

City of Coral Springs
Management & Budget Office
Department of Financial Services
Interoffice Memorandum

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To: Mike Levinson, *City Manager*

Through: David Russek, *Director of Financial Services*

From: Kevin Knutson, *Budget & Strategic Planning Manager*

Subject: **Budget Variance Management for Fiscal Year 2002 (6 pages)**

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Since we are now “officially” in a recession and at the beginning of a new fiscal year, it’s an appropriate time to review the level of risk we have in this year’s budget.

Revenue Forecasts from the State of Florida’s Department of Revenue

On September 18, 2001, the State of Florida convened a Revenue Estimating Conference where General Revenue collections for the current fiscal year were reduced by \$673.2 million or 3.4%. The direct impact to the City of Coral Springs is, of course, difficult to extrapolate from the data, but Sales Tax revenue in particular was expected to be 2.7% lower than was projected in July 2001.

A second Revenue Estimating Conference was held on October 13th that updated the September estimates (see <http://www.state.fl.us/edr/Conferences/GR/grconference.htm>), particularly in the impact of a major decrease in tourism-related spending. Of the total additional reduction of \$646 million recommended, \$505 million was in Sales Tax revenues. Corporate Income Tax and interest earnings were the also downgraded, by \$85 million and \$23 million, respectively.

The State released new revenue estimates with recommended reductions in Sales Tax revenues for Fiscal Year 2002 on October 23rd (<http://fcn.state.fl.us/lcir/estimates/revadjust.pdf>). For Broward County, the recommendation was to make a -4.8% reduction in Sales Tax Revenue from the original State projection.

Elasticity of Revenues

For each category, I've identified the "level" of elasticity, where at low elasticity we would expect $\pm 2\%$ variation normally, medium $\pm 3\%$, and high $\pm 4\%$.

General Fund revenues fall into eight categories:

Description	Percent of Total	Elasticity
Ad Valorem Taxes	31%	Low
Franchise Fees	10%	Medium
Utility Service Taxes	13%	Medium
Intergovernmental Revenues	27%	High
Licenses & Permits	4%	Low
Charges for Services	9%	Medium
Fines & Forfeitures	2%	Low
Other Income	4%	Low

One of the most elastic revenues, Sales Tax revenues was budgeted at \$6,135,000 (or 9.2% of the General Fund total revenues). By taking 2.7% (the September estimate) from the original State estimate of \$6,656,329, we could expect to receive \$6,476,608, or \$341,608 more than budget. In a worst-case scenario of a 7% decrease suggested by the DOR's Chief Economist, we would still exceed budget by \$55,000.

In a conversation between Forrest Lehman, Senior Financial Analyst and Dr. Christian Weiss, Chief Economist for the Florida Department of Revenue, Dr. Weiss speculated that in the worst case, some revenues could experience downward pressure of up to 7% below the original estimates as a result of recent events. Specifically, Sales Tax receipts could drop between 5-7%, Municipal Revenue Sharing could lose 4-6%, and the Communications Service Tax could be as much as 3-5% lower than projected. It's important to keep in mind that these are educated guesses about the possible extent of the effect of economic recession and *not* forecasts. In the case of the Communications Service Tax, no decrease has been forecast, nor is one anticipated.

New forecasts made on October 13th were less precipitous than these "worst-case scenarios." The impact of these new developments is not too worrisome, as variation is a normal part of the budgeting process and we assume a $\pm 5\%$ margin of error in our projections as a matter of course. Our most elastic revenues are budgeted at 2-4% below reasonable expectations every year.

It must be noted, however, that even in revenues considered to have low or medium elasticity, other variables may play a role. The length of the recession, for example, may impact consumer confidence, which may in turn reduce property turnover in the City. In that case, Ad Valorem Tax revenues could be impacted by a reduction in property value growth. In this example, the impact wouldn't be felt for at least two years, when residential tax assessments were completed and revenues were generated based on those assessments. As with any revenue, however, there are multiple variables in Ad Valorem Taxes that will play a role, such as demand, market values, borrowing rates, and employment.

Sensitivity of Revenues

Given the elasticity of select revenues in the current economic environment, the total impact of a recession could be:

General Fund	Adopted Budget	Likely Scenario	Worst Case Scenario
Total Revenues	\$66,905,052	\$67,000,000	\$65,600,000
Total Expenditures	<u>\$66,905,052</u>	<u>\$65,000,000</u>	<u>\$66,300,000</u>
Surplus/(Deficit)	\$ 0	\$ 2,000,000	(\$ 700,000)
As a % of Total Expenditures	0%	3%	-1%

The worst-case scenario assumes no action to curb expenditures is taken.

Policy Reserves

Each year we budget a General Fund contingency of 0.5% of operating expenditures (excluding debt service and interfund transfers), totaling \$278,000 for Fiscal Year 2002.

The City also maintains Policy Reserves of 17% of the General Fund and 25% of the Water & Sewer Fund. Total available fund balances exceed \$35 million.

The Five-Year Forecast includes an "Economic Conditions Contingency" approximately equal to the General Fund Contingency of 0.5% of specific expenditures (by policy) and an additional 7.3% increase in non-personnel operating expenditures as a cushion against unforeseen increases due to new programs or cost-of-goods inflation. These two estimates add between \$1.7 million and \$2.5 million over the five-year period after Fiscal Year 2002.

Historical Trends

Between Fiscal Year 1990 and Fiscal Year 2000, actual revenues exceeded budget by an average of 5.3% (including the addition of the EMS Division to the General Fund in Fiscal Year 1999), which translates to approximately \$2 million over budget annually. Expenditures have averaged 1.8% under budget since 1990, *including* supplemental expenditures to reduce debt and to increase funding levels in pension funds. Actual expenditures have averaged \$1.7 million less than budget creating annual surpluses ranging from \$2.5 million to over \$5.0 million. Positive variance has tended to be highest in recent years with lows during the recession at the beginning of the 1990s. Even during the worst period, from 1990-1994, annual surpluses averaged \$1.3 million.

In Broward County, population growth is expected to continue despite the weakening of the economy, lending support to sagging Sales Tax receipts and continuing to create demand for housing.

Actions Previously Taken to Reduce Risk

Strategic use of existing resources over the past decade has put the City in an excellent financial position for facing an economic downturn. Those steps have resulted in both lower costs and higher productivity. They include:

- Paying down \$13.3 million of our most expensive debt, reducing carrying costs by \$1.2 million,
- Refunding debt to take advantage of lower interest rates, saving \$137,000 annually,
- Leveraging fund balances to create self-perpetuating sinking funds for future capital purchases, avoiding hundreds of thousands of dollars in annual interest payments,
- Creating the Florida Intergovernmental Financing Commission and refunding existing variable rate debt to capitalize on our Aaa and AAA bond ratings, avoiding \$175,000 annually, and
- Making additional contributions to our Police Pension Fund.

Our Financial Strategy for Fiscal Year 2002 includes leveraging an additional \$11 million in pooled resources to:

- Pay cash for \$2 million of our Capital Improvement Program, avoiding \$174,000 in debt service annually, and
- Defeas \$9 million of long-term debt that reduced approximately \$500,000 in debt service annually, with substantial principal savings, exceeding \$3 million, after Fiscal Year 2004.

The combined effect of these management actions removed approximately \$2.2 million in expenditures from the General Fund budget for Fiscal Year 2002, much of which was offset by reductions in development-driven revenues as we begin to feel the direct impact of build-out.

Short-Term Plan for Further Reductions

If necessary, the City could take further action to reduce expenditures to offset lost revenues through incremental steps that could be enacted at various times throughout the year. This three-tiered contingency plan could effectively reduce required resources by approximately \$1.5 million. The plan includes:

- Suspend expenditures in a select group of non-departmental accounts for activities and programs that are not related to basic municipal services. The list¹ includes special events, grants, total quality management spending, and consulting services. Action should be taken in the first or second quarters to ensure our ability to comply. Savings potential is \$505,000.
- Departmental expenditures are typically more than 2% under budget at year-end, which would equal \$1.1 million in Fiscal Year 2002. By requiring Department Directors to reduce total expenditures by 1% by reducing operating expenditures, an additional

¹ Includes: TQM Services \$25,000; Process Improvement Incentives \$15,000; Lobbyist \$25,000; Internal Auditor \$75,000; Other Contractual Services \$100,000; Youth & Family, Sports and Special Event Grants \$100,000; Miscellaneous Events \$20,000; New Years Eve Party \$15,000; *iNet* Projects \$40,000; Arts in Public Program \$10,000; Unallocated Reserve \$50,000; Instant Employee Recognition \$20,000; and Center for the Arts Rentals \$10,000.

\$550,000 could be realized. It's possible, however, that the full \$1.1 million will be realized with no action.

- Defer partial funding of the Facilities Maintenance Reserve until a more economically feasible time. All current facility maintenance is budgeted, so no projects will go unfunded. The \$450,000 included in the General Fund was seed money to create the sinking fund for pay-as-you-go financing. This action could be taken at any time during the fiscal year.

Early warning signs should indicate the probability that revenues would not meet budget at year-end to trigger implementation of these actions.

Even though no action is recommended at this time, the status of budget variance will be reviewed on a monthly basis. The decision of whether or not to implement any or all of these steps will be revisited as well.

No matter what steps we take, prior to commencing any projects in the Capital Improvement Program we will review significant items for their operational impact to determine if the project should be deferred based on economic conditions. Despite the availability of low-interest loans, we don't want to overextend ourselves in lean times.

“Austerity Measures”

Aside from the steps listed above to protect against budgetary deficits, we may wish to take other actions designed to promote economic business practices and conservative financial decision-making. In order to effectively communicate to City staff the need for fiscal conservatism and to bolster resident confidence in the City's ability to weather an economic downturn, it may be necessary to put in place short-term spending limitations. Although most of these suggestions have minor—in some cases insignificant—impact on the budget, they do have value in the “message” they send about the values of the City and our willingness to make do with what we already have.

Potential Action	Potential Impact
Restrict overtime pay (\$1.3 million total)	\$100,000-500,000
All vacancies remain vacant	\$100,000-250,000
Restrict small-item capital expenditures	\$50,000-200,000
No outside hiring	\$25,000-75,000
Restrict non-essential travel	\$10,000-50,000
No food or beverage expenditures	\$5,000-15,000
No embroidered shirts/promotional items	\$0-\$2,000
Reduce use of consultants	undetermined

The impact is dependent upon when the measure is enacted and the definition of what is permissible in each category. Also, reviewing our current program and service package for areas that are not “mission-critical” may identify additional areas for savings, perhaps in programs like the Honda Classic.

Implications for Future Fiscal Years

With projections for elastic revenue receipts being reduced in the current year, forecasts of revenues over the next five years will have a lower starting point and could have lower annual growth rates over the course of the five years. Since certain expenditures have relatively fixed growth (such as payroll and employee benefits), general operating expenditures will carry a much greater burden in balancing the budget. If overall revenue growth falls below 5%, for example, those expenditures may need to be lower than in prior fiscal years in both constant and real dollars.

After we have a few months of experience in the new economic climate, a modified Five-Year Forecast will be prepared to estimate the impact of the current economic outlook. That forecast will include data from the first quarter of Fiscal Year 2002 and will be available in February 2002.

One of the key issues in planning for future years is the duration and severity of the recession. For example, several years of shrinking revenue growth stemming from a weak tourism industry and declines in consumer spending could create the need for changes in compensation policies until growth is resumed.

Conclusion

Where Coral Springs is in its life cycle (at build-out for residential property and near build-out for commercial and industrial property) tends to soften the impact of any recessionary forces on growth-related revenue. On the expenditure side of the equation, there will be less pressure for expansion of City services due to new development.

Although I am not recommending any action at this time, we will closely monitor the progress of the City financially this year by reviewing financial operating statements on a monthly basis, projecting revenues, monitoring expenses, and reviewing capital purchases for operating impact.

Even though recent changes in the local and national economy will tend to put pressure on future revenue growth, we are well positioned to handle even a relatively severe reduction in revenues over the short-term. In fact, the effect of development build-out has been and will continue to be more critical of a factor in our planning and budgeting.

Long-term effects of recession will depend on the length and severity of the contraction, but will certainly place constraints on new initiatives, current programming and service delivery in future budgets.