax revenues in recent years and is projected to decline slightly in the latter years of the forecast. Increases in other local taxes should provide for a stable local tax revenue stream for the remainder of the current fiscal year and into FY 2019/20, with slowing growth projected in the subsequent years of the forecast. An economic downturn is inevitable at some point in our cyclical economy and we continue to watch economic trends for indications of any economic slowdown. We have not included any recessionary trends in the individual fund forecasts. We project healthy fund balances in the General Fund throughout the forecast period, which would help overcome moderate recessionary trends.

Potential Budget Challenges

Current, long-term memoranda of understanding with our four employee groups have stabilized forecasted personnel cost increases, with fair and steady salary increases projected over the forecast period. However, contributions to the Public Safety Personnel Retirement System (PSPRS) continue to be one of the most volatile factors in projecting annual personnel costs. We anticipate further reductions in the assumed interest earning rate for PSPRS, which will lead to continued declines in the funded status, creating ongoing increases to the minimum employer contribution rate. We believe our estimates of future contribution requirements are realistic and that our forecast models accurately portray the City's ability to make the required contributions while maintaining current service levels throughout the forecast period. Per Council direction, we will be utilizing actuarial services to determine the funded obligation of Tempe's Public Safety Retirement System plans and to develop a public safety funding policy, as required by recent legislation.

The forecast assumes that future State-shared revenue and Highway User Revenue Funds (HURF) revenue will continue to be distributed per current statute. Any legislative changes could impact the amount of funding received in future years.

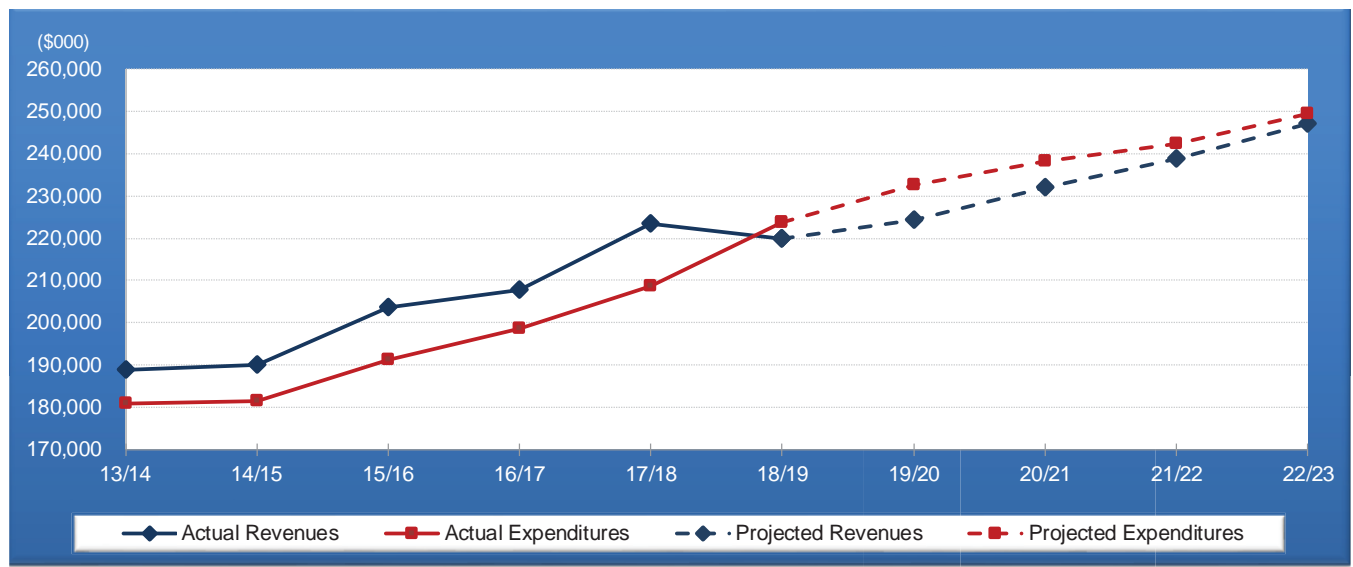
Recent Issues Impacting the Forecast

- 1) The level of development activity in the City has not diminished in FY 2018/19 at the rate we anticipated in recent forecasts. Revenue related to building permits, plan reviews and other development-related activities continues at a rate well above normal.
- 2) Based on Council direction, the General Fund forecast model includes \$2.0 million for FY 2019/20 and \$1.5 million for FY 2020/21 in net expenditures to fund the Tempe PRE program.
- 3) The Emergency Medical Transportation Fund has been added to the forecast.

Forecast Model for the General Fund

Following is the 5-year forecast model for the General Fund

General Fund

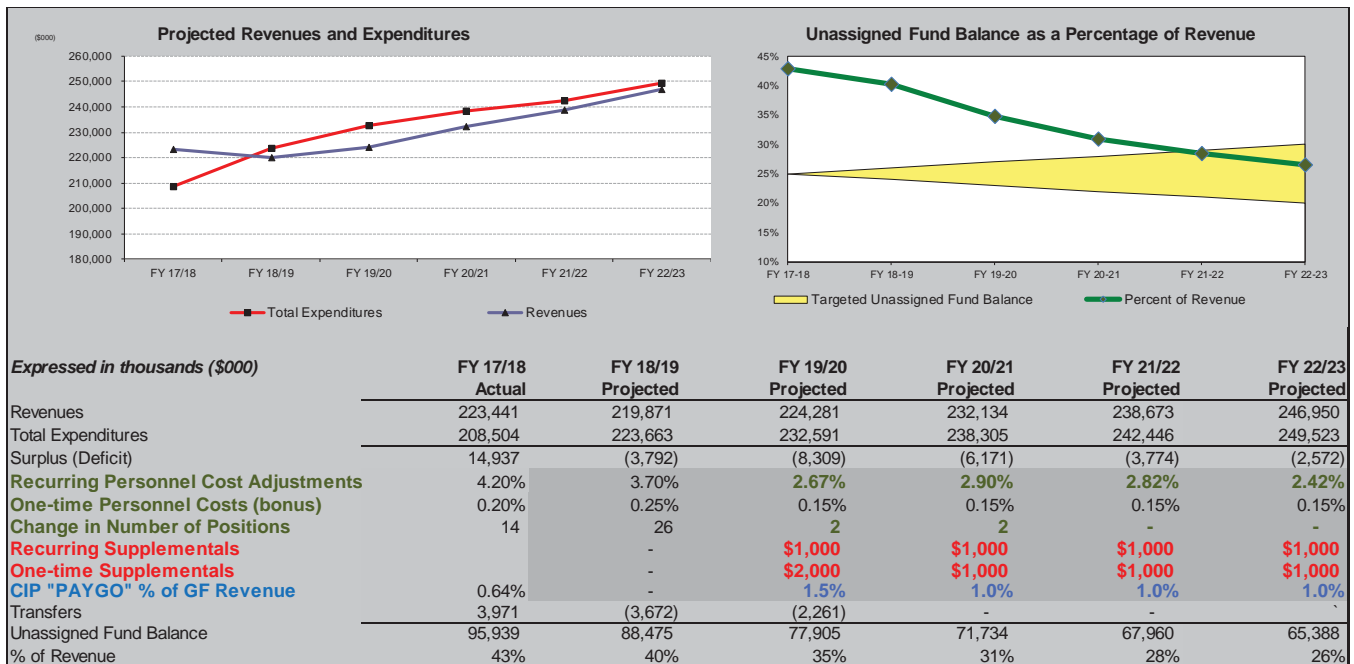


	13/14	14/15	15/16	16/17	17/18	18/19	19/20	20/21	21/22	22/23
	Actual	Actual	Actual	Actual	Actual	Projected	Projected	Projected	Projected	Projected
Revenues (\$000)										
Local Taxes	111,874	107,921	110,770	116,594	123,272	127,195	131,595	136,605	141,686	146,999
Intergovernmental	38,155	40,572	41,473	44,672	48,404	48,933	52,275	55,100	57,351	59,413
Bldg & Trades/Plan & Zoning	10,495	10,266	9,947	9,079	12,632	10,443	7,123	7,294	7,462	7,630
Cultural & Recreation	6,462	6,831	6,970	7,350	7,170	6,044	6,854	7,656	6,301	6,550
Fines, Fees & Forfeitures	8,190	8,436	8,580	8,095	6,839	5,234	5,203	5,417	5,633	5,856
Business Licenses	1,703	1,616	1,597	1,165	2,184	1,073	1,048	1,073	1,098	1,123
Interest Income	356	578	934	1,215	2,008	1,700	2,400	2,622	2,584	2,627
Franchise Fees	3,311	3,441	4,519	3,433	3,576	3,334	3,604	3,691	3,776	3,861
Other Revenue Sources	8,360	10,325	18,693	16,227	17,355	15,913	14,179	12,677	12,782	12,892
Total Revenues	188,905	189,988	203,482	207,829	223,441	219,871	224,281	232,134	238,673	246,950
Expenditures (\$000)										
Personnel Costs	143,609	144,246	152,638	160,228	168,001	178,518	183,529	189,263	194,771	199,652
Materials & Supplies	8,896	9,046	8,140	8,326	8,827	9,334	9,229	9,442	9,621	9,791
Fees & Services	28,421	26,352	28,509	28,465	32,494	35,671	35,218	36,119	34,247	35,088
Travel & Training	337	423	546	751	689	923	756	774	792	809
Non-Deprmtl/Loan Repayment	2,192	1,867	1,391	1,586	1,910	2,708	2,364	2,421	2,476	2,532
Capital Outlay	1,500	2,385	2,727	3,016	4,378	5,075	2,737	3,081	2,627	2,973
CIP - Cash & Muni Arts Funding	-	2,821	3,239	3,420	1,343	2,472	2,445	2,468	2,628	2,781
Community Facilities District	134	(92)	(170)	(242)	(278)	(401)	(458)	(492)	(526)	(562)
Special Assessments	1,006	1,016	1,017	1,016	1,028	1,030	1,030	1,030	1,030	1,030
HURF CIP Funding	626	1,150	1,215	1,116	1,500	-	1,500	1,500	1,500	1,500
Tourism & Convention Bureau	2,130	2,160	2,182	2,300	2,476	2,645	2,680	2,730	2,780	2,780
Internal Services/Adjustments	(7,895)	(10,023)	(10,311)	(11,447)	(13,864)	(14,312)	(14,802)	(15,352)	(15,886)	(16,321)
Additional CIP Paygo	-	-	-	-	-	-	3,364	2,321	2,387	2,470
Recurring Operating Supplementals	-	-	-	-	-	-	1,000	2,000	3,000	4,000
Nonrecurring Operating Supplementals	-	-	-	-	-	-	2,000	1,000	1,000	1,000
Total Expenditures	180,956	181,351	191,123	198,534	208,504	223,663	232,591	238,305	242,446	249,523
Net Operating Surplus / (Deficit)	7,949	8,637	12,359	9,295	14,937	(3,792)	(8,309)	(6,171)	(3,774)	(2,572)
Interfund Transfers	5,326	495	(5,383)	(4,276)	(2,593)	-	-	-	-	-
Change to Assignment of Fund Balance	(2,287)	673	(1,839)	(3,876)	3,971	(3,672)	(2,261)	-	-	-
Unassigned Fund Balance	63,540	73,345	78,482	79,624	95,939	88,475	77,905	71,734	67,960	65,388
Unassigned Fund Balance as a % of Rev.	34%	39%	39%	38%	43%	40%	35%	31%	28%	26%

The figure above provides detail for budgeted accounts within the General Fund, with "sample" budget decisions incorporated from the interactive model appearing below:

- 1) Projected growth in annual compensation represents the projected contributions to retirement systems, salary step increases included in current MOUs, projected market adjustments to the salary ranges and increases to health/dental/life insurance plans as provided in the detailed assumptions on the last page of this report.
- 2) Recurring and non-recurring supplemental budget increases have been included in each year of the General Fund model, but the actual uses of the additional funding have not been determined.
- 3) Pay-as-you go (cash) funding for capital improvement projects (CIP) have been included. A \$1.5 million per year transfer from the General Fund to the Transportation fund for street maintenance projects was statutorily mandated in the past. That mandate has been eliminated but we have continued to budget the transfer to fund approved street projects. The actual amount of the transfer will be based on Council direction for acceleration of the pavement quality index performance measure and the Transportation Division's capacity to complete street repair and maintenance projects.

The forecast includes a measured spend-down of fund balance without jeopardizing the stability of the fund in the future. The projected growth variables displayed in the model are not recommendations by management at this point, but examples to demonstrate how projected resources could be allocated in future years and still comply with the fund balance policy. The graph on the right side of the figure shows how the unassigned fund balance stays above the policy minimum of 20% throughout the forecast period, as required by policy and is projected to be nearer the top of the policy range, as directed by Council.



This forecast for the General Fund shows slightly decreasing revenue projections from the last forecast. However, the current fund balance has been bolstered by several non-recurring revenues and the elimination of the restriction on certain lease and land sale proceeds which added capacity for growth.

Included in projected revenues, but excluded from unassigned fund balance, are the anticipated reimbursements from the Arizona Sports and Tourism Authority for upgrades to Diablo Stadium. Reimbursements to Tempe have begun and are projected to total \$11.5 million during the forecast period. The City Council directed staff to restrict this cash and exclude it from the General Fund Unassigned Fund Balance until a process is completed to determine what future Diablo Stadium improvements might be necessary to maintain the ballpark at Major League Baseball standards. A Diablo Stadium Master Plan study is funded in the current year CIP.

Forecast Models for Individual Operating Funds (other than General Fund)

Listed below are summary comments regarding the status of the City's other major operating funds. As there have not been significant changes to these forecasts since the November 1, 2018 presentation, the individual forecast models are not displayed.

Water/Wastewater Enterprise Fund

The Water/Wastewater Fund is stable with no water or wastewater increases for 2019. Staff will be updating the comprehensive rate study model to determine the timing of future rate adjustments and ensuring a planned draw down of fund balance in a sustainable manner.

Solid Waste Enterprise Fund

As with the November 2018 forecast, deficits are projected for every year of the forecast. The Solid Waste division continues to closely monitor its operating revenue and expenses and has taken steps to improve efficiency. The division continues to be concerned about the solvency of the commercial operation and continues its efforts to retain customers and improve the efficiency of the commercial operations.

Golf Enterprise Fund

The fund projects modest operating deficits during the forecast period due to green fees revenue increasing at a slower rate than anticipated. Staff anticipates future green fee increases and operational efficiencies will be necessary to return the fund to operating surpluses. In the future, large golf course capital projects will be funded with bond funds, repaid with secondary property taxes. This will help to stabilize the Golf Fund and will require future bond authorization from voters.

Emergency Medical Transportation Enterprise Fund

The Emergency Medical Transportation program recently completed its first full year of operations. Revenues are in-line with projections. Two additional ambulances were added in January 2019 with additional ambulances will be placed into service in the next several years as logistics allow.

Transit Special Revenue Fund

The Transit Fund is stable, and the forecast includes a measured spend-down of fund balance without jeopardizing the stability of the fund in the future. Operating costs for the streetcar were included in the projections as well as pay-as-you go (cash) funding of CIP projects. To ensure fund stability, future Transit Fund priorities will be focused on maintaining existing assets and minimizing the amount of system expansion or grant-funded projects that have recurring fiscal impacts to the fund.

Transportation (HURF) Special Revenue Fund

The Transportation Fund receives a majority of its funding from the State-shared Highway User Revenue Funds (HURF). HURF collections are projected to be slightly less than the last forecast. Future HURF monies are subject to pending legislation that may increase or decrease the amount of HURF funds the City receives. The forecast assumes a transfer from the General Fund of \$1.5 million per year for street repair and maintenance projects. However, the actual amount of the transfer each year will be based on Council direction for acceleration of the pavement quality index performance measure and the Transportation division's capacity to complete street repair and maintenance projects.

Performing Arts Special Revenue Fund

With the passage of the one-tenth of one percent Arts and Cultural tax (Proposition 417) in November 2018, the structural deficits in the previous forecast due to the expiration of the existing Performing Arts Tax on December 31, 2020 have now been eliminated. Over the next several months, the Community Services Department will be developing plans for funding arts and cultural services in Tempe, including funding the operations of the Tempe Center for the Arts, with the new tax. In addition to the Performing Arts Tax, the fund also generates revenue from the Tempe Center for the Arts facility. This revenue is projected to slightly decrease during the current and next fiscal year due to construction of the IDEA campus.

Listed below are the forecast growth rate assumptions utilized in the forecast models.

Forecast Growth Rates - February 21, 2019

Revenues	<u>FY 18/19</u>	<u>FY 19/20</u>	<u>FY 20/21</u>	<u>FY 21/22</u>	<u>FY 22/23</u>
Taxable Sales Growth	2.5%	3.1%	3.4%	3.7%	3.7%
General Fund Sales Tax Revenue	3.0%	3.4%	3.8%	3.7%	3.7%
Total Sales Tax Rate	1.8%	1.8%	1.8%	1.8%	1.8%
General Fund	1.2%	1.2%	1.2%	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%	0.0%	0.0%
Primary Property Tax Levy Growth	5.0%	4.0%	4.0%	4.0%	4.0%
Bed Tax Revenue Growth	1.5%	3.1%	3.5%	3.2%	3.7%
Bed Tax Rate	5.0%	5.0%	5.0%	5.0%	5.0%
City Population Growth	1.7%	1.7%	1.7%	1.7%	1.7%
State Population Growth	1.7%	1.6%	1.6%	1.6%	1.5%
State Shared Income Tax Growth	-0.9%	9.3%	7.4%	4.4%	3.4%
State Shared Sales Tax Growth	-1.0%	4.3%	3.3%	3.9%	3.9%
State Vehicle License Tax Growth	12.0%	5.7%	4.4%	3.7%	3.4%
Building and Trades Growth	-17.3%	-31.8%	2.4%	2.3%	2.3%
Cultural and Recreational Growth	-15.7%	13.4%	11.7%	-17.7%	4.0%
Fees, Fines, Forfeitures Growth	-23.5%	-0.6%	4.1%	4.0%	4.0%
Licenses Growth	-50.9%	-2.3%	2.4%	2.3%	2.2%

Expenditures	<u>FY 18/19</u>	<u>FY 19/20</u>	<u>FY 20/21</u>	<u>FY 21/22</u>	<u>FY 22/23</u>
Personnel Costs Growth ⁽¹⁾	7.6%	3.4%	3.7%	3.5%	2.7%
FICA (% of payroll)	7.7%	7.7%	7.7%	7.7%	7.7%
State Retirement (% of payroll)	11.80%	12.11%	12.41%	12.69%	12.63%
Police Retirement (% of payroll)	61.25%	66.20%	69.44%	72.68%	73.18%
Fire Retirement (% of payroll) ⁽²⁾	67.23%	70.78%	75.18%	79.58%	80.08%
Health, Dental, Life Actives	22.5%	8.0%	7.0%	7.0%	7.0%
Health, Dental, Life Retirees	0.8%	-2.3%	2.9%	3.3%	8.3%
Mediflex Growth	0.0%	0.0%	0.0%	0.0%	0.0%
Other Fringe Benefits Growth	0.0%	0.0%	0.0%	0.0%	0.0%
General Inflation	3.0%	2.6%	2.4%	2.3%	2.3%
Electricity Inflation	3.3%	3.3%	3.3%	3.3%	3.3%
Water Inflation	4.3%	0.0%	4.3%	4.3%	4.3%
Sewer Inflation	0.0%	0.0%	2.0%	2.0%	2.0%
Gasoline Inflation	16.1%	6.3%	2.0%	0.4%	-0.2%

Notes:

⁽¹⁾ Excluding OPEB Trust Fund Advance/Withdrawal

⁽²⁾ Net of Fire Insurance Premium Tax credit