

2010 And Beyond Budget Issues

Introduction

Ever since the City began to experience revenue declines and a slowing of growth in 2002 it has had to adjust by making budget reductions and generating savings by holding open vacant positions and deferring one-time expenses. Despite a financial policy that fund balances would be used only as a funding source in the General Fund for capital and one-time expenses, those fund balances often have been used to fund programs or operating type expenses with only a "one year commitment" such as the Longmont Community Justice Partnership and the Longmont Economic Gardening Initiative. Thus, our community has an ongoing dependence on programs that do not have an ongoing source of funding.

Since 2002, the City has been transitioning for the time we approach final build-out of our LACP since that will mean a sharp corresponding reduction in construction related revenue. At that time the slowed population growth will most likely impact the growth in our sales and use tax revenue. Financial policies have been created to lessen the dependence of General Fund operating expenses on volatile growth-driven revenues. On two separate occasions the City Council worked to engage the public and gather input on service priorities in the event that cuts to the General Fund budget were necessary. While some adjustments have taken place, solutions for new revenues and operational efficiencies have precluded the need to significantly reduce services to this point.

With all of the recent economic events on a global, national and local scale, we are now in danger of actually experiencing revenue stress similar to the scenario of reaching build-out. In December, staff presented the City Council with revised sales and use tax revenue projections for 2009 (Attachment A) showing a potential decline of 8% to 11% from this source. While those are still just projections, it is prudent to prepare contingency plans for what will surely be a tough economic time. Not only is our sales and use tax at risk but property tax will suffer due to declining property values.

There are three areas to focus on in preparing the City for these fiscal challenges. First is a continued effort to improve the efficiency of our organization. Second is to continue to explore new revenue options for the City. Third is to identify a new process that will sustain our City budget in 2010 and beyond as the budgeting process that we have traditionally employed is not likely to be successful in this environment. As we learned from Fort Collins officials on December 30, an open transparent budget process that prioritizes services can improve the organization and help focus our resources on services that the citizens need and expect.

Longmont's Budget Process

The City currently uses a budgeting approach in which incremental base budget increases and one-time items are prioritized and requested by each General Fund department. There are three prioritization lists that each department submits: 1) level 1 ongoing; 2) level 2 ongoing; and 3) one-time items. Level 1 ongoing requests are increases that will maintain the current level of service, such as increased costs for contracts, utilities or maintenance. Each division is required to assess its current base budget to determine if it can cover any required Level 1 increases by moving base budget amounts from one line item to another before it makes requests for additional funding. Level 2 ongoing requests are increases to base budgets that may enhance current service levels, including new position requests. One-time requests are types of budget items for which the requestor needs the funding on a one-time basis, as opposed to an annual basis, such as for equipment, IT enhancements, and one-time consulting or temporary wages. The City's financial policy requires that ongoing expenses be covered with ongoing revenues and that one-time revenues be used only for one-time expenses. Scheduled replacements of vehicles and computers are all reviewed by Fleet and ETS staff and deferred if continued maintenance costs of the assets are still cost effective.

Each General Fund division prioritizes and ranks its budget requests. The division requests are then prioritized and ranked at the department level so that each department submits prioritized Level 1, Level 2 and one-time lists. Budget staff reviews these requests for accuracy. In recent years budget staff has completed detailed reviews of line-item base budget amounts to determine where cuts could be made. Departments discuss their prioritized requests with the City Manager and Executive Directors. The Finance Department prepares revenue estimates, and Human Resources staff prepares pay estimates. The City Manager and Executive Directors then make final decisions for the proposed budget to be presented to the City Council.

The incremental budgeting approach worked well for the City throughout the 1990s. Near the end of 2001 the City began experiencing slowing sales and use tax and building permit revenues. In the middle of 2002 the City took the first of many steps that have reduced expenditures in the General Fund over the past six-and-a-half years as outlined in Attachment B and Attachment C.

Prior years budgeting processes have included attempts at service prioritization beginning with the 2003 budget, in which Executive Directors and City Council went through a detailed prioritization process. This process resulted in a ranked list of services (Attachment D) that was intended to guide budget decisions. Although never really used the way it was intended, this list was the original service level prioritization and did serve to guide funding discussions at the director level. The 2009 budget process used community input in a process that we titled "Setting the Priorities of Government." The input received from this

process (Attachment E) was used by the City Council to guide them in making the decisions that led to the adoption of a balanced budget for 2009. While the process did not result in a full service level prioritization, it did result in the decision to make service level reductions in the area of Parks Maintenance. In addition, citizen input led to the proposal by City Council for revenue increases to help bridge other gaps in the 2009 General Fund budget.

The City has reached a point where the incremental budgeting approach may no longer be viable. The next section of this paper shows how it is difficult to make further reductions in line items and FTEs without reducing service levels. It is possible that future revenue limitations in the General Fund may require reductions in service levels in order to bring our services in line with ongoing revenue. When decisions regarding service levels need to be made they should reflect the needs and desires of the community. The resource allocations in our budget should be in alignment with community priorities reflected in documents such as the *Focus on Longmont* strategic plan.

General Fund Services Supported by Taxes

Last summer, in the Community Forums, the focus was on prioritizing General Fund services that are delivered directly to the public and are supported by taxes. They are the services that compete for the non-earmarked tax dollars and other general revenues of the General Fund. Within the General Fund, approximately \$45.2 million of the \$58.4 million of ongoing revenue originally budgeted for 2009 are non-earmarked tax dollars and other general revenues. The other \$13.15 million are revenues generated by or earmarked for specific General Fund programs or services. When there are reductions in funding for some General Fund services they can have the resultant impact of also reducing their offsetting earmarked revenue. The biggest example of this is in the administrative transfer fee (ATF) revenue received from other operating funds for the City in return for the internal support services provided from the General Fund. The following data give a summary view of earmarked revenue and the services it supports.

2009 General Fund Budget
(in thousands)

<u>Revenue</u>	<u>Ongoing</u>	<u>Earmarked</u>		<u>Non-earmarked</u>	
Taxes	\$44,994	\$175	0.4%	\$44,819	99.6%
Licenses and Permits	996	996	100%	N/A	0%
Intergovernmental	505	464	91.8%	41	8.2%
Charges for services	4,525	4,525	100%	N/A	0%
Fines and forfeits	1,025	1,025	100%	N/A	0%
Interest	360	N/A	0%	360	100%
Miscellaneous	67	37	55.5%	30	44.5%
Transfers	<u>5,925</u>	<u>5,925</u>	<u>100%</u>	<u>N/A</u>	<u>0%</u>
	\$58,398	\$13,148	22.5%	\$45,250	77.5%

<u>Expenses</u>	<u>Ongoing</u>	<u>Revenue Offset</u>	<u>% Offset</u>
Mayor and Council	\$ 365	\$ 75	20.7%
City Attorney	808	241	29.8%
Economic Development	385	175	45.4%
Administration	2,950	1,520	51.5%
Community Development	9,443	3,122	33.1%
Community Services	10,405	3,001	28.8%
Finance	6,726	3,977	59.1%
Fire	9,337	402	4.3%
Police	16,086	347	2.2%
Police/Fire Shared Serv	1,420	102	7.2%
Non-Departmental	406	175	43.1%
Transfers	<u>68</u>	<u>14</u>	<u>20.8%</u>
	\$58,398	\$13,151	22.5%

Police and Fire services are two of the largest categories of expenses from the General Fund, and they are funded primarily through taxes as they have the smallest amount of offset from direct revenues of 2% and 4% respectively. Community Services Department services have a 29% offset from direct revenues due mostly to fees for recreation services. While recreation services are about 80% offset by direct revenues, the remaining services in Community Services are offset by less than 10%. These other services include the Library, Museum, Senior Services, Youth Services and outside agencies.

In Community Development Department services there is a 33% offset from direct revenues, related mostly to the development activities of building inspection and planning. The Union Reservoir service is being offset by almost 70%, but the rest of parks services receive 85% of their support from tax revenues.

The categories of Finance and Administration have a direct revenue offset of 59% and 51% respectively, primarily from administrative transfer fees (ATF) as they provide internal support throughout the organization. A similar offset from ATFs is provided to the Mayor and Council (21%), City Attorney (30%) and

Economic Development (45%) services. Reductions in funding for these services may impact the service that can be provided to the Enterprise Funds and thus reduce the administrative transfer fee revenue received from those funds. For example, a budget cut of \$1 in Finance may generate only 41 cents savings while a cut of \$1 in City Attorney may generate only 79 cents of savings.

Options For Dealing With Our Budget Challenge

Over the past 25 years, public entities have tried numerous budget processes in attempts to improve the allocation of scarce resources. Zero based budgeting, program budgeting and incremental budgeting are the common approaches that have all been used in that period of time. More recently there are two newer approaches that have been recognized to be successful in difficult times: “Budgeting for Outcomes” and “Prioritization.”

Budgeting for outcomes – Budgeting for Outcomes (BFO) was developed by David Osborne and Peter Hutchinson and originally used by Washington State followed by the City of Spokane, Snohomish County, Wash., and several cities in California. Locally, Fort Collins and Mesa County have used this budgeting approach for a couple of years now. Attachment F is an article that explains the concepts of BFO. The impetus for a new budgeting process was the realization that traditional budgeting usually focuses on the small amounts to be added or cut each year, but the vast majority of spending was never scrutinized or discussed. The BFO process was designed to create a budget that gives residents the results they really want and need at a price they are willing to pay. A complete BFO process involves the following seven steps:

1. *Set the Price of Government.* This step establishes how much citizens are willing to pay for the results they want. This is essentially the percentage of personal income that residents devote to taxes, fees and charges. This amount is relatively fixed over time; however, the City has control over this in terms of tax or fee increases.
2. *Set the Priorities of Government.* This step defines the outcomes that matter most to residents along with indicators to measure progress. A great deal of community input is needed to arrive at these priorities. *Focus on Longmont* provided the beginning of these priorities; however, it was not a complete picture as it lacked vital services such as Public Safety.
3. *Set the Price of Each Priority.* In this step, total revenue is divided between the outcomes established above based on their relative value to residents. The 2009 budget process included community forums that attempted to provide the necessary information to complete this step. Since the public forums were not designed with this step as the primary outcome, the information obtained during these forums did not produce the results needed to complete this step in the process.

4. *Develop a Purchasing Plan for Each Priority.* This is a crucial step in the BFO process. It requires the creation of “buyer teams” who will act as purchasing agents for the residents. These teams will determine what factors will have the most impact on the desired results. The creation of Cause-and-Effect maps will show which factors have the most impact and how the different factors interact to provide the desired results. These maps become the basis for the buyer teams to evaluate proposals and assign a relative priority to each.
5. *Solicit Offers from Providers to Deliver the Desired Results.* With the goals and strategies developed in step 4, the buyer teams then solicit offers that can deliver the most results for the money. This solicitation replaces traditional budgeting instructions and asks each of the participants to identify how they would deliver the expected results and at what price. Since this step builds in competition it forces sellers to make their offers as competitive as possible.
6. *Buy the Best, Leave the Rest.* The buyers rank the proposals in terms of results per dollar. They will “buy” according to the priorities established earlier until all funds have been spent. Mandates must be respected and, consequently, some low ranking mandates will end up being purchased. This buying plan becomes the budget.
7. *Negotiate Performance Agreements with the Chosen Providers.* These agreements will lay out the expected outputs and outcomes, how they are to be measured, the consequences for performance or non-performance, and the flexibilities granted to help the provider maximize performance.

Fort Collins has been using BFO for a couple of years. As noted by the Fort Collins mayor, since BFO is a complex and time intensive process, the City changed its charter requirement from an annual budget process to a biennial budget process. All Funds, including Enterprise Funds, went through the same budgeting process. While there are many different possible levels of community involvement at each step in this process, Fort Collins completed this process with little citizen participation. The City Council defined the outcomes (step 2) and allocated the dollars to each of the efforts (step 3). They used high performing teams comprised of City staff to define the resources needed for each outcome (step 4) and rank the proposals (step 6).

The benefits that Fort Collins has attributed to its BFO process include:

- ◆ Earlier and more meaningful engagement with Council
- ◆ Deeper level of staff involvement
- ◆ A communication tool regarding City services
- ◆ Set expectations for performance measurement
- ◆ Increased credibility with citizens

Prioritization – Recently, Jefferson County, Colorado, has begun using an approach that is quickly gaining favor and recognition. It is referred to simply as “Prioritization.” It is a focus on the priorities and objectives that ensure the success of a community and a strategic approach to budgeting that attempts to understand what we do, why we do it, and how we should invest our resources to achieve the results our community needs, to achieve our strategically stated objectives. Attachment G is an article that addresses the concepts of Prioritization.

As Jefferson County explains it, the key objectives of implementing a successful prioritization initiative are to:

- Evaluate the services we provide, one versus another.
- Better understand our services in the context of the cause-and-effect relationship they have on the organization’s priorities.
- Provide a higher degree of understanding among decision makers as they engage in a process to rank services based on priorities.
- Articulate to people in the organization and to the public how we value our services, how we invest in our priorities, and how we divest ourselves of lower-priority services.

Effective resource allocation decisions are transparent when the results of an organization can be identified and defined, when programs and services can be distinctly evaluated as to their influence on any of the results, and when programs can be valued relative to one another and ultimately prioritized based on their impact on results.

The key steps to a successful prioritization process include:

- **The right results.** We need to comprehensively identify the results we are in business to achieve.
- **The right definitions.** We need to clearly identify the cause and effect relationship between a program and the results we are in business to achieve.
- **The right valuations.** If we have the right results and definitions, we can more accurately place a value on a program relative to its influence on achieving those right results.

Once the first two steps of identifying and defining the results are achieved, the valuation process leads to a prioritization of programs. For this step, Jefferson County first had the program providers themselves value their programs. This valuation was then subject to a peer review by others within the organization. They also solicited a general prioritization of the defined results by elected officials. This step could also be extended to citizens similar to the input solicited from participants of the community forums last summer.

Finally, the results are weighted, program scores are calculated, and the outcome is a top to bottom summary of all programs in order of priority. Jefferson County then separated them into four quartiles with County resources allocated to programs in relationship to their priority.

In Jefferson County, the results were that Snow Removal was the highest priority while Natural Resources and Horticulture was the lowest ranked program. Snow Removal was ranked highest because it had the greatest influence on all of the County's results while the Horticulture program had the least amount of influence on the results. Thus, County resources go more toward Snow Removal as it theoretically gets the best "bang for the buck" by achieving more of the results.

Prioritization offers an objective process that allows those responsible for resource allocation decisions to ensure that programs of higher value to citizens, programs that achieve the organization's objectives most visibly and effectively, can be sustained through adequate funding levels regardless of any fiscal crisis.

In lieu of adopting one of these two new budgeting processes, the following options remain as approaches to dealing with reductions in revenue available to the General Fund.

Across the board budget cuts – This is, quite simply, exactly as it is named. If, for instance, we were expecting to experience a 10% reduction in General Fund revenue, this approach would call for a 10% reduction in the budgets of each of the programs within the General Fund. This approach does not consider any of the relative priorities of the organization or the community. Both the highest valued services or programs and the least valued services or programs would all be subjected to the same percentage reduction in funding. This is an approach that the City used in the past when it was trying to generate savings within a budget year. More recently the City has set different savings goals for different services based on service priority with smaller goals in the area of public safety.

This approach is not the most logical as it does not consider the relative services provided. When across the board cuts were suggested by the governor of California, the *Mercury News* of San Jose reacted with the following: "The governor's approach would be like a family deciding to cut its monthly mortgage payment, dining-out tab and Netflix subscription each by 10%, rather than eliminating the restaurant and DVD spending in order to keep up the house payments."

Increased revenues and efficiencies – This option is one that will continue to be pursued regardless of the budgeting option chosen. Our organization has been guided by continuous improvement principles for more than 10 years. We will always seek further efficiencies so that service can be provided more cost effectively. Unfortunately the scope of the potential revenue shortfalls we are facing is probably greater than what can be generated through efficiencies alone.

It still is prudent to examine where cost reductions can be realized in existing systems and practices. The City organization is entering 2009 with a new structural alignment aimed at making it more efficient. Also, with a \$135,000 budget allocation for examining efficiency, some selected areas will be examined in detail to ensure that services are delivered most cost efficiently.

In the 2009 budget process the City Council directed staff to pursue a number of different options for increasing revenue. As a result there was an increase in the electric franchise fee and a number of new fees for service put in place for 2009. Other revenue alternatives were identified that could still be pursued further such as the park maintenance fee, museum fees, library fees and senior services fees. Tax increases require voter approval, but, it should be recognized, those options do exist for the sales and use tax, the property tax, or other less common taxes such as the recent suggestion for a tax on cell phone lines. The Colorado Municipal League has begun similar discussions regarding alternative revenues for cities such as a real estate transfer tax, local income taxes, occupational privilege tax, and sales tax on services. All of these require a vote at the local level and most also require state constitutional changes.

Under the current worst case projections for sales and use tax for 2009, each 0.25% of sales and use tax would generate approximately \$3.11 million. Each mill of property tax would generate approximately \$1.05 million at 2009 rates of valuation although that rate is likely to drop in 2010 with the expected decrease in property values lowering assessed valuations.

Use of fund balances – The General Fund maintains an unreserved, undesignated fund balance of 8% as an emergency reserve. In 2009 that amounts to \$4.9 million. That emergency reserve is inclusive of the TABOR reserve of 3% of fiscal year spending that amounts to \$3.1 million. Fiscal Year Spending is a measurement that is defined within TABOR and excludes enterprises and state grants. The TABOR emergency reserve cannot be used for fiscal emergencies. Even if it were allowed, the law essentially requires the reserve to be restored by the fiscal year-end. That basically limits it to being a short-term emergency reserve. Essentially that makes the \$3.1 million TABOR emergency reserve unavailable.

The difference between the General Fund 8% emergency reserve of \$4.9 million and the \$3.1 million TABOR reserve is \$1.8 million and theoretically is available for emergencies. Nevertheless, the question still remains whether a fiscal emergency is a proper use for this reserve. A temporary loss or reduction in revenue might be an appropriate use of this reserve, but a possible sustained decrease in the revenue base can be offset only by the \$1.8 million for a limited time. In essence, it becomes a one-time fix for an ongoing problem. In any case, it becomes a challenge to replenish the reserve within a reasonable period of time.

There is a \$6.8 million reserve balance in the Health Benefits Fund that might also be used as an emergency reserve if necessary. Unlike the General Fund emergency reserve this is not a reserve required to be maintained by financial policy. Depending on the scope of a revenue shortfall, this size balance may be able to offset shortfalls for a number of fiscal periods. Nevertheless, if the reduction in the revenue base is one that is not restored in full, even these reserves are still considered to be a one-time fix. Eventually the City would have to deal with the challenge of bringing General Fund service levels in alignment with ongoing base revenues.

Conclusion

While the sales tax revenue base is expected to take a hit in 2009, the property tax base will begin to see the impact of reduced property values in 2010, and with the lag effect on assessed valuations it will continue for some time. We could face a dramatic decrease in General Fund revenue for both the immediate and long term futures. There is a need to prioritize services to be prepared for the time when we reach build-out and can no longer rely on growth to support ongoing services. Options such as increased efficiencies or the use of fund balances are short-term solutions that will do very little to deal with the potential hole in the revenue base. A new approach to budgeting is necessary to position the City to make critical decisions regarding the allocation of limited resources.

Questions for Consideration

1. What is the City Council's preferred process for budgeting in 2010 and beyond?
2. What roles should the community and the City Council have in the future budgeting process?
3. What specific revenue increases would the City Council like to pursue in 2009?
4. Does the City Council wish to pursue amendments to the City Charter to allow for a biennial budget process?