

TO: SALEM CITY COUNCIL
FROM: COUNCIL WORK GROUP ON FISCALLY SUSTAINABLE SERVICES
DATE: April 26, 2017
SUBJECT: WORK GROUP REPORT FOR MAY 6, 2017 WORKSESSION

Council Work Group Report on Sustainable Services

Issue

The City's General Fund has a structural imbalance between revenues and expenditures, precluding the City's ability to sustain current or new services.

Goal

Ensure fiscal sustainability and provide for improved services by aligning resources with the cost of services and maintaining an adequate fund balance.

Recommendation

The City must identify the services and levels of services it desires to sustain and methods to generate the funding necessary, or reduce the costs required, to provide those services. Solutions to achieving fiscal sustainability may require tradeoffs, reduced programs, or new or increasing revenue sources.

Recommended Actions:

Assign a revenue committee to explore new, potential funding mechanisms and revenue sources

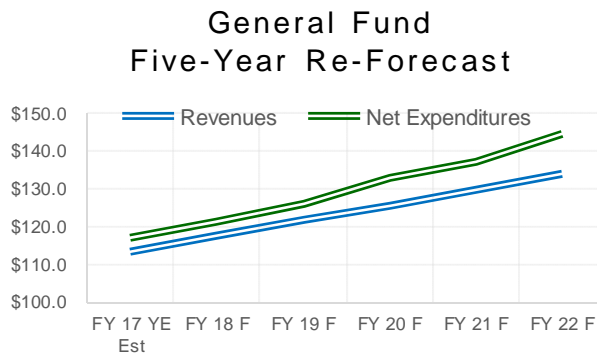
Review fees charged for services and the adequacy of recovered costs

Determine whether services can be conducted in a more cost effective or efficient manner

Summary and Background

Definition and scale of the issue:

The City's General Fund has a structural imbalance between revenues and expenditures. Continuity of services has been accomplished through efficiencies, deferral of ongoing needs, and forgoing long-term investments. These practices along with reductions to the work force during the recession, temporary PERS rate relief, recovery in the housing market have enabled the City to accumulate working capital in excess of the amount established by policy. Increased



property tax receipts have resulted in an improved fiscal condition; however, it is estimated that during FY 2017, fund expenditures are expected require the use of approximately \$3 million of working capital. The chart to the left, *General Fund Five-Year Summary*, illustrates this structural imbalance continuing into the future.

The General Fund is predicted to realize annual increases in almost every revenue type over the five-year period. The forecasted growth in revenues will not be sufficient to meet the increasing cost of providing current levels of service. In later years of the forecast, balancing the General Fund budget will require significant expenditure reductions absent more robust growth in revenues.

Details on the causes and effects of the issue:

There are a number of factors that present direct challenges to the City's ability to sustain services. Under the Oregon tax system municipalities rely heavily on property taxes as the primary source of income (approximately 60 percent of Salem's General Fund revenues). Two constitutional amendments passed by voters in the early 1990's, Measures 5 and 50, created a rate-based tax system while reducing taxable values and limiting tax rate growth. As the state capital and home to a number of other governmental, educational and non-profit institutions, Salem's revenue is further constrained by the number of properties exempt from taxes. Revenue sources other than property taxes are projected to grow only modestly at rates near general inflation.

The costs associated with the City's workforce comprise a majority of the General Fund expenditure budget. PERS (Public Employee Retirement System) obligations to retired and current employees are funded through a combination of pension system investment earnings and contributions from public employers. As the unfunded pension liability increases with insufficient returns on system investments and adjusted expectations, the rates charged to public employers escalate. All public employers are confronting unusually high pension rates which are expected to continue into the foreseeable future.

The City must be competitive in its compensation offerings in order to attract and retain talented employees. The compensation and classification study currently underway found that for non-represented positions the City is competitive at the bottom and middle of the scale, but the ranges should be expanded at the top to achieve competitive equity with similarly situated cities. The implementation of the recommendations will lead to increase in wage rates above those forecasted. Further, the Public Employee Collective Bargaining Agreement Act requires the City to compensate in a manner commensurate with “comparable cities,” defined as those with fifty percent less or greater population. It will be a challenge to remain competitive with those cities at the annual two percent increases built into the forecast.

Health care costs will be another future driver of expenditures above the rate of revenue growth. Current projections are for these costs to increase by 6.5 percent annually. The City is exploring options, including an employee clinic, to minimize the costs of providing employees with health care coverage.

Absent new revenue sources or reduction in costs, the gap between expenditures and revenues will continue to expand with current service levels. Additional service demands and reliance on the General Fund to move strategic priorities forward accelerate the urgency to identify service priorities and sustainable methods for funding those priorities.

Desired outcomes:

The ultimate desired outcome is an inclusive identification of core services to be funded and strategic initiatives to move forward with a sustainable plan to fund those services and initiatives. Questions to be answered include the following:

- What is the desired baseline service level, and what is the associated cost?
- What additional services and initiatives beyond baseline services are needed to enrich the lives of present and future residents, the quality of the environment and neighborhoods, and the vitality of the economy in accordance with the City’s mission, and what are the associated costs?
- What opportunities exist to shift funding sources or generate the revenue necessary to deliver the desired services?
- Are current fees and charges adequately recovering costs and should cost recovery be addressed in financial policies?
- Are there opportunities to modify the methods by which services are delivered or partner with other entities to reduce costs to the City?

How sustainable services fits within the City’s business:

By law, the City is required to adopt a balance budget. Pursuant to its mission the City is to provide fiscally sustainable services, which indicates that available resources are equal to or less than the cost of service provision, now and into the future. A fiscally responsible, and

financially sustainable organization is guided in its fiscal decisions by sound financial policies, which include maintaining a prudent level of reserves or working capital. These reserves enable the organization to meet cash flow needs and debt requirements and maintain a sound credit rating. A sound credit rating, in turn, provides greater access to capital and reduces the cost of borrowing to Salem's tax payers.

City departments that might work on the issue:

This is an enterprise issue that will require the collaborative effort of many parties. The City Manager's Office, more particularly Budget, Finance and Procurement will have primary responsibility for most of these services. The City's executive management team and their staff will also offer support. Given the analytical capacity reductions of prior budget years, outside services will be required to move the issue forward in an expeditious and effective manner.