



**Minutes
Ad Hoc Long Range Budget &
Finance Planning Committee
January 17, 2008**

Minutes of the Ad Hoc Long Range Budget and Finance Planning Committee held on Thursday, January 17, 2008, 4:00 p.m., in the Public Works Conference Room, Tempe City Hall, 31 E. 5th Street, Tempe, Arizona.

Committee Members Present:

Mayor Hugh Hallman
Vice Mayor Hut Hutson
Councilmember Onnie Shekerjian

City Staff Present:

Mike Crusa, Mayor's Chief of Staff
Mark Day, Sr. Budget & Fin Analyst
Tom Duensing, Deputy Financial Svcs Mgr
Molly Enright, Mayoral Aide
Bryan Hall, President of Tempe Police Officers Assn
Jerry Hart, Financial Svcs Mgr
Jan Hort, City Clerk
Shelly MacDonald, PD Mgmt Asst
Carol Martsch, SEIU President
Jayson Matthews, TCC
Tom Mikesell, Lead Budget & Fin Analyst
Kerby Rapp, TSA President
Adam Williams, Budget & Fin Analyst
Rich Woerth, President of Tempe Firefighters Assn

Citizens Present:

Lorraine Bergman
Randy Bologna
Charles Ice
Dan Frantz
Darryl Jacobson-Barnes
Dianna Nanez, Arizona Republic
Mary Ann Miller, Tempe Chamber of Commerce
Todd Skinner

Mayor Hallman called the meeting to order at 4:10 p.m.

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Agenda Item 1 – Welcome and Introductions

Mayor Hallman welcomed the group and introduced a new citizen member, Lorraine Bergman. Everyone introduced themselves.

Agenda Item 2 – Purpose of Committee

Mayor Hallman summarized that the Council sets an annual budget and policies for that budget, and this committee would analyze that budget to examine ways in which funds are expended to determine, given the projections, how to best achieve a balanced budget. In 2001, upon recognizing we were entering a recessionary period, this committee worked to create a four-step plan. The first step eliminated \$8M in expenditures of both capital and O&M cost. The second step instituted a hiring freeze for the entire city staff, with the exception of police and fire, and through the third phase, 125 positions were frozen and ultimately others were retired. The fourth phase was never done. Those first three steps allowed the City to remain in balance and in the first year, we overshot and had a \$2M surplus.

He continued that this committee is to seek ways the City might trim its budget without affecting services to residents. There may also be some revenue enhancements. This week, Jerry Hart presented a long range forecast to the Finance, Economy and Veterans Affairs (FEVA) Committee and the projections show that we would complete this year with a slight surplus. The original view was that we could finish the year with as much as a \$10M surplus which would help fund our obligations under Other Post Employment Benefits (OPEB), the healthcare benefits our retirees are entitled to under various programs. An early-on determination suggested that the obligation amounted to approximately \$300M, but further projections indicate that it will be higher than that. Council started to address this, first, by rolling out a different program for new employees coming on. Mr. Hart's projections have suggested that we may face a budget deficit without changes to our budget of approximately \$12M for next year and as high as \$17M for the year after that. That does not include the policy to reserve \$10M per year for our OPEB obligations. If we are going to continue to do what Tempe has done, unlike almost any other city, and begin reserving funds for those obligations, the City needs to come up with \$22M in resources for next year and \$27M for the year after that.

Agenda Item 3 – Identify Roles and Responsibilities

Mayor Hallman summarized that the finance staff is present to help us interpret and understand the numbers; residents are here on behalf of the other community members to protect the services and deliverables to our businesses and residents; and employees who represent almost every employee through the union organizations to help us understand better what the employees, who are the largest beneficiary of the City's budget, need. The City of Tempe produces service. Services are generated not by spending money on things, but by spending on people who deliver the services to the residents.

The Mayor explained that this is a different kind of slowdown from the last time. He distributed a monthly statistical report of tax revenues which showed year-to-date revenue growth for previous periods. The revenues climbed from 1998/1999, 1999/2000, and 2000/2001, and then started stepping down. For the first time in City history, there wasn't just a reduction in growth.

There was a drop-off in revenue to the City in general fund revenues in 2002/2003, and although there was a slight recovery in 2003/2004, we did not get back to the amount of revenue of 2000/2001. This year, even in this downturn, we still have a little bit more than last year. What is different this time is not a huge loss of revenue. We have to manage our expenses and that is the good news. Retail sales have dropped off significantly compared to the last recessionary period. How are our revenues still growing ahead of last year? There has been a lot of work over the last four years generated by our City employees and by City Council in repositioning the City. That has put the City in a different position and the loss of revenues, this time around, is coming primarily from declining auto sales and durable goods. This is true for every community. Tempe is different, however, because of its construction sales tax and other longer term sources of revenues. The rebalancing that has occurred in Tempe has helped avoid what otherwise would be a significantly worse position this time around. Retail sales have plummeted compared to prior recessionary periods, yet our revenues are still ahead of where they were.

The committee's task will be to focus on how to reduce the size of this budget on the expenditure side.

Agenda Item 4 – Establish Goals of Committee

Mayor Hallman summarized that staff's projections, without adjustment for the formula of state shared revenue, are based on continuing standard growth in our employment process. It may be realistic, but it may be unrealistic. The City of Tempe bases its salary scales on a market approach, comparing the eight competitive cities and adjusting our salaries to the market. He assumes that the eight competitive cities will not adjust their salaries this year, so the likelihood that we will have any change in our salary ranges is small. However, we still have to deal with the fact that this City still implements, unlike other cities, a merit increase that we may or may not be able to afford. How do we balance these issues?

The Mayor continued that the question is where does that come in relative to funding OPEB, to funding PhD education programs, or Master's programs, or B.A. programs. In addition, these projections assume no changes in the state shared revenue formula, and he asked staff if it included an adjustment based on a projected reduction in the pool of state shared revenues.

Mr. Hart responded that it does.

Mayor Hallman summarized that four years ago, the State Legislature, in its panic to cut its budget, not only caused a reduction in state shared revenues based solely on the fact that the pool of revenues shrank, but decided to take the share of money put into that pool and reduce it as well. So when the block of money that was supposed to be divided up by the cities shrank, the legislature cut out another .2%, not recognizing that if the revenues were down, the cities had already taken the cut. It took two years to fight that issue out and due to some leadership in the City of Tempe, the legislature made up for that in 2005 and increased it for a year to 15.2%. The goal at the legislative level is to prevent a reduction in that percentage.

He asked if it is a fair challenge to be looking to find \$12M in the upcoming budget cycle in specific reductions or revenue enhancements and \$17M in the next year. That still doesn't address OPEB, however, and he would challenge the committee to find the money for OPEB as

well. He asked if the committee should start with the assumption that we are looking for \$22M and \$27M, respectively.

Mr. Hart clarified that the OPEB number is based upon an actuarial study done as of June of 2005. An updated actuarial study is currently being completed, and staff will have information for the committee's consideration later.

Mayor Hallman clarified that we probably need to boost our annual OPEB contribution from \$10M to between \$11M and \$12M.

Mr. Hart added that it might be higher than that. Staff is engaging in conversations with our actuary regarding the methods they are using. We have not come to agreement on the method, and that method has a significant affect on the size of that number.

Mayor Hallman added that if we said we really ought to be looking for \$15M for the OPEB contribution, we are actually looking at \$27M for next year and \$33M for the next year. That puts us about where the challenge was last time, or about a 10% adjustment in budget. We challenged each department to look for savings or enhancements that would provide 10%.

Mr. Hart added that this long range forecast in its entirety is the most recent. The budget process is currently underway, so staff does not have those numbers compiled yet.

Mayor Hallman summarized that in looking at the general fund revenues, it is about \$180M in the next year, and close to 12% to 15% as a first cut. That is a fair assumption to start with. We would probably want to challenge departments to look for 15% as a start and see how close we can come.

Councilmember Shekerjian stated that she would like to see last year's ideas as a start point.

Mr. Hart stated that he would pull that information and provide it to everyone.

Vice Mayor Hutson added that the FEVA Committee was charged with implementing the recommendations after Council decided which ones were appropriate.

Mayor Hallman explained that those ideas were generated by these committee meetings and each department was requested to come forward with recommendations to achieve that amount.

Councilmember Shekerjian clarified that it wasn't just cuts, but also revenue enhancement ideas. She asked to see what happened last time after the cuts or revenue opportunities were implemented. For example, if one department decided not to fill two vacancies, are those vacancies now filled?

Mr. Hart agreed to provide that information on all of the recommendations and what was implemented.

Councilmember Shekerjian asked staff to investigate what other cities in the Valley are doing, as well. Although some options might not work for our community, there might be variations that would work for Tempe.

Mayor Hallman summarized the goals:

1. In terms of budget growth, from the 2005/2006 year, let's look at how those budgets grew, both in numbers and the supplementals so we can examine department by department. We need to see what was added into this budget and if there is still policy support for whatever those additions were.
2. Look at what other cities have done so far.
3. Investigate any organizations that can generate ideas of nationwide solutions, such as National League of Cities.

Mayor Hallman added that this is the kind of exercise where the problem is very localized, and the kinds of services we have are different from other communities, but there are some areas that might be of help. This committee might have discussions about OPEB solutions that have been applied elsewhere. The revenue issue we are addressing for general fund operations next year is \$12M, and we're adding another \$15M on top of that, so we are adding almost twice as much in both years. Essentially, we are doubling the challenge we have for OPEB. The private sector has already done it with accounting changes in 1991 for healthcare liabilities.

Vice Mayor Hutson added that he sits on the National League of Cities Finance Committee and although it predominantly deals with government issues, there is a lot of information about OPEB in other states.

Mayor Hallman clarified the goals of \$12M plus \$15M and \$17M plus \$15M.

Mr. Hart added that once the final actuarial report is completed, the numbers could change.

Councilmember Shekerjian asked whether the state revenue sharing will be protected this year and is the hit we think we will take included in the projections.

Mayor Hallman clarified that staff has already adjusted downward the amount of state shared revenue based on the reduction of total revenues in the state. They have assumed that the legislature will not cut the share of revenues and he thought that was probably an appropriate determination.

Mr. Hart added that even though the forecast assumes no change in the formula, because of Tempe's declining population, it is apparent in the last year of the forecast, and we need to be aware of that.

Fire Captain Woerth suggested that if the committee will start delving into OPEB, maybe this is a good time to get the City's health insurance committee together.

Mayor Hallman added that as we go through the departments first, one of the last items would be an OPEB overview to see how much is appropriate to do at this level. He was looking more at how to fund the program, and the insurance committee would be looking more at the program itself. We have to figure out not only how to fund that liability but how to bring that liability down.

Vice Mayor Hutson added that the FEVA committee decided to wait until the actuarial study is presented and then they will go to the 5-sided partnership and the insurance committee and let them have a swing at it.

Mayor Hallman added that he didn't think the committee would get all the way to \$12M plus \$15M and the \$17M plus \$15M, and that's where the insurance committee will need to work to reduce that \$15M down to something affordable. If this committee can get there, that's great. That's where the employee groups are most important. He asked the people who served on the prior committee if they had found having the prior budget documents useful.

Mr. Hart distributed copies.

Mayor Hallman summarized that the approach used last time in terms of setting a future meeting schedule was to go department by department and have two departments at each meeting, each taking about an hour to present their best ideas.

A suggestions was made to start with the broad overview with what funds are dedicated, so we know what we are really working on here.

Mayor Hallman clarified that the purpose of this committee is to look at the general fund. We looked at whether the other funds are paying their fair share of the costs of the overhead and costs of running the operation, but we could probably look at that again. A good place to begin is with an overview of the City's finances.

Agenda Item 5 – Overview of City Finances

Jerry Hart provided an overview of City finances. The forecast was presented to the FEVA committee on Tuesday and he is scheduled to make the same presentation to full Council at IRS next Thursday. He summarized that:

- Our major revenue source is sales tax revenues which comprise about 50% of the City's revenues in the general fund.
- The second source is state shared revenues (intergovernmental revenues).
- The City's general fund is the fund for which the bulk of City services are provided. Services such as police, fire, park and recreation programs, development services, building safety, etc., are all financed from the General Fund and that stream of revenues.
- On the expenditure side, personal services include all salaries, wages, fringe benefits for employees. Personal services comprise 80% of the expenditures of the City's general fund.
- Some of the largest departments, our high priority departments (public safety) comprise almost 50% of the total general fund budget.

Mr. Hart explained that over the last few years, we have been seeing a trend where our overall revenues have been growing at a slower rate than our expenditures. This City has been dedicated to maintaining the City's status as the employer of choice and we are interested in attracting top-notch talent and retaining that talent. In order to do that, we must be competitive in salaries and fringe benefits. That has put some pressure on the budget as the expenditure growth rate has grown faster than revenues. Our revenues in this forecast from the most recent

fiscal year through 2011/12, average an annual growth of about 3%. The projected expenditure growth over that period is 4% to 5%. At some point, the lines will cross unless new revenue sources can be identified or controls are implemented to slow expenditure growth.

There was a question as to whether the benefits or the salaries are growing faster.

Mr. Hart responded that there are some significant pressures. OPEB is an issue. Our general healthcare costs are growing at an astronomical rate of about 13% year after year in just healthcare costs for our current employees and current retirees. We will also see a tremendous increase in the contributions required to fund our public safety pensions beginning next year.

There was a request to outline the projected increases for those pensions.

Mr. Hart responded that on page 3 of the forecast under fringe benefits, FY 07/08 is compared to FY 08/09, and it shows a \$3M increase. That's not all due to the increase in the contribution rate, however. There have been additional staff added to public safety in the last few months, but the increase in the contribution rate will have a significant impact.

There was a question regarding who imposed that increase.

Mr. Hart responded that it was done legislatively.

There was a question of whether any projected pay increases are included in these numbers.

Mr. Hart responded that the numbers assume the continuation of the market adjustments, as well as moving forward at an average rate.

There was a question as to the rate of market adjustments.

Mr. Hart responded that it is 3%.

There was a question as to what percentage of this increase is based on the 5% step. That kind of information would be helpful.

Mayor Hallman added that he guessed there won't be any rate adjustments. But we, unlike the other cities, have our 5% step increases. He would also like to see how those break out.

Mr. Hart continued that although the focus of this committee will be on the general fund, he has also provided information on the other major operating funds.

Mayor Hallman added that will be in the forthcoming information regarding the previous process; he didn't want the committee to ask departments for less than it will really take. It's very important to identify the issues and the results. There were also cuts offered in public safety, but those cuts didn't seem probable. So, he would like to look at what those suggestions were and make sure we are looking at 15% across the board. 15% might be too much for some.

Mayor Hallman added that the challenge will be for each department to achieve that. There will be those who will say that there are departments that took the lion's share last time and never

recovered, and to ask another 15% is an issue we need to address. We need to ask all departments to look at ways to cut resources without undermining services.

Agenda Item 6 – Set future meeting schedule

It was decided to meet twice a month from 4:00 to 6:00 p.m., trying for the 2nd and 4th or 5th Thursday of the month. The next meeting would be on January 31st. Jan Hort and Jerry Hart will prepare a draft meeting schedule. The goal would be for workable ideas to be forwarded to the budget process. The Council would receive those that need further deliberations later and they would be implemented later in the process. Workable ideas that can be placed in the current budget process would be implemented by July 1st.

Agenda Item 7– Set preliminary agenda for next meeting

- Proposed order of departments (Jerry Hart will communicate with departments after the meeting schedule is set and schedule presentation times, starting with one department at the next meeting.)
- Schedule of meetings
- Review and consider prior recommendations

Meeting adjourned at 5:07 p.m.

Prepared by: Connie Krosschell
Reviewed by: Jerry Hart



Jan Hort
City Clerk