Introduction

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FISCAL YEAR 2010-11 BUDGET
City Manager's Budget Message

Mayor Melissa Johnson and City Council
City of West Jordan, Utah

Dear Mayor Johnson and Council Members,

END-OF-YEAR PROJECTIONS

To a great extent we rely on historical trends and results to help determine future performance. That is not a "straight-line" exercise, but more of a distribution analysis. So, for example, we try to draw correlations between economic events (unemployment, foreclosures, business closures, building activity) and performance, while recognizing two important overall truths: (1) we are inexorably tied to Salt Lake County, Wasatch Front, and Statewide results … we are not a strongly independent economic driver; and (2) even though total volume of economic activity may vary (recently on the negative side), historic distribution of revenue over time tends to show the same cycles. That is important both on a micro scale (month to month changes in activity), and on a macro scale (multi-year up and down cycles).

Sales tax performance

We could explain the percentage drops in sales taxes over the last two years, but maybe the most graphic comment we could make is to note that sales tax revenues are back to the same levels we saw in FY2005. Remember that of the sales taxes collected from West Jordan business, cities are allocated 1% of the total 6.85% tax (or about 14.6% of the total sales tax). So, for every $100 spent in West Jordan, $6.85 in sales tax is collected, and of that amount, cities receive $1.00. The State has attempted to level the playing field somewhat between more locationally advantaged cities and others, by equalizing a portion of that tax. So, of that $1.00 in city sales tax for purchases made within West Jordan, the City receives $0.50 of the actual point of sale (POS) revenue, and the other half is put in a statewide pool that is distributed by population. If a community received more in POS tax than population based tax, the obvious conclusion is that they are generating more tax per capita than the average. West Jordan has never been in that situation. However, during our fastest retail growth we were getting close some months. So, for example, in FY2005 we collected about 49% of our total sales tax from the POS source, and 51% from the State pool. That ratio is down to the extent that so far this year the ratio is about 44.5% POS and 55.5% state pool. That would indicate that we are faring slightly worse than the state average. Why? Without an actual audit of sales tax payers that is difficult to know with total confidence, but we can speculate, based on some sales tax data, that the principal cause is the loss of building activity. Because of West Jordan's physical location within the valley, when homebuilding is high much of the materials are purchased from West Jordan businesses. In fact, those construction material businesses have been hit considerably harder in this downturn than business in general. So, while cities like Sandy are banking their recovery hopes on the return of auto sales, our recovery is significantly dependent on the return of homebuilding.

Currently we are projecting deficits (budget shortfalls) due to sales taxes in the $2.2 to $3.3 million range for the current fiscal year. One interesting note is that we are now tracking more closely to statewide averages because our building materials bottomed out at the beginning of the recession, and having hit rock bottom cannot perpetuate a further decline.

Foreclosures and Property Taxes

It may be instructive to understand what happened over the years in California with respect to property taxes. Thirty years ago there was a regular annual run on property taxes because (1) the era of rapidly increasing home values had begun, thus the assessed valuation base was rising precipitously; and (2) governments injudiciously abused their reliance on the property tax, raising rates to further exacerbate the impact. So you had an exponential growth in property taxes as higher rates were applied to growing values.

When the Gann initiative (Proposition 13) eventually passed in the '70s, it froze existing assessed valuations (AV) where they were (actually rolled them back a couple of years). However, if a property changed hands, or a new property was built, it could be assessed at market value. In addition, the rate applied against that valuation was limited such that the property tax for any property could not rise more than 2% per year, unless overridden by a public vote. Now, many changes and nuances have developed over the years, but much was made of the chilling effect of a revenue system that was designed to essentially self-destruct, assuming average growth of service costs over time exceeded 2% per year. Perhaps more insidious was the unintended result that communities that could afford it would override the limitation to keep services funded, and communities that could least afford, and therefore not pass, overrides, struggled to maintain services.

Compare the California experience to the Utah solution. Utah chose to limit property tax growth, not on the assessed valuation base or on the rate per se, but on the actual amount of revenue you derive from property tax without an override vote. In higher growth communities, the effects of that strategy are temporarily hidden … because your property tax income can grow by the amount generated from new building. But, unlike California's 2% self destruct, Utah determined to accelerate the erosion by not allowing any growth in the base tax for any property. Why then do individuals see tax increases? The major reason is tax override elections for schools, and voter-passed overrides for General Obligation bonds (like our Justice Center and Open Space bonds). A secondary, less understandable effect can be the "redistribution" of impact. Through unequal changes in assessed valuation, one area may see a larger increase in AV than another area. Since the base income from those areas cannot increase, the distribution is shifted so that the area seeing the higher AV changes are now paying more of the total, and the other areas paying less. When a community reaches buildout, and the only increase in values comes in the form of redevelopment, the self-destructive nature of the property tax system becomes much more apparent and timely. Communities then are faced with either "zoning for dollars" to try to enhance their revenue base with increased sales tax, adopting a plethora of fees and charges so that services are offered "ala carte" (pay for what you use), or enter the murky world of truth-in-taxation to increase the property tax to keep up with costs. You could reasonably argue that a public vote on tax increases would be a more direct, accountable method of establishing levels and quality of service … and would address the reluctance of many elected officials to even broach increased property taxes that, in the truth-in-taxation system shines the accountability spotlight directly on the Council. In fact, the business center concept we will be working on this year will be adaptable to either representative (Council) direction and/or public votes, based on organized, analyzed, and clear information availability.

Notwithstanding the tenuous nature of property tax income, the City will be in a growth mode for several years to come, so the rate and variableness of that growth can be an important factor to consider. And one issue we watch carefully in a recession is the level of loan default and subsequent foreclosure … because it can dampen or defer the level of property tax income. We have been tracking those statistics for the last eight months. We try to assess both the existing risk as well as the probability of continuing problems. Interestingly, the "later" stages of foreclosure are still seeing significant increases, a rise in the number of homes that are bank owned rising by 0.23% and the number of trustee sales rising 0.4% from October to April. However, the front end of the process, the loan defaults, rose over that same period of time by just 0.05%. Since we're not back into a strong overall economy, you have to understand the lack of permanence in those figures, but it does mean that the short term outlook is for an overall decrease in the number of homes with foreclosure actions.

Now, the next key is to understand how that has affected the property tax income. We have watched two key indicators over the last five years: (a) Total taxable assessed value (TAV); and (b) actual property tax collections. Over five years, the TAV has averaged an increase of 15.6% per year; the last yearly increase was 8.3%. Part of that lower gain was due to lack of new building, and part was due to deflation of home values. Nevertherless, note that the percentage this year was still rising. I would guess that the number would drop again next year, but may be offset by a slight increase in new building. Remember that the assessed valuation doesn't drive the amount of revenue we receive (except for the increment attributable to new growth), just how it is distributed. So if we look at the actual property tax collections over the same five years, we see a steady decrease in growth (19.2%; 4.2%, 3.4%; 0.1%; and this year's 0.2%). Declining, but note that (a) the collections are still positive and have never dipped into the negative side; and (b) this year was a reversal of the downward trend, albeit in a very small increment.

We are not proposing increases in property taxes this year, not because there is no need, but in recognition of the economic struggles across the community, and the political angst that results.

Conclusions on end-of-year estimates

We ask our departments every February to develop estimates of both department-specific revenues and expenses for the year ending June 30th. The tax revenue analysts (Eric Okerlund and Dave Zobell) prepare the remainder of the revenue estimates. Based on lower-than-anticipated trends to date with sales tax, the preliminary numbers indicate the potential of falling below the state standard fund balance of about $2.2 million by as much as a million dollars. Typically the actual year end numbers come in a bit better than our February predictions, and we anticipate the final fund balance will improve somewhat by year end … we're hoping to be back up to the state minimum. We are taking several steps to help reach that goal, including continuing to hold open positions not included in the January layoffs; holding some projects until the next budget year; and cutting off major expenses as of May 1st this year. In all fairness, I should point out that we made significant cuts in each department's materials and services budget this last year, so there is considerably less "play" in what was already a pretty tight budget, and savings at the end of the year will be tough to come by.

CHALLENGES, ASSUMPTIONS AND PROJECTIONS

In many respects, this is not a challenging budget year … it is not a time to move off in new directions, to build speculative dreams, to throw non-existent money at every community need. While we can and should spend time and thought to plan, to create vision, to improve … the immediate goals of this upcoming budget should, (1) be flexible and adaptable to a changing and at risk economic environment; (2) preserve resources and protect services; and (3) begin designing the reinvention and retooling of service delivery. So the main thrust of our budget development efforts have been to bridge this difficult time, and try to position ourselves to move forward as the world settles down. The budget does not look significantly different from last year's budget. What you'll find is primarily a few tweaks of the program distribution while keeping bottom lines reflecting only the cost saving adjustments made over the last year.

There are, however, a number of challenges, assumptions, and projections that will rivet our attention, and be reflected in both the formal budget, and our responsiveness throughout the next fiscal year:

Retirement

We have explained in previous communications how the retirement system is in dire crisis, and has been the subject of recent State law changes to try to address the challenges. I won't cover the complex range of issues in this budget discussion, except to address the immediate funding problems we'll be faced with.

As you're aware, the City is a captive member of the State retirement system … and ultimately the deep pocket responsible for covering any costs of the plan not funded by investments. The result is that the contributions (from employers and/or employees) will rise significantly over the next four years. The first key to understanding the retirement system is to know that the City's general policy is to pay a standard 17.85% of salary toward retirement, including both the Utah Retirement System (URS) defined benefit program, and supplementary 401 and 457 deferred compensation programs (the City does not participate in Social Security). The General Employees (everyone other than uniformed police and fire) are in what is called a URS "noncontributory" plan (meaning the city pays the entire contribution). The URS rate this year is 11.66% of salary; which means that the city also contributes a total of 6.19% (the difference between 17.85 and 11.66) of salary to the deferred comp programs (the employee also is required to contribute 7.65% to deferred comp). The new URS rate for next year will be 13.37%, and the result will be that the amount the City contributes to deferred comp will decrease to 4.48% (so that the total remains 17.85%).

The firefighters have a unique twist to their plan. Every homeowners insurance policy in the state is charged a fee that is dedicated to offset firefighter retirement. That results in reducing the employer/employee contribution rate by about 12%. The firefighters are in a "contributory" system, which in this case means the city and the employee pay the remainder of the premium. This year that remainder was 9.68% of salary, of which the employee contributes 7.65% and the city contributes 2.03%. The City then pays the difference (15.82%) into their deferred comp accounts. The URS rate for next year will be 16.18%, or an increase of 6.5%. The City will pay that increase, but it will be offset by a decrease in contributions to deferred comp to 9.32%.

Finally, uniformed police are in a third system. They are "noncontributory," but their funded rate this year is 26.21%. That exceeds the city's standard 17.85%, but because their program is noncontributory the city is required to pick up the full rate. That of course also means the city has nothing leftover to contribute to any deferred comp program. The police rate for next year will be 28.24% (an increase of 2.03%), and must be paid entirely by the employer.

So for this coming year, the city budget will not be affected directly by the retirement increases, except in the case of sworn police officers. We anticipate the cost in increased contributions will be about $100,000. By the way, similar increases are planned for the next four years. You can see that the police rate will simply continue to rise – all at city cost; that the general employees rate will exceed the city standard in two-three years and become a total city cost; that the firefighters may not exceed the city standard for about four years.

Benefit insurances

Three factors have colluded to potentially affect the cost of insurance in a catastrophic way this year. Last year we took full advantage of a good experience year plus major plan changes to see a significant reduction in the cost of insurance. An unexpected result was that the number of employees covered dropped (mostly due to layoffs), so the overall premium revenue dropped; but at the same time the number of family members covered rose slightly. We can probably attribute the increase in enrollees to the economy: we likely had some employees who also had coverage through their spouse's employment, and so didn't cover their children (or spouse) on City insurance. We may have seen some of those spouses either lose coverage in their jobs, or lose their jobs, so the dependents had to be added to City coverage. The second problem was the steady, greater-than-cost-of-living inflation in medical costs (if you think the new national health plan is going to reverse that trend, I have a bridge in Brooklyn I'd like to sell you). The average in the industry this year was around 12%. Finally, we had a relatively poor performance year for medical claims. Not much in the way of huge problems, but enough to push the losses over the premiums.

Armed with those elements, Blue Cross came in with a proposed 37% increase in premium (about $1.4 million). We instructed our new benefit insurance broker (GBS) to bid our insurance, which resulted in a much lower increase that proposed by Blue Cross. Our intent is to move in the direction of a high deductible/health savings plan, and hope to have it well in place over the next year or two … so any movement we make with our insurance plans will move us in that direction.

Sales tax trends

We have already discussed some aspects of the sales tax, so I will only mention here that we do an extensive internal analysis of sales tax trends, as well as rely on both general economic advice from a variety of regional sources, and on the statewide tax analysis updated monthly by two very bright people with the Utah League of Cities and Towns. We are at this point assuming that the tax trend is bottoming out this quarter, and will be flat for most of next year, with a possible small recovery in the last quarter or so of FY2011.

Compensation

I will discuss below some recommended uses of one-time monies again this year, but the effect of that situation on compensation is that it makes no sense to increase the compensation component of the budget based on one-time revenues sources.

I propose a second year of frozen compensation (very limited exceptions … some promotions, etc.). That means no step increases, no cost of living increases, and no career ladder increases. I will not budget for excess vacation buyout, but will retain year-end sick leave buyout and educational reimbursement.

If, when we evaluate at mid-year, there appears to be enough strength in the economy and the budget, I will hold open the possibility of recommending one-time bonuses in about January (through an amended budget). The bonus would help take the edge off of the growing economic stress some families may be feeling, but will not create an ongoing obligation for the city budget.

One-time funds

This budget includes several potential uses of monies that cannot be replaced until the economy turns around. There are two basic approaches you could take to lingering economic doubt. The first is to cut back more drastically, perhaps to employment levels last seen in 2005. The challenge is to cut just the "right" amount … without creating consequences that will take even longer to recover, including the loss of good, key, talented people. If you have strong evidence that the economy will not begin recovering any time soon, or may get worse, then the consequence is an acceptable choice. I might add that this approach will require significant cuts across the board, even into the police and fire ranks.

The second approach is to calculate the risk of moving some one time funding to fill the gap for another year. Obviously, if we completely miss the boat, then the adjustments in the future may have to be marginally deeper because of the wait. I believe this approach is prudent, and recommend it. But recognize that I am trying to balance the risk versus the opportunity to come through the recession with an intact organization. We will constantly monitor trends, and propose adjustments as needed. But I would rather take this risk than dismantle too early.

The one-time sources recommended in the budget include:

- After paying this year's amended budget obligations from Capital Support, and paying our entire obligation to the new library, there will be additional uncommitted monies available to transfer back into the general fund.
- For several years, we have charged departments a rate-based amount for unemployment benefits. However, we pay the cost of those benefits based on actual use. So we have collected essentially $80-$100,000 more each year than it has cost us. There will be additional costs this year because of the layoffs, but we can, if needed, move up to $750,000 from the Risk Management fund back into the general fund.
- We have purchased a surety bond to guarantee (not pay, guarantee) the last two years of sales tax bond payments, in order to free up the approximate $1.4 million sitting in a bond reserve account. The cost of the surety bond is $58,000, which buys us immediate access to the reserve.
- I have moved in the current year's budget from a replacement funding of computer equipment to a level, pay as you go system. There is still a balance in the IT replacement fund, and we can pay for this year's equipment purchases out of that fund instead of budgeting it in the general fund.

Although we have budgeted these one-time sources, we will only use them if and when needed.

ENTERPRISE FUNDS AND CAPITAL PROJECTS
Adjustments to utility rates are under current consideration by the City Council. Some adjustments will require either significant increases in rates or decreases in services and capital projects. After final rate adjustments are adopted by the Council, we may need to revise and adjust the budget to reflect those adjustments.

Capital projects will tend to trend down somewhat again this year in response to declining resources. Plans are in place to pick up the pace once the resources become available. That does not mean we will be without work … the road maintenance activity will still be high, and we have a number of projects that we will be carrying over into next year in storm, water, and sewer. We pushed a lot of envelopes this year to get critical projects in the ground, both because they are needed, and we wanted to take advantage of the bidding climate. That effort, however, is stressing our fund balances, so will need to be moderated for a time.

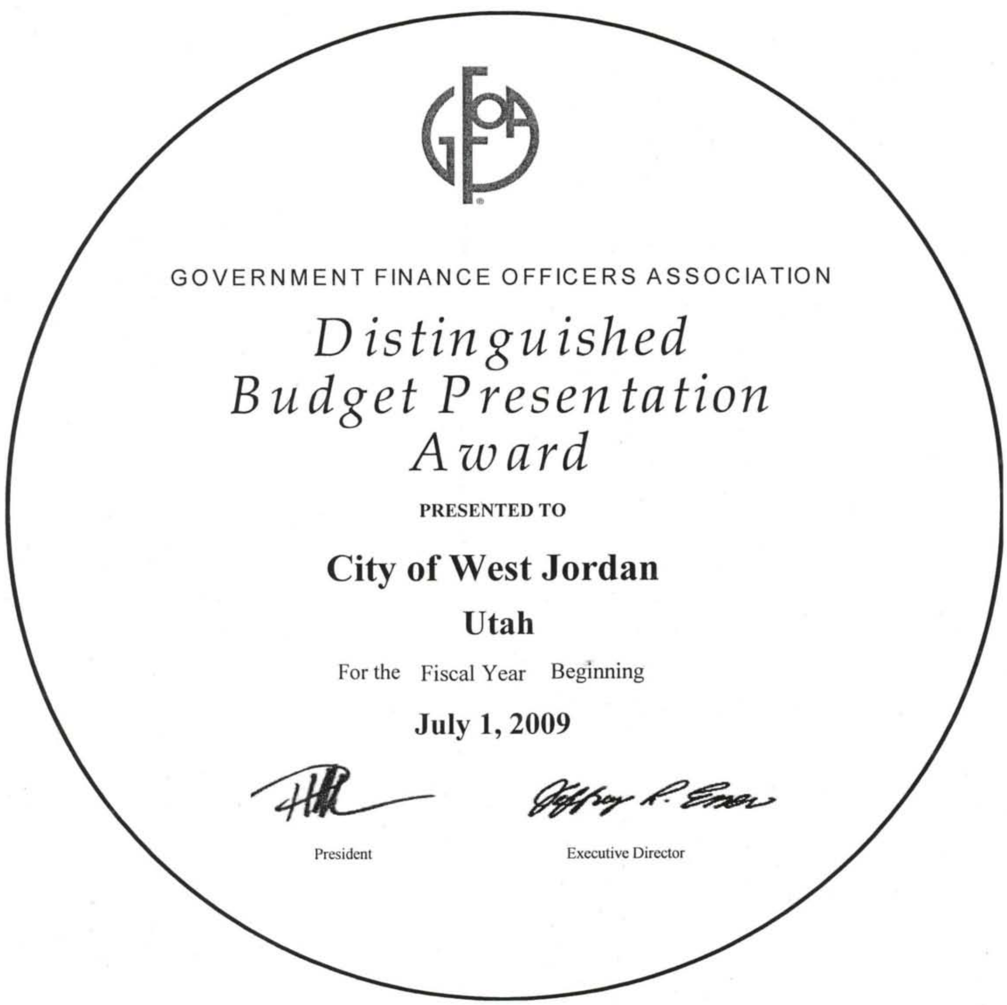
FINAL COMMENTS
We are working toward the completion of operations strategic planning; have begun design of the business center concept; and have begun a series of training sessions to focus on issues of process/outcome improvement. We are not sitting on the sidelines during the recession. We are engaged and involved in a wide and deep range of issues and challenges. Our commitment is to implement your vision, to effectively serve the community, and to do whatever it takes to thrive as an organization.

Sincerely,

Tom Steele
City Manager

The Government Finance Officers Association of the United States and Canada (GFOA) presented a Distinguished Budget Presentation Award to the City of West Jordan for its annual budget for the fiscal year beginning July 1, 2009 and ending June 30, 2010. In order to receive this award, a governmental unit must publish a budget document that meets program criteria as a policy document, as an operations guide, as a financial plan, and as a communications device.

This award is valid for one year only. We believe our current budget continues to conform to program requirements, and we are submitting it to GFOA to determine its eligibility for another award.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July 1, 2009

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