

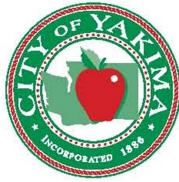


2012

City of Yakima

Five-Year Financial Plan

Presented to City Council August 21, 2012



To: The Honorable Mayor and Members of City Council

From: Tony O'Rourke, City Manager
Cindy Epperson, Director of Finance and Budget

Subject: Five-Year Financial Plan

We are pleased to provide for the City Council review and consideration the following Five-Year Financial Plan that is balanced, prudent and responsive to the service and capital needs of the community. This is the next step in looking at long-term strategies to balance the General Government (i.e. tax-supported funds, which include General; Streets and Traffic Engineering; and Parks and Recreation) budgets. At a study session on July 31, 2012, we presented the Preliminary Five-Year Financial Forecast that was based on existing revenue streams and city services. Those projections were based on an assumption of continuing business as usual – with our current structure, services, operating practices, etc. That report provided a look at the financial consequences of maintaining the status quo, which were annual deficits ranging from \$1.5 to \$4.0 million between FY 2013 and FY 2016.

Once we knew the extent of the budget “gap”, we looked at different ways to close the gap. This Five-Year Financial Plan proposes initiatives to assure the elimination of the projected annual deficits, and is an integral part of planning the City’s future financial strategy and a key tool in ensuring long-term fiscal sustainability. A Five-Year Plan allows the City to look into the future to meet our financial challenges by developing long-term solutions rather than short-term fixes.

By providing a forecast of revenues and expenditures over a five-year period (FY 2012-FY 2016), the Five Year Financial Plan will assist the City Council in meeting the following key goals:

- Ensuring a financially sustainable future.
- Preservation of the City’s core services.
- Commitment to funding infrastructure; facilities and rolling stock.
- Addressing Strategic Plan priorities.

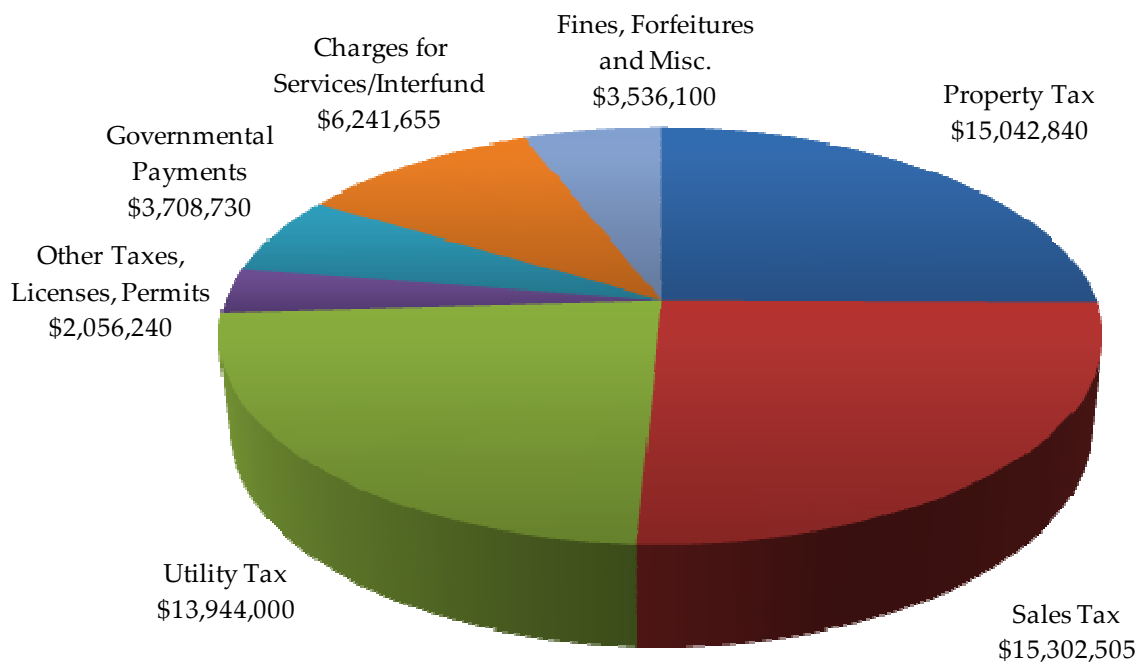
The Five-Year Financial Plan is designed to focus on the City’s General Government given these are core to the City’s ability to provide essential services and capital improvements. The balance of the City’s other funds will be addressed during the budget process. As time goes on, this plan will be monitored, as economic/business conditions will likely be different from preliminary estimates. Any significant changes in assumptions will require future modifications to the plan.

GENERAL GOVERNMENT REVENUE

The revenue forecast represents an analysis of the economic factors driving the City's revenue base and specific revenue sources available to the City. The City's core General Government revenues are increasingly affected by the economy. The financial plan revenue projections reflect various assumptions about the future economic environment based on national, state and local economic forecasts. The General Government revenue forecast takes into consideration that the City's economy will lag behind the recovery of the State and National economy based on the following:

- The unemployment rate for Yakima County is over 10% (10.8% in May, 2012).
- The Property Tax levy is capped at 1% growth plus new construction which has been negatively affected by the real estate market decline.
- Total taxable sales are projected to increase marginally as the economy improves over the next 5 years.
- Utility customers are practicing conservation measures to manage their total bills. The city-owned water and wastewater utilities are experiencing reducing consumption, and hard-line telephone services are being eliminated as consumers convert to cellular only.
- With the decline in the real estate market there has been a correlated decline in the number of building and planner permits submitted to the City negatively impacting permit fee revenues.
- The State budget crisis is expected to continue to impact local municipalities across the state.

The following chart depicts the 2012 projected budget in generalized categories:



The following projection summarizes the General Governments major revenue source totals and growth for the next five fiscal years. Over the next five years, the average annual increase in General Government revenue will be 1.3%.

General Government Revenue Growth Forecast

Revenue Category	2012 Forecast	2013 Forecast	2014 Forecast	2015 Forecast	2016 Forecast
Property Tax	1.3%	2.0%	2.0%	2.0%	2.0%
Sales Tax	0.7%	2.0%	1.5%	1.5%	2.0%
Utility Tax	17.2%	0.2%	0.5%	1.0%	1.0%
Other Taxes, Licenses, Permits	(8.5%)	0.7%	0.7%	0.9%	0.9%
Governmental Payments	(7.2%)	1.9%	0.4%	0.3%	0.5%
Charges for Services/Interfund	(3.6%)	0.0%	0.2%	0.4%	0.4%
Fines, Forfeitures and Misc.	5.0%	0.5%	0.5%	0.5%	0.5%

Property Tax

	2012 Forecast	2013 Forecast	2014 Forecast	2015 Forecast	2016 Forecast
Property Tax	\$15,042,840	\$15,343,697	\$15,650,571	\$15,963,582	\$16,282,854
Growth Forecast	1.3%	2.0%	2.0%	2.0%	2.0%

Property tax is the city's largest revenue source, representing 25.8% of the General Fund revenue for 2011. The City sets the amount of the levy each year within limits set by state law. The tax is then distributed among the taxpayers by the assessed taxable value of all real property within the City.

Projections and Assumptions

The Property Tax levy is limited to 1% per year increase due to a citizen initiative from several years ago. However, the increase in revenue is generally higher than the 1% because new construction and annexations add to the base. We are not anticipating any annexations in the near future, but new construction is increasing ever so slightly again, and is estimated to add 1% annually to the property tax roles.

Retail Sales and Use Tax

	2012 Forecast	2013 Forecast	2014 Forecast	2015 Forecast	2016 Forecast
Sales Tax	\$15,302,505	\$15,608,555	\$15,842,683	\$16,080,324	\$16,401,930
Growth Forecast	0.7%	2.0%	1.5%	1.5%	2.0%

The City of Yakima receives 0.85% (or about 10.4%) of the 8.2% sales and use tax collected within the city under this revenue source (an additional 0.7% is currently received for restricted purposes – 0.3% for transit, and 0.4% for criminal justice purposes). This tax represents 21.9% of the General Fund revenue for 2011.

The portion of sales and use tax restricted to providing criminal justice related services represents 4.5% of the General Fund revenue. There are two taxes – a 0.3% and a 0.1%. The 0.3% tax on sales was originally passed in November, 2004, and is based on sales inside the County only - the proceeds are divided between the County and Cities on a predefined formula under which the County receives 60% and all cities within the County share the remaining 40%. The 0.1% tax was originally approved by voters in 1992 - proceeds are allocated by the state between the County and Cities based on a predefined formula.

Projections and Assumptions

Sales tax history shows a large drop in 2009 after a decade of healthy growth. It has been pretty flat in 2010 and 2011, but has started trending up in the first 6 months of 2012 (about 2.4% over last year at the same time). The projection is held to 2% for 2013 and slightly upward thereafter. Growth in this category is expected to slowly increase over the next several years, in anticipation of a recovering economy.

Utility Tax

	2012 Forecast	2013 Forecast	2014 Forecast	2015 Forecast	2016 Forecast
Utility Tax	\$13,944,000	\$13,970,283	\$14,040,134	\$14,180,535	\$14,322,341
Growth Forecast	17.2%	0.2%	0.5%	1.0%	1.0%

Utility tax represents approximately 20.0% of the General Fund revenue. It comes from taxes on utilities, both City-operated and outside utilities. This revenue varies according to weather conditions, consumer conservation efforts and utility rates.

Projections and Assumptions

Utility tax rates were increased 6% by the Council effective in February 2012 to increase Public Safety funding. Certain rates were also increased which will of course increase the tax revenue. However, as consumers learn to conserve and as we have had mild weather for a couple of years now, the revenue has actually trended down in a few areas. The City's bond covenants require that the water, wastewater and irrigation systems be maintained adequately to serve our citizens throughout the life of the bonds. Rate studies are done every 3 to 5 years to help us determine that we have adequate financial resources to maintain the system. These rates will anticipate necessary capital replacement, improvements or potential mandated upgrades by regulatory agencies.

Other Taxes, Licenses, and Permits

	2012 Forecast	2013 Forecast	2014 Forecast	2015 Forecast	2016 Forecast
Other Taxes, Licenses, Permits	\$2,056,240	\$2,070,921	\$2,085,720	\$2,103,463	\$2,121,367
Growth Forecast	(8.5%)	0.7%	0.7%	0.9%	0.9%

This category includes business licenses, gambling taxes and building licenses and permits, representing only about 3.4% of total revenue.

Projections and Assumptions

The business license fee has been unchanged since the late 1980s, when these fees were increased so that the City could participate in building the SunDome. Any change would just be the number of businesses and/or employees operating within the City limits. Gambling tax has been rather steady over the past several years. Building permits dropped during the recent recession, but the major school rebuilding projects have shored up this revenue in 2011 and 2012. Future revenues are conservatively projected to grow just slightly less than 1% over the next 5 years.

Governmental Payments

	2012 Forecast	2013 Forecast	2014 Forecast	2015 Forecast	2016 Forecast
Governmental Payments	\$3,708,730	\$3,779,276	\$3,793,371	\$3,805,529	\$3,823,666
Growth Forecast	(7.2%)	1.9%	0.4%	0.3%	0.5%

Intergovernmental revenue makes up about 6.2% of the total pie. The major component of this category is state-shared revenue, including the liquor taxes and profits; gas tax; and criminal justice distributions. Also included is the contract with Yakima School District for school resource officers, and Yakima County for the joint purchasing agreement, among other grants/agreements.

Projections and Assumptions

Although the anticipation going into 2012 was that the State would cut much of this revenue to balance its budget, it did not come to pass. Instead, a voter initiative to privatize state liquor sales actually increased the amount to be distributed to local governments to maintain local criminal justice systems. Part of the increase in 2013 is tied to the School District's commitment to fund 2 school resource officers as the COPS grant winds down. Because of potential long-term issues for the State's budget, this revenue is projected to remain rather flat through the next several years.

Charges for Services/Interfund

	2012 Forecast	2013 Forecast	2014 Forecast	2015 Forecast	2016 Forecast
Charges for Services/Interfund	\$6,241,655	\$6,241,655	\$6,255,844	\$6,278,006	\$6,303,539
Growth Forecast	(3.6%)	0.0%	0.2%	0.4%	0.4%

Charges for Services represent 10.4% of the 2012 General Government revenue. The majority of this revenue comes from fees paid by other City funds in order to allocate the costs of general fund support services (legal, administration, purchasing, accounting, payroll, etc.). These services are billed to each department based on a percentage of the total amount of costs required to be recovered from other funds. Also included are certain charges for services to the public such as Parks program fees.

Projections and Assumptions

The State Auditors have issued new requirements for the allocation of City Service charges. In preliminary analysis it appears that we may not be able to recover such costs as easily as in the past. This revenue is held constant until 2014 pending further research and discussion with the State Auditor. Outside charges trend slightly upward.

Fines, Forfeitures and Miscellaneous

	2012 Forecast	2013 Forecast	2014 Forecast	2015 Forecast	2016 Forecast
Fines, Forfeitures and Misc.	\$3,536,100	\$3,553,781	\$3,571,549	\$3,589,407	\$3,607,354
Growth Forecast	5.0%	0.5%	0.5%	0.5%	0.5%

Fine and Forfeiture revenue is derived primarily from criminal fines, noncriminal penalties, and parking violations, and represents 2.7% of the 2011 General Fund revenue. This also includes the transfer of 3.5% of water, wastewater and refuse utility tax designated for Parks and Recreation programs from General Fund. Other miscellaneous revenue consists primarily of interest income from investing available cash balances.

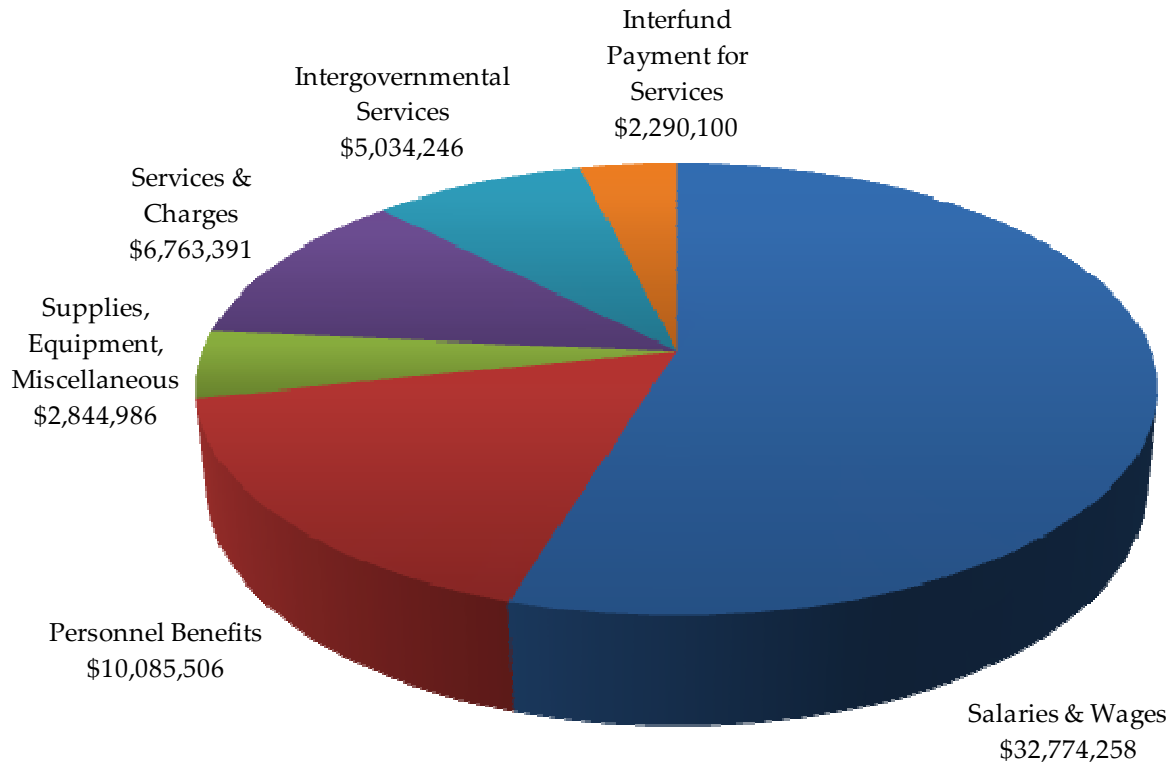
Projections and Assumptions

Prior to the recession, interest income was 3 times more than it is today. These projections are held mostly flat with just minor increases in miscellaneous sources.

GENERAL GOVERNMENT EXPENDITURES

The primary costs of the General Government expenditures are for salaries and wages, and personnel benefits, which combined comprise 70.7% of the General Government expenditure budget.

The following chart depicts 2012 projected budget in generalized categories:



The following chart shows projected General Government expenditures for the next five fiscal years by major category. Over the next five years, the average annual increase in General Government expenditure will be 2.8%.

General Government Expenditure Growth Forecast

Expenditure Category	2012 Forecast	2013 Forecast	2014 Forecast	2015 Forecast	2016 Forecast
Salaries & Wages	3.4%	4.3%	1.9%	0.8%	0.8%
Personnel Benefits	11.2%	7.2%	7.3%	8.0%	8.0%
Supplies, Equipment, Misc.	(5.9%)	1.0%	1.4%	1.9%	1.9%
Services & Charges	5.9%	1.0%	1.5%	2.0%	2.0%
Intergovernmental Services	0.6%	1.0%	2.0%	2.0%	2.0%
Interfund Payment for Services	0.4%	0.0%	0.0%	0.0%	0.0%

Salaries & Wages

The primary costs of the General Government expenditures are for salaries and wages, which reflect the service nature of local government. Salary costs account for 55.0% of general government expenditures.

Projections and Assumptions

Salaries and wages have been held constant with only minor adjustments for step increases. Police and Fire salaries reflect estimates for recently negotiated increases. Most employee classes have not had a salary increase in several years although benefit deductions have increased, resulting in lower take home pay across the board. Beginning in 2013, the COPS Hiring Grant begins to run out. Additional annual police salaries will be \$305,000 in 2013, \$277,000 in 2014 and \$7,100 in 2015. The increase in total annual salary due to expired grant funding is \$589,000. There are some associated revenue increases that occur earlier in the cycle in that certain outside agencies (Yakima School District and the Yakima Housing Authority) are paying the full salaries of 3 of the 7 officers that were funded on the grant. These revenues are included in the Projection as Intergovernmental Services.

Personnel Benefits

The second largest City expense is the cost of personnel benefits. These benefits include Social Security, pension costs, and medical, dental, vision and life insurance. Personnel Benefit costs represent approximately 15.7% of the General Fund expense. The City is self insured for its medical, dental and vision; unemployment; and workers' compensation programs for all eligible employees, which is the least expensive way to provide these benefits.

Projections and Assumptions

Benefit costs are anticipated to rise at a rate double the CPI. Although certain benefit costs such as Social Security have not increased at all, health care costs will potentially increase at a rate of 6.5% to 10%. Co-pays and incentives were designed into the plan in 2012 to help mitigate the cost increases. These changes have only been marginally successful and current year claims have eaten into the health plan reserve. When outside plans have been considered, the estimated rates have been considerably higher. The City pays a variable contribution rate, dependent upon bargaining group. The most generous plans are in Police and Fire although both groups have begun to share more of the cost of their plans.

As health care is the largest component of personnel benefits and is estimated to increase more rapidly than other costs, this category is broken out as follows:

	2012 Forecast	2013 Forecast	2014 Forecast	2015 Forecast	2016 Forecast
Medical	\$4,652,713	\$4,987,708	\$5,351,811	\$5,779,956	\$6,242,352
Dental	\$467,720	\$501,396	\$537,998	\$581,038	\$627,521
Total	\$5,120,433	\$5,489,104	\$5,889,809	\$6,360,993	\$6,869,873

Supplies, Equipment and Miscellaneous

This represents the tangible goods purchased by the City. Examples include office supplies; fuel; gravel, tar and deicer for street programs; items sold at the concession stands for parks programs; ammunition for the police department; and hoses for the fire department. The equipment budget has been greatly reduced through these last recessionary years. Although the City cannot continue to offer services without investment in facilities and equipment, **virtually no capital expenditures are included in this projection.**

Projections and Assumptions

Supply and equipment costs are expected to increase at a modest rate as the economy moves slowly forward.

Services and Charges

The majority of these expenditures are for professional services needed that are from outside sources. Items include communications (telephone, postage); utilities; training; and repairs & maintenance.

Projections and Assumptions

Service costs are expected to increase at a modest rate as the economy moves slowly forward.

Intergovernmental Services and Interfund Transfers

Jail costs provided by other governments make up about half of this category, while the other half consists of interfund transfers. The largest transfer is from General Fund to the Parks and Recreation Fund for the 3.5% of utility taxes that are designated for that purpose. Also included in this category is the General Fund support for Fire and Police dispatching, and transfers to debt service funds.

Projections and Assumptions

The City has negotiated a jail contract with Yakima County which has brought some stability to this expenditure. Internal utility taxes are projected to slightly increase, so that the transfer to Parks and Recreation is matched to that revenue source. Dispatch personnel received a negotiated labor settlement similar to Fire personnel, so that transfer is expected to increase, as well.

Interfund Payments for Services

These payments are made between funds for services offered by other areas of the City. The largest of these interfund payments are for equipment rental by various areas of the City, along with Public Works Administration charges for streets and parks and contributions to the Risk Management Fund.

Projections and Assumptions

These costs are held steady pending new requirements by the state in the process by which we allocate the cost of City Services to other departments and funds.

Deferred Maintenance and Capital Improvements

Over the years, the City has failed to keep pace with needed capital investment and deferred maintenance of its capital assets. Currently, approximately 50% of the Equipment Rental Fleet (which excludes Police, Fire, and Transit rolling stock) is beyond its calculated replacement age. Street maintenance programs have been severely extended since the beginning of the Great Recession, and the current index pavement condition is at 51%. Parks capital funding is completely depleted—there is not enough in the Parks Capital fund to respond to any major maintenance emergency. This forecast as it stands today is extending the deferred maintenance, so that current equipment and facilities will continue to deteriorate.

FUTURE OUTLOOK

Based on projected revenue and expenses the Preliminary Five-Year Financial Forecast reflects projected structural budget deficits between \$1.5 million and \$4.0 million annually between 2013 and 2016.

5-Year Forecast

General Fund (Millions)	2012 Forecast	2013 Forecast	2014 Forecast	2015 Forecast	2016 Forecast
Revenues	\$59.8	\$60.6	\$61.2	\$62.0	\$62.9
Expenditures	\$59.8	\$62.1	\$63.8	\$65.3	\$66.8
Net	\$0.0	(\$1.5)	(\$2.5)	(\$3.3)	(\$4.0)

Projected General Government Reserves

The City has a policy to maintain 7.5% unassigned operating reserve in the combined General Government funds to address unforeseen expenditures of an emergency nature. The following table depicts the ending reserve balance based on the summary forecast presented above, and the calculated percentage of operating expenses.

	2012 Forecast	2013 Forecast	2014 Forecast	2015 Forecast	2016 Forecast
Operating Reserve % of GF	9.9%	7.1%	4.5%	0.5%	(4.4%)
Total Reserve	\$5.9	\$4.4	\$2.9	\$0.3	(\$2.9)

In the absence of proactive budget reduction measures, the City's unassigned General Government operating reserves will be below the City's 7.5% policy threshold starting in 2014, and actually be negative in 2016.

BUDGET ALTERNATIVES

Based on the results of the preliminary Five-Year Financial Forecast, we are confronted with some challenging budget decisions over the next several years. It is clear we must develop a longer-term strategy for dealing with both our current and future budget reality.

The projected budget shortfalls are not the same as budget deficits. The City will have budget deficits only if we do nothing. However, by looking ahead and taking corrective measures to close these projected shortfalls, we can avoid actual budget deficits and complete erosion of our General Government (i.e. General, Parks and Recreation, and Streets and Traffic Engineering) operating reserves.

Reorganization Plan – In my first few months at the City, I observed areas in the organization that were being underserved and needed additional resources allocated to them to better accomplish the City's strategic priorities. This will be adding slightly to the cost of operating the City, however, we anticipate this investment in economic development and strategic planning will bring long-term stability and growth to revenue.

Expenditure Reductions

- **Wage and Benefit Concessions** – As bargaining units negotiate wages and benefits, we will be asking for zero cost-of-living wage growth and benefit concessions – AFSCME has already discontinued longevity and deferred compensation for new hires. The plan assumes termination of the City's deferred compensation benefits program, with a current cost of \$1.5 million annually, subject to collective bargaining negotiation. The reduction is estimated to be \$300,000 in 2013 growing to \$1.5 million by 2016.
- **Airport Fire Service** – The City has been fully staffing the Aircraft Rescue Fire Fighting (ARFF) apparatus at the Yakima Air Terminal, without any reimbursement from airport operations. The Fire Department is proposing to transfer 3 full-time firefighter positions assigned to this apparatus to other fire stations with vacancies, and staff mandated coverage on overtime. There are currently 3 vacant firefighter positions which will be eliminated. This change is expected to result in net savings of about \$200,000 annually.
- **2% Vacancy Rate** – Historical vacancy/turnover rate for the City is between 4 and 5%. To more accurately budget for salaries and benefits, I am proposing that the budget reflect the estimated savings in personnel expenses attributable to vacancies, attrition, leave of absences and turnover. All authorized positions are generally not filled throughout the fiscal year, reflecting in savings from short-term vacancies, under-filled positions, and newly hired employees starting at lower salaries and benefits. By instituting a 2% personnel vacancy rate in General Government, the City can avoid budgeting about \$800,000 in 2013, up to \$1 million in 2016.
- **Health Care costs** constitute the single largest benefit cost of the City. Currently, the total average cost for health care per employee is approximately \$12,800 annually. On average, employees are contributing about 14% of the total cost of coverage or about \$1,800. The balance of \$11,000 per employee per year is being paid by the City. In recent years, this component of

wages and benefits is growing at a rate of 6% to 8% annually, and is not fiscally sustainable. We are working with our self-insured broker, Health Benefit board, and collective bargaining units to look at benefit design and health care delivery options to lower the steep increase projected in health care costs. We have identified reductions starting in 2013, which will be maintained in the Health Benefit fund, as that reserve balance is below required levels. We expect to reduce costs to the rest of the City by \$500,000 beginning in 2014, and growing to \$1 million by 2016.

- **Managed Competition** – To achieve efficiencies in City operations, the City should pursue competitive managed competition of City services and assets on a regular basis. Departments have been tasked with identifying operations that can be subject to managed competition.
- **Attrition/Service Reductions** – Departments are also looking at the levels of service being provided and to determine if similar results can be obtained with fewer resources. Every vacant position will be critically examined to determine if and when it would be replaced. We anticipate attrition and the subsequent elimination of a few positions to result in savings of \$200,000 in 2013, growing to \$500,000 in 2015 if revenue growth remains slow.

Capital Improvements -- Council has been studying the need for a stable funding source for major street maintenance and improvements. The next step to address the issue of the declining quality of our streets is to dedicate a new revenue source to make needed capital investment in our infrastructure. Two viable revenue options have been discussed in the past few months at various study sessions and public meetings.

Revenues

- **Metropolitan Parks District (MPD)** – Should the MPD go forward as a funding option for Parks and Recreation, the City would also have an opportunity to use resources currently allocated for that function to street improvements. As presented at the Council Study Session, the City could retain up to \$1.5 million of the property tax levy, which could be re-directed for any municipal purpose. I would propose that Council dedicate this for major street projects/improvements, as presented in the Transportation Benefit District materials.
- **Car Tab Fee** – The Transportation Benefit District can establish an annual car tab fee of \$20 per vehicle. This is estimated to generate about \$1 million annually. This would be a good source of revenue for necessary annual maintenance that is currently being deferred because of the lack of dedicated resources.

CONCLUSION

The following chart summarizes the budget gap identified in the 5-year Financial Forecast, and our proposals to bring the next several budgets into balance.

General Fund (Millions)	2012 Forecast	2013 Forecast	2014 Forecast	2015 Forecast	2016 Forecast
Revenues	\$59.8	\$60.6	\$61.2	\$62.0	\$62.9
Expenditures	\$59.8	\$62.1	\$63.8	\$65.3	\$66.8
Budget Gap	\$0.0	(\$1.5)	(\$2.5)	(\$3.3)	(\$4.0)
Recovery Plan Element					
Wage and Benefit Concessions		\$0.3	\$0.7	\$1.0	\$1.5
Airport Fire Service		\$0.2	\$0.2	\$0.2	\$0.2
2% Vacancy Rate		\$0.8	\$0.9	\$1.0	\$1.0
Health Care Costs			\$0.5	\$0.7	\$1.0
Managed Competition					
Attrition/service reduction		\$0.2	\$0.2	\$0.5	\$0.3
Net Budget	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0

Street Maintenance Program Revenue					
Revenue Options	2012 Forecast	2013 Forecast	2014 Forecast	2015 Forecast	2016 Forecast
Property Tax-MPD creation			\$1.5	\$1.5	\$1.5
Car Tab Fee			\$1.0	\$1.0	\$1.0
Net Revenue	\$0.0	\$0.0	\$2.5	\$2.5	\$2.5

Although the City of Yakima is slowly coming out of the worst economic recession in recent history, the Five Year Financial Plan represents a prudent and balanced strategy for meeting its fiscal challenges. The strategy reflected in the Five Year Financial Plan allows the City to eliminate projected budget gaps, and make critical investments in its street infrastructure. Moreover, the strategy will allow the City to continue to provide essential, outstanding cost effective service and capital improvements to our residents and businesses.