

**CITY OF GOODYEAR
COUNCIL ACTION REPORT**

<p>SUBJECT: General Fund FY2019 and FY2020 Initial Revenue and Status and Five-Year Forecast</p>	<p>STAFF PRESENTER: Lauri Wingenroth, Finance Manager-Budget and Research</p> <p>CASE NUMBER: None</p> <p>OTHER PRESENTER: None</p>
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PROPOSED ACTION:

Staff will provide Council with a presentation on the General Fund FY2019 and FY2020 initial status updates along with a five-year forecast. In addition, information on revenue categorization and the financial policies will be provided for Council discussion.

BACKGROUND AND PREVIOUS ACTIONS:

At the October 5 and 6, 2018 City Council Retreat, there was discussion of the budget process, financial policies, and budget priorities for developing the FY2020 Annual Budget and five-year Capital Improvement Program. Revenue categorization and addressing the financial policies at the beginning of the budget process was discussed and are included in this item.

STAFF ANALYSIS:

This Work Session provides an early look at the magnitude or the bottom lines likely to be available for the FY2020 budget in terms of the ability to fund new programs, services, and one-time projects and initiatives. The five-year forecast will also serve to help guide the Council in understanding how decisions of the FY2020 budget may impact the future.

This initial look provides the context in which the Council can provide policy direction in terms of both revenue and expenditures. With the direction from this Work Session and the Retreat, staff will return in February for Council adoption of the Financial Polices with changes if needed. Those adopted policies along with other input such as the citizen satisfaction survey, the Council Retreat, and other Work Sessions will guide the City Manager in developing a recommended budget to be presented in April.

FY2019 and FY2020 Initial Revenue Estimates

The attached revenue schedule shows FY2019 budget and estimate, FY2020 initial estimate, and forecasts for FY2021-25.

For FY2019, General Fund revenues are anticipated to exceed budget by \$5.6 million or 5.5%. Of that increase, \$2.2 million is construction sales tax, \$1.7 million non-construction sales tax, \$1.0 million in unusual use tax collections, and \$1.0 million in development related fees (permitting, review, and inspections).

FY2020 General Fund ongoing revenues are projected to grow 3.0% over FY2019 estimates. When including one-time revenues projected growth is less than 2.0% over the FY2019 estimate. These increases result from a 5.5% growth in non-construction city sales tax; 2.5% growth in state shared sales and motor vehicle taxes and no growth in state shared income tax. State shared sales taxes are projected to fall short of the FY2019 budget as they did in FY2018. State income taxes are projected with no increases as they are still impacted by legislative changes that lowered corporate revenues over a span of several years. State income taxes are based upon collections from two years ago, making it easier to predict the magnitude of the impact of the legislative change. State shared revenues are distributed in part based upon our population which is adjusted annually in May, a small population increase has been applied to all state shared revenues. Property tax collections are established at the maximum allowable levy and are up 5.6%. Property taxes are based on February 2018 levy data and will be revised when new valuations are received in February 2019. Development related fee revenue is conservatively projected at \$7.0 million which is a \$1.0 million drop from the \$8.0 million estimated for FY2019. FY2017 and FY2018 actuals were \$9.1M and \$10.4 million respectively. Unusually high use tax collections in the current year accounts for the decline in projected one-time revenues that attributes to the lower total General Fund revenue growth rate.

FY2019 and FY2020 Initial Status

FY2019 is expected to end with a General Fund balance of \$47.0 million as follows:

Unbudgeted beginning balance increase	\$17.4 M
Allocation to development related needs	(1.1)M
Revenue and transfers in	5.7 M
1.5% estimated base budget savings	1.3 M
Unspent portion of the Capital Project Contingency	9.0 M
15% contingency	14.6 M
Total	\$47.0 M
FY2020 Operating Cost Set Aside	(\$2.1 M)
Available for FY2020 One-Time needs	\$44.9 M

As our current systems do not readily support re-estimating salaries and benefits, the base budget savings are estimated at 1.5% which is on the low side of prior practice which has ranged from 1.5 to 2.5% for developing the budget. This is conservative and savings are anticipated above this amount. Staff are exploring options for better estimating salaries and benefits based on year-to-date and current employment information for incorporation into the City Manager recommended budget or for the FY2021 budget process. Although it is assumed that all one-time budget amounts will be spent, some level of expenditure savings should always be allowed for in preparing budget estimates.

For FY2020, \$44.9 million in FY2019 savings is allocated to one-time purposes. Combined with the previously described revenue estimates; 3.5% growth in the base budget; transfers in and out for operating purposes; existing asset management plans and fully funding the required 15% of

ongoing revenues for reserves the outlook for FY2020 is positive. The following provides a high level summary.

FY2020 General Fund Initial Outlook

Item	Ongoing	One-Time	Total
Beginning Balance	\$ 2.1 M	\$ 44.9 M	\$ 47.0 M
Revenues and transfers in	106.4 M	5.5 M	111.9 M
Operating Cost Set-Aside Adjustment	(3.3)M	3.3 M	0.0 M
Base Budget (3.5%)	(88.4)M	0.0 M	(88.4)M
Debt Service	(1.4)M	0.0 M	(1.4)M
Contingency (15% of ongoing revenue)	0.0 M	(15.4)M	(15.4)M
Transfers out for debt, ballpark, HURF and Asset Management	(14.8)M	(8.6)M	(23.4)M
Estimated balance remaining for supplementals and CIP projects	\$ 0.6 M	\$ 29.7 M	\$ 30.3 M

Due to the early nature of this estimate, such as the base budget is still in development and asset management plans and new operating cost set-aside not updated, City Council should anticipate some changes to available funds when the City Manager’s recommended budget is presented in April.

FY2021-2025 Five-Year General Fund Forecast

For our five-year forecast, revenue growth rates are more conservative than used to develop the budget. The forecast is intended to provide a general understanding of future trends and to provide insight about the potential of unusual upward or downward trends or spikes. In practice and in the absence of revenue policy change, expenditures are controlled or constrained into revenue.

Recession, or negative year-over-year growth, is not predicted in the next few years. However, there is an indication that at least residential construction will stabilize to a near flat level over the next year or two. This means, the high level of activity will be continuing for several years in the development related areas, but not the significant levels of year-over-year growth of the last couple of years.

The forecasted year-over-year growth rates for the major revenues are 4% for non-construction sales tax, 2.5% for state shared revenues, and 2% for development related fee revenue. Primary property taxes are based on the February 2018 forecast assuming the maximum allowable levy consistent with financial policy. Construction sales tax is held consistent at \$8.5 million annually over the five-year period. Expenditures and operating transfers are at 3% year-over-year growth.

As shown in the attached summary of the five-year forecast, as expected this conservatism results in a compounding gap of expenditures and revenues passing from a positive to a negative position by FY2023. It should be noted that even a 0.5% increase in the ongoing revenue estimates would result in revenues exceeding expenditures for the full five years. To provide a sense of the level of conservatism in current practice, consider that current year ongoing revenues are now anticipated to exceed the budget by 2.4% and we finished the prior year over the revised estimate.

Revenue Categorization and Financial Policies

Following Council questions and discussions from both the retreat in October and the FY2019 budget discussions surrounding allocating a portion of construction sales tax to ongoing, staff evaluated all significant General Fund revenues to refine the categorization of one-time and ongoing. GFOA best practice calls for each entity to define one-time revenues and there is not a universal standard that can be applied to all jurisdictions or in many cases a clear cut delineation between one-time and ongoing. In addition to construction sales tax and project specific reimbursements already treated as one-time; use tax, development related fees and anticipated AZSTA revenues were identified for discussion.

Construction Sales Tax

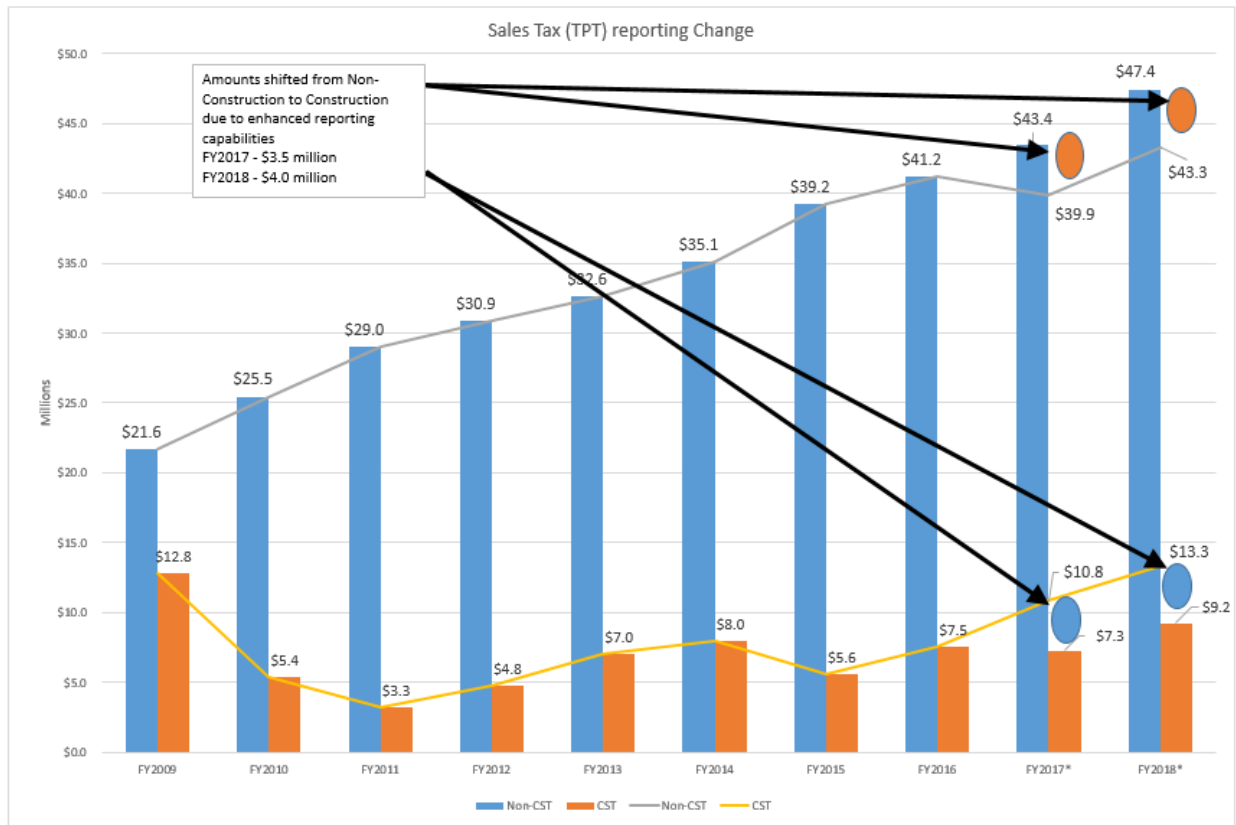
At the October retreat, information on construction sales tax was requested and is provided here.

By way of history, a new reporting system acquired from the city of Phoenix showed that there was a significant amount of construction activity previously reported in one of the available non-construction ongoing classified revenue categories, mainly retail and leasing. In the development of the FY2019 budget staff proposed that \$5.0 million of construction sales tax be treated as ongoing both due to the historical reliance through misreporting and based on a review of historical levels of reported construction sales tax collections. This change recognized the fact that even in the extremes of the ‘great recession’ and related housing industry crash there was and will always be some level of construction activity in the city, regardless of the state of the economy. Council adopted a financial policy conservatively setting the ongoing level of construction sales tax at \$4.5 million.

Although the financial policy change was initiated due to the reporting change, the basis for the amount recommended to be treated as ongoing was solely based upon actual construction activity reported under the old system. The recommended policy was based on the average of the reported construction sales tax for the five (5) lowest collection years over the preceding 10-year period. Under the old reporting system this generated an average low collection of \$5.1 million, with the lowest collection in FY2011 of \$3.3 million.

With two full years of actual sales tax data (FY2017 and FY2018) now available in the new system, a comparison of data to the old reporting structure for these two years has been prepared. The following graph shows the split between construction and non-construction tax receipts under the old system (bar chart) and the new system (line chart). In FY2017 \$3.5 million of sales tax

collections historically reported as non-construction was reported as construction and in FY2018 that number increased to \$4.0 million.



If the results from these two years are extrapolated back to 2010, construction sales tax was underreported by \$2.0 to \$4.0 million annually. Applying these same results to the 5-year average would increase the supportable allocation of construction sales tax to operations from \$5.1 million to \$7.7 million, and increase the lowest collected amount in FY2011 from \$3.3 million to an *estimated* \$5.3 million.

Use Tax:

Use tax is paid when items that are used or consumed, rather than resold, are purchased without paying an equivalent sales tax. This typically occurs with purchases made by local businesses from out of state vendors.

Staff has noted and have been reporting in the monthly financial report that some unusually large transactions have been occurring this year involving activity which may be attributable to initial set-up of new business operations within the City. With the improved reporting system, staff are now monitoring non-construction sales tax collections for unusually large and significant items and then classifying those amounts as one-time in the revenue schedule. These adjustments also keep those unusual collection amounts out of our non-construction sales tax revenue estimates.

Development Related Fees:

Staff have identified that with the high levels of development activity that there was a potential that revenues collected were exceeding the costs they were designed to recover (both direct and indirect). Additionally there was the potential that the financial policy of funding these activities in relationship to the revenue may not be met.

User fees are designed to recover both the direct and indirect costs such as legal services, financial services, and management services that support the service delivery departments. An analysis of the FY2019 budget and the indirect cost recovery rates established in the prior cost allocation study suggest that ongoing recoverable costs are at least \$7.4 million. The budgeted level of ongoing revenue was \$7.0 million. This supports that the current revenue practice is consistent with financial policy, ongoing expenditures are supported by ongoing revenues and one-time revenues treated as one-time.

AZSTA Reimbursement:

For the first time, staff have included the anticipated AZSTA reimbursement in the five-year financial forecast. This revenue has now become more certain and our forecast matches this revenue with the treatment of the related debt service. The debt service is treated as an ongoing expense and therefore AZSTA reimbursement would be ongoing.

The currently adopted Financial Policies are attached for reference and discussion.

Next Steps in Budget Process

Based on the feedback on financial policies, the Council will be asked to adopt the financial policies in February for use in development of the FY2020 City Manger’s Recommended Budget. Over two meetings in April the Recommended Budget will be presented and discussed with related background information and reports distributed in advance for Council review and consideration.

As you are aware, staff continue to work toward developing a sound five-year capital program. The resources and recommendations for a capital program will also be discussed with City Council throughout this process.

FISCAL ANALYSIS:

This is information that will be used to develop the City Manager’s Recommended FY2020 budget.

RECOMMENDATION:

This item is for information and discussion for developing the financial policies and direction that will guide development of the FY2020 City Manager’s Recommended Budget.

ATTACHMENTS:

General Fund Revenue Estimates
FY2021-FY2025 Forecast
Financial Policies