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CITY MANAGER
JOHN F. VIDAURRI

MEMORANDUM

Date: June 27, 2019

To: All Councilmembers

Through: John Vidaurri, City Manager

From: Lourdes Aguirre, Finance Director

Subject: AVOID A BUDGET CRISIS (Fund Balance Overview)

Dear Mayor & Council,

I have prepared this piece to inform you of the repercussions your decisions might have on next year's budget. Unfortunately, this information is no different from what was presented 3-4 years ago and the constant change in leadership has interrupted the city's long-term planning process.

Currently available – "unassigned" fund balance: $782K (projected by June 30, 2019)

Unavailable "restricted" fund balance: $608K this money is tied to the bond in case the city defaults payment. Please note the release of these funds is not even an option unless the city proves it is stable and sustainable.

Required for cash flow purposes (1 month):
$280,000 for 2 payroll's
$150,000 to pay for general fund bills (accounts payable)
$80,000 to pay for grant reimbursable bills (accounts payable)
$510,000 Total Cash Flow Requirement

Please note that recommended / conservative fund balance levels are between 20-30% = $1 Million
The city is nowhere near that. The following 4 scenarios provide a visual for your consideration.

1. If the 1/2 Cent Sales Tax Passes and the Budget is adopted as presented:

Fiscal Year	Projected Deficit	Additional Expense	Running "Unassigned" Fund Balance
Projected "Unassigned" Fund Balance at 6/30/2019			$782,620
FY 2020	-$97,624	$0	$684,996
FY 2021	-$31,796	$0	$653,200
FY 2022	-$7,396	$0	$645,803
FY 2023	$17,381	$0	$663,184

This option will help PREVENT the depletion of fund balance reserves while further planning / financial stabilization is under way. This also provides the cash flow necessary for operations.

If the city can prove it is stable and sustainable, it can seek bond refinancing opportunities to further assist through planning. This includes exploring the release of "restricted" funds.

2. If the 1/2 Cent Sales Tax Passes AND Additional Expenditures are added:

Fiscal Year	Projected Deficit	Additional Expense	Running "Unassigned" Fund Balance
Projected "Unassigned" Fund Balance at 6/30/2019			$782,620
FY 2020	-$97,624	-$114,000	$570,996
FY 2021	-$31,796	-$114,000	$425,200
FY 2022	-$7,396	-$114,000	$303,803
FY 2023	$17,381	-$114,000	$207,184

Of course, the implementation of a 1/2 cent sales tax will help PREVENT the depletion of fund balance reserves while further planning / financial stabilization is under way.

However, adding additional expenditures will NOT help prove the city is stable and sustainable. The City will NOT be able to seek bond refinancing opportunities to further assist through planning. This includes exploring the release of "restricted" funds.

3. If the 1/2 Cent Sales Tax Does not pass:

Fiscal Year	Projected Deficit	Additional Expense	Running "Unassigned" Fund Balance
Projected "Unassigned" Fund Balance at 6/30/2019			$782,620
FY 2020	-$244,824	$0	$537,796
FY 2021	-$220,796	$0	$317,000
FY 2022	-$196,396	$0	$120,603
FY 2023	-$171,619	$0	-$51,016

This option alone could lead to the depletion of fund balance by FY 2023. This does NOT help prove the city is stable and sustainable.

This will NOT help the city move forward with bond refinancing opportunities of any kind.

4. If the 1/2 Cent Sales Tax Does not pass AND Additional Expenditures are added:

Fiscal Year	Projected Deficit	Additional Expense	Running "Unassigned" Fund Balance
Projected "Unassigned" Fund Balance at 6/30/2019			$782,620
FY 2020	-$244,824	-$114,000	$423,796
FY 2021	-$220,796	-$114,000	$89,000
FY 2022	-$196,396	-$114,000	-$221,397
FY 2023	-$171,619	-$114,000	-$507,016

Adding additional expense could basically deplete fund balance reserves by FY 2021.

This will NOT help the city move forward with bond refinancing opportunities of any kind, nor will it help the city sustain service levels through the long-term planning process.

The topic of city resources or lack thereof, begs the discussion on: the history, what led to this point, main challenges and the need for future planning. We certainly want to learn from history so the city can maintain on the path to sustainability.

Page 7 of this memo contains a fund balance overview based on audited actuals for Fiscal Years 2007-2018 and projection for Fiscal Years 2019-2023. Please make sure to follow those figures along with each of the following subtitles to capture the full/accurate recreation of events.

A LITTLE BIT OF HISTORY

2008-2011 Economic Downturn – during this time, the city experienced drastic drops in sales tax revenue from $5.4M in 2007 to nearly $3.4M in 2012 and a cumulative deficit of -$952K, despite the following drastic steps:

- Reduction in staffing levels; city staffing levels are still at 50% of what they once were in 2001.
- Employee Salary Cuts
- Unpaid Holidays
- Furlough
- Cuts to operating budgets

2012-2014 A Secondary Property Tax instituted to help sustain service levels. This brought in $600K/year and was barely enough to operate.

ATTEMPTING TO MAKE THINGS RIGHT

2014-2015 With new leadership, there was an attempt to reinstate a lot of the elements that had been cut during 2008-2011, but the jump was NOT sustainable, leading to a cumulative deficit of -$480K in just two years. This reduced unassigned fund balance reserves down to $154K.

The secondary property tax was suspended in 2014 and sales tax rates were increased in 2015 for the first time in more than 10 years to help cover a revenue shortfall of $600K. As demonstrated on page 8 of this memo, there is absolutely no way the city could have survived with the way sales tax revenues were trending. The sales tax rate increase was absolutely crucial.

IMPROVED FISCAL OVERSIGHT

2016-2019 Since 2016, the goal has been stability and sustainability, despite having 4 Mayors and 4 Managers since new leadership took over in 2013. Still, for staff, the challenge has been: maintaining focus and education on the main issues, resolving lawsuits, working to reduce risk and liability, while still ensuring employees and services to the community are left unaffected. The cumulative surplus during this time has been $633K.

In 2016/2017, there was another slight increase in sales tax rates to align most rates at 5.5% with restaurant and bar. This increase was necessary to help sustain service levels and excluded retail, communications and utilities (still below 5.5%, please refer to page 8). In addition to these increases, the city took steps to reduce expenditures. Here's a brief summary of the main contributing factors for fund balance growth:

2016 – savings from personnel vacancies
2017 – sales of the library space to Pima County
2018 – one-time sales tax revenues (revenue accruals from the Arizona Department of Revenue)
2019 – expected mostly due to savings in personnel vacancies

GETTING THROUGH THE LAWSUITS

During this period, staff has worked to limit the city's liability of approximately $4.2 Million as follows:

Waste Management Lawsuit for $300K in unpaid **resident** bills.
This was settled and finally paid off October 2018.

Pasadera Lawsuit for $2.4 Million
Lawsuit dropped after 2+ years of litigation

Secondary Property Tax Lawsuit $1.8 Million
Lawsuit has been in litigation for approximately 3 years and is currently in the process of being settled. The City will more than likely be liable to pay off debt over a number of years (decades).

CAN THE CITY USE "RESTRICTED" FUND BALANCE?

The answer is no. As previously mentioned…

Unavailable "restricted" fund balance: $608K this money is tied to the bond in case the city defaults payment. Please note the release of these funds is not even an option unless the city proves it is stable and sustainable.

(CAN THE CITY USE "RESTRICTED" FUND BALANCE?, CONT…)

Scenario's 2, 3 and 4 listed at the beginning of this memo do not help prove that sustainability.
Other requirements: In addition to proving the city's budget is stable, stability in leadership and management are also required, as are the qualifications of management.

CURRENTLY
The city is operating with minimal staffing levels across the board and the main expense driver (as discussed since 2016) is public safety pensions (statewide problem). Although long term pension debt at approximately $12M, the city is meeting its "short-term" obligations year to year. Unfortunately, delayed reaction in the resolution of lawsuits and so much change in leadership has made it very difficult to keep the momentum going with long-term planning.

BUDGET STRUCTURE
The budget is not structurally balanced. What this means is that the city has not diversified its revenue opportunities. Only $56K comes from primary property tax which is 1% of the almost $5M budget (primary property tax is constitutionally limited). Unlike other jurisdictions, there is no secondary property tax to help sustain service expenditures (secondary property taxes can only be approved by vote). Sales tax rates and fees make up more than half of general fund revenues; necessary increases in the last few years have allowed the city to survive.

THE PROPOSED ½ CENT SALES TAX INCREASE
Without the ½ cent sales tax increase: As illustrated in "Scenario 3", without the sales tax increase, the city is expected to deplete fund balance by 2023, assuming expenditures stay the same and do not increase more than 0.5% ($23K/year) and sales tax revenues continue to grow 1% year over year. The projected, cumulative deficit from FY 2020 – FY2023 is -$833K.

With the ½ cent sales tax increase: "Scenario 1" illustrates that with the sales tax increase, the city will reduce the impact on fund balance reserves by approximately $618K by FY 2023. Of course, this is also true if the budget is adopted as presented "status quo" – containing only the approved recommendations from City Staff and the Citizens Advisory Committee. This option will provide the city enough cash flow to continue meeting its month-to-month obligations.

As discussed on June 10th, the ½ cent sales tax increase in the areas of retail, communications and utilities are a mere "short term" solution that would help sustain city operations during the necessary, but long-term economic development/planning efforts. While the increase will affect both business and residents, we estimate the impact will be minimal, conservative and across the board. Just as an example: for a business with a utility bill of $1,000/month the increase will result in $5, whereas the average homeowner with a utility bill of $100/month will see an increase of $0.50.

IN CONCLUSION

Ultimately, the goal is financial sustainability, but long-term planning will be INNEFFECTIVE without the resources to help carry it through. The decisions of today, have the potential of aiding or harming city employees and services to the community in years to come.

This same information will be presented at upcoming council meetings. Should you have any questions, please do not hesitate to contact me.

Thank you,

Lourdes Aguirre
Finance Director

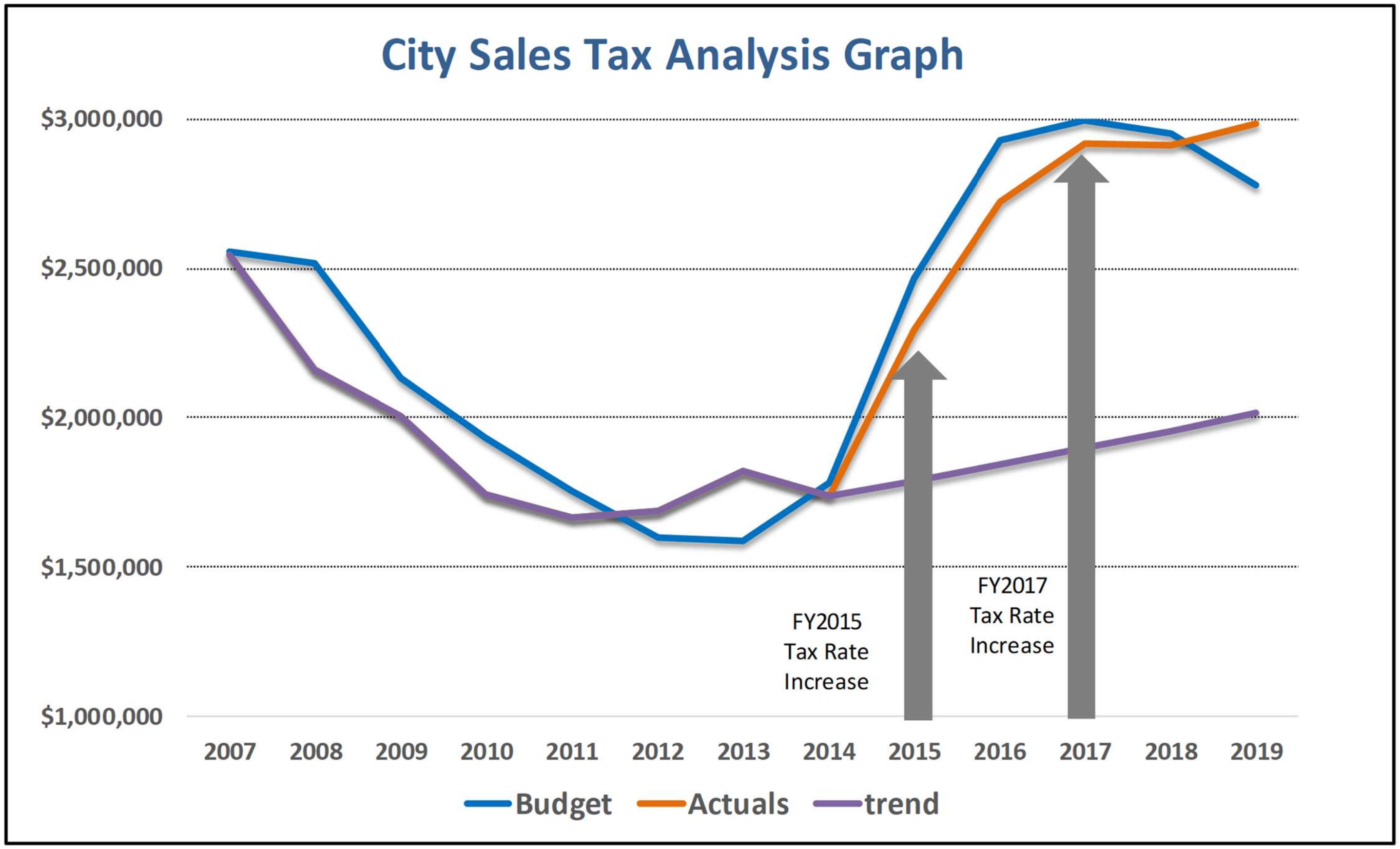
CITY OF SOUTH TUCSON
GENERAL FUND - FUND BALANCE OVERVIEW
ACTUALS: 2007-2019 PROJECTIONS: 2020-2023

Column...

A.	B.	C.	D.	E.	F.	G.	H.	I.						
Dates	Fiscal Year	Adopted Operating Budget	Revenues	Expenditures	Surplus/ (Deficit)	Fund Balance (Restated)	**RESTRICTED** Fund Balance	Unassigned Fund Balance	Mayor Eckstrom Resigned	Mayor Diaz (1yr, 11 mo) Recalled	Mayor Rojas (1yr, 7mo) Ended Term	Mayor Green (1yr, 2mo) Recalled	Mayor Teso (1yr, 3mo) Current	City Manager
					Starting at 6/30/2006	**$628,753**								
AUDITED FINANCIALS														
7/1/06-6/30/07	2007	$4,862,751	$5,389,069	-$4,970,221	$418,848	$1,047,601	$603,975	$443,626						
7/1/07-6/30/08	2008	$4,808,761	$4,760,192	-$4,975,547	($215,355)	($20,040)	$603,975	($624,015)						
7/1/08-6/30/09	2009	$4,742,113	$4,208,020	-$4,215,992	($7,972)	($10,862)	$603,975	($614,837)						
7/1/09-6/30/10	2010	$4,246,909	$3,617,064	-$4,152,269	($535,205)	$539,000	$603,975	($64,975)						
7/1/10-6/30/11	2011	$3,560,161	$3,408,752	-$3,602,456	($193,704)	$355,611	$603,975	($248,364)						
7/1/11-6/30/12	2012	$3,366,837	$3,480,971	-$3,351,073	$129,898	$678,018	$603,975	$74,043						
7/1/12-6/30/13	2013	$4,319,620	$4,950,461	-$4,685,770	$264,691	$1,237,850	$603,975	$633,875	Ended: 4/10/2013	Started: 6/10/2013				Luis Gonzales (6/10/2013-12/19/2014)
7/1/13-6/30/14	2014	$4,559,045	$4,599,969	-$4,894,057	($294,088)	$943,762	$603,950	$339,812						
7/1/14-6/30/15	2015	$4,968,900	$4,672,108	-$4,858,139	($186,031)	$757,731	$603,950	**$153,781**		Ended: 5/25/2015	Started: 5/19/2015			Benny Young (3/23/2015-7/5/2015)
7/1/15-6/30/16	2016	$5,453,711	$5,038,300	-$5,017,095	$21,205	$778,936	$603,982	$174,954						
7/1/16-6/30/17	2017	$5,213,857	$5,430,823	-$5,087,957	$342,866	$1,121,802	$604,618	$517,184			Ended: 12/19/2016	Started 12/19/2016		Sixto Molina (2/27/2017-4/5/2018)
7/1/17-6/30/18	2018	$4,986,218	$5,062,349	-$4,893,548	$168,801	$1,290,603	$608,758	$681,845				Ended: 3/13/2018	Started: 4/2/2018	
UNAUDITED (Projected)														
7/1/18-6/30/19	2019	$4,998,401	$4,917,044	-$4,816,269	$100,775	$1,391,378	$608,758	$782,620						John Viduarri (3/4/2019-Current)
PROJECTIONS WITH NO REVENUE GENERATING OPTIONS (INCLUDING 1/2 CENT SALES TAX PROPOSAL)														
Assumes 1% increase in sales activity year over year and a 0.5% increase in operating expenses (status quo)														
7/1/19-6/30/20	2020	$5,295,154	$5,050,330	-$5,295,154	($244,824)	$1,146,554	$608,758	$537,796						
7/1/20-6/30/21	2021	$5,321,630	$5,100,833	-$5,321,630	($220,796)	$925,758	$608,758	$317,000						
7/1/21-6/30/22	2022	$5,348,238	$5,151,842	-$5,348,238	($196,396)	$729,361	$608,758	**$120,603**						
7/1/22-6/30/23	2023	$5,374,979	$5,203,360	-$5,374,979	($171,619)	$557,742	$608,759	($51,017)						

City sales tax collections

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Budget	2,554,036	2,515,752	2,132,923	1,935,236	1,752,735	1,602,456	1,589,024	1,780,376	2,468,110	2,930,358	2,993,990	2,948,955	2,778,955
Actuals	2,542,399	2,162,366	2,007,709	1,741,531	1,664,576	1,689,509	1,820,391	1,738,130	2,292,634	2,724,478	2,915,535	2,912,955	2,981,442
Below / (Over)	11,637	353,386	125,214	193,705	88,159	(87,053)	(231,367)	42,246	175,476	205,880	78,455	36,000	(202,487)



The increase in sales tax collections can be attributed to sales tax rate increases in FY 2015 and FY 2017, not sales tax trend.