

Mayor Cal Sheehy
Vice Mayor Jeni Coke
Councilmember Nancy Campbell
Councilmember Jim Dolan
Councilmember David Lane
Councilmember Michele Lin
Councilmember Cameron Moses



Lake Havasu City
Police Facility
2360 McCulloch Blvd North
Lake Havasu City, Arizona
86403
www.lhcaz.gov

City Council Work Session

Minutes – Final

Wednesday, March 31, 2021

9:00 AM

CALL TO ORDER

Mayor Sheehy called the meeting to order at 9:00 a.m.

PLEDGE OF ALLEGIANCE

The Mayor led in the Pledge of Allegiance.

Mayor Sheehy announced that members of the public could attend in-person, watch or listen to the meeting on Channel 4, or live stream on the City's website. He added that public comments are being accepted by emailing the City Clerk at cityclerk@lhcaz.gov at least one-hour prior to the posted start time of the meeting.

ROLL CALL

PRESENT: Councilmembers Cal Sheehy, David Lane, Jeni Coke, Jim Dolan, Michele Lin, Cameron Moses, and Nancy Campbell.

ABSENT: None.

PUBLIC HEARING

4.1 Presentation, Discussion, and Potential Direction to Staff on the Financial Condition of the City Including Budget for Fiscal Year 2020/21 (Year-End Estimates), Fiscal Year 2021/22 Annual Budget, Future Budget Estimates, and Potential Revenue Options (Jill Olsen)

Administrative Services Director Jill Olsen addressed the Council and said the budget presentation would focus on the financial condition of the City budget for Fiscal Year (FY) 2020-21 (year-end estimates), future budget estimates for the next four fiscal years, and future financial considerations and potential revenue options for the Council's consideration.

Ms. Olsen reviewed the financial considerations as follows:

- Deferred Capital and Maintenance
 - Facilities and other City properties
 - Equipment & Vehicles
- Levels of service
 - Limited staff
 - Expand levels of service only when resources available, i.e., additional funding required
- PSPRS Unfunded Liability
 - Currently at \$60 million
 - Pension funding policy shows 100% funding by 2036
 - Requires additional \$4 million per year (not feasible with current revenue sources)
- PSPRS Rate increasing by 6 to 8 percentage points

She said the City has deferred the capital and maintenance of assets over the years with property and facilities, including equipment and vehicles, exceeding their lifespan and deferred maintenance on many facilities due to lack of funding. She said the City also has limited staff struggling to maintain the current service levels as the budgets have not grown to accommodate additional staff or budget funding to allow for increased levels of service or some adequate levels of service at the current level. She said to expand any service levels in any areas would require additional funding in the form of additional revenues or expenditure reductions in other areas. Ms. Olsen said the City's Public Safety Personnel Retirement System (PSPRS) unfunded liability for police and fire is around \$60 million. The City's pension funding policy currently shows 100 percent funding by 2036, which would require an additional \$4 million per year that is not currently budgeted in an annual amount to pay the liability down by the projected date. Staff is currently reviewing the policy to see whether it can be updated with a more realistic figure based on requirements in state law. Ms. Olsen said the upcoming rate for PSPRS in FY 2021-22 is also increasing 6 to 8 percentage points depending on the tier for police and fire.

Mayor Sheehy asked when the City would know the PSPRS percentage increases, to which Ms. Olsen said the City has received the percentages and the level of increase depends on the tiers. Mayor Sheehy asked if the financial forecast includes the PSPRS percentage increases, to which Ms. Olsen said the increases have been included in the salaries, wages, and benefit estimates.

- Court Operations Budget
 - Additional operating costs for Court at new location not included

Ms. Olsen stated that with the purchase of the new courthouse building the City would need to adjust the Court operations budget to ensure adequate funding for operations and staff.

- Legislative Offset begins in FY24
 - Reduced share of State Income Tax
 - Reduction of \$289,100 FY24
 - Reduction of \$578,200 FY25
 - Reduction of \$867,300 each year thereafter
 - 10-year share of reductions: \$7.8 million

Ms. Olsen said due to recent legislation, staff has included the reduction of the state shared income tax projections with increments for FY's 2024 and 2025 and \$867,300 each year thereafter with a total ten-year reduction of \$7.8 million to the City.

- Capital Improvement Plan (CIP)
 - Use one-time revenues for one-time expenditures
- Budget Stabilization Reserve at Appropriate Levels – currently 25%
 - Prepare for future budget shortfalls
 - Higher level may be recommended

Ms. Olsen said the availability of new resources would allow the City to increase the amount that the General Fund contributes to the CIP, which is generally limited to \$2.2 million annually based upon estimated construction sales tax. She said there are items needed in the future that have not been included in the CIP due to lack of funding, emphasizing that there are still needs outside of the current CIP in order to meet the needs of the community for the current levels of service. Ms. Olsen said the Budget Stabilization Reserve (BSR) is included in the estimates at the current rate of 25 percent, which is calculated from 25 percent of the five-year average of General Fund revenues. She said because the City is heavily reliant on sales tax, we could have significant shortfalls in the future

with little time to react; therefore, staff is researching what other cities are using for their BSR to see whether 25 percent is adequate and reasonable.

- Position Analysis Implementation effects
 - Net increase to employee costs of \$3.1 million for FY21
 - Compounded thereafter at 3.0% (average)

Ms. Olsen spoke on the positional analysis implementation and net increase to the budget, noting that this amount will compound every year around three percent. She said some employees will cap-out at the top of the range therefore it should not reach the full 3.5 percent but moving forward it is a number that is going to go up consistently with a compounding effect.

Ms. Olsen reviewed the FY 2020-21 year-end estimates as follows:

General Fund: Five-Year Forecast (in millions)

	2021YE Estimate	FY 21-22	FY 22-23	FY 23-24	FY 24-25
Beginning Resources	\$38.1	\$51.1	\$53.7	\$55.4	\$57.3
Revenues	69.5	62.0	61.3	62.9	64.5
Expenditures	(52.9)	(56.1)	(57.1)	(59.1)	(60.7)
Debt Payments	(.9)	(1.2)	(0.5)	(0.1)	(0.1)
Transfers In/(Out)	(2.7)	(2.1)	(2.0)	(1.8)	(1.7)
Surplus/(Deficit)	13.0	2.6	1.7	1.9	2.0
Resources Available Before BSR	\$51.1	\$53.7	\$55.4	\$57.3	\$59.3
Budget Stabilization Reserve (BSR) – 25%	(13.3)	(13.9)	(14.4)	(14.9)	(15.5)
Ending Resources Available After BSR	\$37.8	\$39.8	\$41.0	\$42.4	\$43.8

Ms. Olsen added that the revenue increases are reflected in the five-year forecast, noting that the higher amount in FY 2021 reflects the CARES funding and FY 2022 removes any CARES and new American Rescue Plan (ARP) funds as they are one-time monies. The City does not know what the eligible expenditures for those monies look like; therefore, the City has not included them at this time.

	2021YE Estimate	FY 21-22	FY 22-23	FY 23-24	FY 24-25
Beginning Resources	\$38.1	\$51.1	\$53.7	\$55.4	\$57.3
Revenues	69.5	62.0	61.3	62.9	64.5
Expenditures	(52.9)	(56.1)	(57.1)	(59.1)	(60.7)
Debt Payments	(.9)	(1.2)	(0.5)	(0.1)	(0.1)
Transfers In/(Out)	(2.7)	(2.1)	(2.0)	(1.8)	(1.7)
Surplus/(Deficit)	13.0	2.6	1.7	1.9	2.0

Deferred Maintenance, Vehicles, & Staffing	-	(7.0)	(5.5)	(4.0)	(3.0)
PSPRS Unfunded Liability	-	(4.0)	(4.0)	(4.0)	(4.0)
Surplus/(Deficit)	13.0	(8.4)	(7.8)	(6.1)	(5.0)
Resources Available Before BSR	\$51.1	\$53.7	\$55.4	\$57.3	\$59.3
Budget Stabilization Reserve (BSR) – 25%	(13.3)	(13.9)	(14.4)	(14.9)	(15.5)
Ending Resources Available After BSR	\$37.8	\$39.8	\$41.0	\$42.4	\$43.8

She explained that the line items in red include the deferred maintenance, vehicles, and staffing as well as PSPRS unfunded liability dollars that when applied shows that the City has structural deficit and is something to keep in mind when looking at future considerations. She said the deferred items include departmental requests over the years such as vehicles and facility improvements (including patrol vehicles, fire engines, court capital, etc.) that could be funded should those resources become available at that higher level.

Ms. Olsen reviewed the potential revenue sources as follows:

- Commercial Lease Tax
 - Each 1% generates approximately \$250,000
 - Truth in Taxation hearing
 - Requires ordinance and Council approval
- Sales Tax
 - Additional 1% rate generates \$13 million
 - Current sales tax rate is 2%
 - Truth in Taxation hearing
 - Requires ordinance and Council approval
- Property Tax Rate Increases
 - 2% levy increase allowed each year
 - Current rate: \$0.6718
 - Allowed rate: \$0.9015
 - Additional levy = \$1.9 million per year
 - Each \$.05 generates an additional \$400,000
 - Truth in Taxation hearing
 - Requires Council approval
- Bed Tax Rate
 - Additional 1% generates \$340,000
 - Current Bed Tax Rate is 3%
 - Truth in Taxation hearing
 - Requires ordinance and Council approval

Ms. Olsen said for informational purposes the following is a list of the comparable cities used in the positional analysis and utility rate study for comparison of commercial lease tax, sales tax, and bed tax percentages as well as the primary property tax and secondary property tax rates.

COMPARABLE CITIES

City/Town	Commercial Lease Tax	Sales Tax	Bed Tax	Primary Property Tax Rate	Secondary Property Tax Rate
Avondale	2.50%	2.50%	2.00%	0.7003	0.954
Buckeye	2.00%	3.00%	3.00%	1.8000	None
Bullhead City	2.00%	2.00%	3.00%	None	None
Casa Grande	1.80%	2.00%	2.00%	1.0606	0.2752
Flagstaff	2.28%	2.28%	4.28%	0.7933	0.8366
Goodyear	2.50%	2.50%	2.50%	1.0619	0.6713
Kingman	2.00%	2.50%	4.00%	None	None
Lake Havasu City	None	2.00%	3.00%	0.6718	None
Marana	2.00%	2.00%	6.00%	None	None
Maricopa	2.00%	2.00%	2.00%	4.7845	1.1871
Oro Valley	None	2.50%	6.00%	None	None
Prescott	2.75%	2.75%	3.00%	0.2599	None
Yuma	1.70%	1.70%	2.00%	2.3185	None

Ms. Olsen reviewed the budget calendar and timeline for FY 2020-21.

Mayor Sheehy asked if the additional \$4 million for the City's PSPRS unfunded liability is dictated by PSPRS or by policy, to which Ms. Olsen stated that it is dictated by the City's pension funding policy that was estimated a year and a half ago.

Mayor Sheehy said the City has experienced some robust sales tax and property tax collections over the last year that has given a different year-end projection than what was discussed at the Council Planning Session in January. He said this gives the City room to do some of the deferred capital expenses but also room to keep the rates the same to provide services to the community.

Councilmember Campbell said the General Fund revenues appear to have increased by \$20 million compared to FY's 2015-16 and 2016-17. Ms. Olsen said she did not have the revenue numbers from those fiscal years to compare; however, the City starts with what is in the annual report each year. Councilmember Campbell said it appears the City's revenues have been coming in fluently and questioned the need for additional revenues and concerns about a structural deficit.

Mayor Sheehy noted that in 2015 the City had debt due to the expenditure limitation that is not reflected in the FY 2015-16 and 2016-17 budgets. Mayor Sheehy said the items presented are options for the Council's consideration, but not something that the Council has to do.

Ms. Olsen explained that in addition to the expenditure limitation, which is how the City grew the fund balance, historically even though the revenues were increasing at a certain percentage the expenditures were growing at an even higher percentage outpacing the revenues.

Councilmember Lane asked why the debt payment amounts fluctuate each year, to which Ms. Olsen explained that the debt payments include bonds for advanced payment of PSPRS unfunded liability and fire department equipment leases that decrease as the City gets to the end of the debt amounts. Councilmember Lane asked if the debt payments include sewer debt, to which Ms. Olsen replied no, only general fund debt.

Councilmember Lane asked what percentage the City is currently funded for the PSPRS unfunded liability, to which Ms. Olsen replied approximately 50 percent, adding that the City's pension funding policy targets 100 percent funded by 2036 which she believes needs to be adjusted to a more realistic number. Councilmember Lane said he would like to see the system funded around 70 percent as he does not believe a system that is not doing well should be funded at 100 percent.

Councilmember Lane asked if a future increase in bed tax would be required to go towards tourism, to which Ms. Olsen said state statute reads that it cannot exceed a rate that is more than two percent above the retail tax rate without dedicating the additional funds to tourism activities, therefore, staff believes any increase would fit within the requirements.

Councilmember Lane asked if a half a percent increase in both sales tax and bed tax would generate enough money to take care of the structural deficit and deferred maintenance on the buildings, to which Ms. Olsen said staff would need to take a closer look at the actual numbers; but it would certainly have an impact.

Councilmember Dolan was concerned about potential inflation affecting City revenues, to which Ms. Olsen said staff has tried to keep potential inflation in the estimates budgeting a reasonable increase based upon the market with the potential of growing inflation, which she would not expect until sometime after FY 2024. Councilmember Dolan asked if property taxes are factored in the budget estimates, to which Ms. Olsen said property taxes are captured in the assessed valuation numbers, which applied to any tax rate should the assessed valuation increase then the revenue would increase.

Councilmember Dolan said he thinks the City needs to look at addressing any deferred maintenance, facility and equipment needs now. He said regarding possible revenue options, he would consider increasing the bed tax as it is something that is passed to the visitors with the least impact on the residents and believes the city has the economy to support it.

Mayor Sheehy said the City has renegotiated the economic development and bed tax contracts so those contributions are already going into the General Fund. The City has a CIP budget that takes care of all the necessary priorities and added that the City is in a good position financially where the Council does not need to try or start new things but has options for additional revenues for when the time is necessary. Mayor Sheehy noted that the five-year forecast projects ending resources (prior to any deferred maintenance) to be \$43 million.

Councilmember Campbell noted that revenues in sales tax have increased \$10 million since 2016.

Mayor Sheehy said sales tax is a volatile source of revenue for the City because it is based on consumer spending versus secure sources of revenue that can be forecasted based on models. He said the presentation includes two different areas for the Council to be mindful of future expenses that are going to have to be addressed.

Councilmember Dolan said staff has been asked to do more with less over the last 10 years and he would like to see the City get ahead of any deferred maintenance issues now.

Mayor Sheehy agreed with Councilmember Dolan and said he feels the priorities of the Council are within the five-year forecast, including the positional analysis, CIP, and room for additional elements from operations, citizens, and the Council. He added that the only area he is concerned with is the funding for PSPRS, which has nothing to do with the City but how the funds are managed at the state level. He said the five-year forecast and data presented allows the Council in a conservative way to address items and sets future councils and citizens for success.

Councilmember Campbell stated that she supports addressing any deferred maintenance needs.

Councilmember Moses said he was in favor of addressing deferred maintenance needs but was concerned with the current staffing levels, which are operating at the same staffing levels from 2009, and added that he would like to see strategic hires that can assist departments with the help needed and what that budget would look like.

Councilmember Lane agreed and thanked Mr. Knudson and staff for doing more with less with deferred maintenance needs and staffing issues.

Mayor Sheehy said as Ms. Olsen explained, the revenue sources do not include any funds received from the federal government which based on the recent Census data should total around \$13 million over a two-year period; however, the use of these funds at this time is unknown. He said staff has presented a balanced budget based on priorities from the Council and a five-year forecast that shows a positive outlook moving forward.

Mayor Sheehy asked if the Council was comfortable with the current projections and revenue sources, or wished to discuss additional revenue sources.

Councilmember Dolan was concerned about ending resources projecting a structural deficit after the deferred maintenance items and PSPRS unfunded liability needs and questioned the priority levels of the deferred maintenance items. Mr. Knudson explained that City staff is doing the best they can with limited resources to provide services to the citizens. He spoke on departmental base budgets, additional positions, cost savings, Proposition 409, expenditure limitation, and one-time costs for equipment. He said the goal of the City is to provide service delivery to the citizens using both short-term and long-term decisions to accomplish that goal.

Councilmember Moses was concerned with the gradual decrease of ending resources in the five-year forecast and asked what the ending balance should be each year to remain fiscally responsible, to which Ms. Olsen explained that funding is set aside in the BSR as a savings account for emergencies. She said the steady decrease in the ending resources shows that after FY 2025 the City will reach the point with no excess resources.

Mayor Sheehy explained that by policy the BSR's current funding level is 25 percent, which will be researched and brought back to Council to determine whether that percentage is adequate and reasonable. He said the BSR is the true savings account and the other monies are carry-forwards or additional resources left after each budget year. Councilmember Moses asked if Mayor Sheehy was saying that the ending resources after BSR should be zero, to which Mayor Sheehy said it could be zero while still having a savings account. He added that the numbers should always be in the positive but where the Council finds equilibrium is the balance of putting the taxpayers' dollars to good use and being fiscally responsible to ensure the City can deliver services to the citizens. He said the five-year forecast presented allows the City to bring strategic hires and still find the balance point with the Council's priorities.

There was consensus from the Council that no additional revenue sources be considered for the upcoming budget year.

ADJOURN

Upon motion by Councilmember Lane, and seconded, the meeting adjourned at 10:06 a.m.

CERTIFICATION

I hereby certify that the foregoing is a full and true copy of the Work Session Minutes of the Lake Havasu City Council held on the 31st day of March, 2021. I further certify that the meeting was duly called and posted, and that a quorum was present.

Kelly Williams, City Clerk/MMC