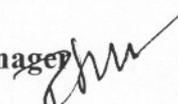


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MEMORANDUM

Date: March 30, 2006
To: Mayor and City Council
From: Ron Miller, City Manager 
Re: Structural Revenue Study

Attached are several documents that highlight findings from the Structural Revenue Study, independently conducted by the firms Public Financial Management and New West Economics. The Study was commissioned to provide a thorough and comprehensive assessment of future revenues and expenditures for the city of Aurora. The research indicates that Aurora is facing significant projected gaps between the cost of meeting its current and long-term service needs and its revenue capacity. As is true of other cities across Colorado and the nation, the projected gap, to a large extent, is driven by economic trends and changes in household spending patterns.

Recognizing that Aurora's ability to continue providing high-quality services depends on a diversified and stable revenue stream, the study sought to identify options that would proactively eliminate the projected gap.

There are a number of factors that contribute to these gaps. They include:

- The city's over-dependence on fluctuating sales and use taxes for approximately 2/3 of our General Fund revenues;
- Changes in consumer spending habits that affect the tax base;
- Declining per capita tax revenue;
- Slow economic growth;
- Increases in mandated costs, including gas, electricity, water, police staffing, and compensation; and,
- Increasing cost to deliver general services.

Fortunately, the city has a variety of options to choose from to remedy the projected gaps. The opportunities exist for Aurora to modify our revenue structure so as to be able to meet current and future operational and capital needs. These opportunities are identified in the report.

The report notes that Aurora has a history of strong financial management. I think that this study, and the resultant recommendations, represent an important step in continuing that tradition. Staff and I look forward to working with City Council to effectively address these challenges, to ensure the city's long-term financial health and stability, and to provide services that will maintain Aurora's extraordinary quality of life.

Attachments:

- Attachment 1: Executive Summary of the Structural Revenue Study
- Attachment 2: Power Point Presentation of Key Findings and Solutions
- Attachment 3: Additional Detail on the Facilities Master Plan, Phase II
- Attachment 4: List of All Revenue Options Identified by Study

EXECUTIVE SUMMARY

(Draft, for Discussion Purposes Only)

Introduction

During the late 1990s, Aurora experienced strong revenue growth, primarily due to four factors:

1. A structural change in the regional economy toward higher paying engineering and knowledge-based jobs;
2. Increases in earned and unearned income, which resulted in large increases in household income levels;
3. Rapid appreciation in housing values, which fueled additional household spending;
4. Falling interest rates, effectively giving households increased spending power.

As with many other cities around the country, Aurora encountered budget difficulties as conditions changed in the wake of the 2001 national recession. The City experienced a sales tax revenue decline – Aurora relies on sales and use tax collections for approximately two-thirds of its general fund revenue -- and overall revenue growth was sluggish. However, the impact on its budget was partially offset by increased retail development (and redevelopment), residential development in the southeast portion of the City, and increased upper middle-income housing.

While positive revenue growth has returned, it is not expected to match the historically-high levels of the 1990s. At the same time, there are significant demands for services both in the core city and in newly developing areas. In addition, long-term trends suggest that Aurora's (inflation-adjusted) per capita tax revenues are likely to steadily decline, limiting growth in current revenue sources to levels that will not be sufficient to meet anticipated service needs.

Given these circumstances, the City contracted with Public Financial Management, Inc. and New West Economics to examine its revenue and expenditure patterns in both the short and long term. The study was conducted to:

1. Inform the City's financial and budget decisions by providing information to better understand the relationship between revenues and expenditures in the short and long run.
2. Help the City determine whether its current revenue structure, given its expenditure needs, will result in about the same, better, or a worse financial position than exists at present.

To address these goals, the consultants constructed a 5-year projection model and assembled key data to prepare a longer run (5 to 20 years) revenue growth forecast. While the short-term model's revenue estimates are based on the current economy and projections of short-term changes, the long run model examines how broader changes will affect the City's revenue structure.



Five-Year Model

The five-year model is a simulation that compares anticipated service needs to reasonable economic and revenue assumptions. *This simulation is not a budget forecast and any projected gap between expenditures and revenues is not a budget deficit.* The gap simply represents the difference between City of Aurora levels of service needs and anticipated revenues from current sources. As part of the modeling process, multiple scenarios were developed to give Aurora's appointed and elected officials a range of outcomes based on different revenue and spending assumptions.

Each scenario is based on a set of assumptions related to local and regional economic factors, local development patterns, and current fiscal conditions. For example, the baseline economic forecast uses current and forecasted economic conditions in Colorado and the metro area. By contrast, the optimistic revenue forecast incorporates stronger employment growth and its corresponding impact on the economy. Expenditure assumptions are based on differing sets of service, facility, and infrastructure needs as identified by the City.

Among the major cost increase factors that affect all of the scenarios are:

- Public Safety costs, including mandated Police staffing levels and the need for several additional fire stations;
- Transportation costs including staffing to maintain current infrastructure, major new projects, and major reconstruction programs;
- Other mandated costs, such as compensation increases (which are not currently keeping pace with inflation); gasoline, electricity, and water costs; and increased costs for City-funded health benefits.

Findings: Five-Year Outlook

The five-year model shows that, under each scenario, including one forecasting extremely optimistic revenue growth, the City will face structural budget challenges that require significant adjustments to close the gap between current revenues and projected expenditures. The City's actual experience is likely to fall somewhere between the scenarios outlined below.

The most likely scenario, given current trends and expected needs, forecasts an annual gap of approximately \$11 million in FY2007, growing to more than \$35 million in FY2011. This scenario is based on current revenue trends and expenditure growth that includes:

1. Gradual restoration of funding for key City services
2. Funding for service needs in newly developing areas
3. Annual pay increases between 3 and 4 percent each year.
4. Gradual restoration of the General Fund transfer to the Capital Projects Fund to normal levels.



The gap falls to between \$7 and \$12 Million if the scenario above is varied according to the following:

1. The City funds only police staffing increases, other mandated costs, and a select few immediate service needs (namely Fire Stations 14 and 15 along with some Public Works and other staff)
2. No increase in capital funding
3. No additional fire services in newly developing areas
4. No funding to restore services cut in prior years
5. Pay increases that average only 2 percent per year.

If the City were to experience a recession similar to the one experienced earlier this decade (a possibility discussed in several economic forecasts), the gap in this scenario would rise to more than \$30 million by 2011.

Under a more optimistic scenario in which sales tax revenues are projected to grow by an average of 6 to 9 percent per year through 2011 (a level that is highly unlikely to be achieved) the City would still face gaps of \$12-\$22 million per year under the following expenditure assumptions:

1. A restoration of budget cuts in most service areas
2. An increase in the capital transfer to the level required by ordinance
3. Providing services in newly-developing areas
4. Funding for operating costs associated with several FMP II projects.

All of these scenarios exclude the impact of funding capital needs in excess of the transfer required by ordinance (one hundred percent of all building materials and equipment use taxes plus four percent of all other GF revenue). Given the magnitude of the City's capital needs, the study included separate capital funding scenarios. The first option assumed that the City issued 15-year bonds for \$50 million in Public Safety capital improvements and \$50 million in transportation improvements. In this situation, the City would need to make annual debt-service payments totaling \$9.2 million or approximately 3.52 mills. The second option assumed the City issued 20-year bonds to finance the entire \$281 million revised estimate of the cost of the City's Facilities Master Plan, Phase II. In this situation, the City would need to make annual debt-service payments totaling \$21.6 million or approximately 8.5 mills.

Many cities in Colorado and throughout the nation are struggling with similar challenges, although some factors are attributable to Aurora's economic and household characteristics. Aurora's decision to undertake this study before these issues become more difficult to resolve is commendable. It provides the City an opportunity to anticipate and understand the choices required to pro-actively deal with the situation.

Findings: Long-term Outlook

Variations among the scenarios in the five-year model reflect differing assumptions about underlying economic and financial conditions. For this period, household characteristics and other long-range factors were not considered. However, over time, these characteristics of both the State and the City will change. To account for this, the



consulting team constructed a long-term revenue model where underlying economic and household characteristics evolve according to national and regional forecasts. This longer-term view helps to determine whether anticipated development, economic, and other factors will be sufficient to close the gap in the years beyond the five-year horizon

Based on the projections incorporated into the long-term model, growth in existing revenue sources over the next 25 years will not be sufficient to close the fiscal gap. The long-term model reflects the following key changes:

- The population will age, resulting in slower workforce growth as the share of senior households will increase from less than 15 percent today to nearly 25 percent by 2030.
- Mortgage borrowing rates will likely remain higher than rates of the last several years, and the share of owner-occupied households is projected to decline;
- The average household size is projected to decline over time.

The long-term revenue forecast also finds that:

- Economic growth over the next 25 years will likely be slower than that of the middle to late 1990s, although more robust than during and immediately after the 2001 recession.
- Revenue growth will slow even more than the overall economy due to expected changes in mix of households in Aurora and the nature of Aurora's tax base.
- While Aurora can and will likely continue to encourage retail and commercial development, this development activity will not, by itself, be sufficient to overcome the impacts of these economic and demographic conditions.
- Changes in household characteristics in the community will likely have an impact on the demand and type of local government services and programs. These changes are projected to necessitate higher expenditure levels to meet service demands.

In combination, these changes will have a material impact on the City's future revenue and budgets. Each of the projected changes can be associated with a decline in household spending. While there will be more households in 2030, changes in the types of households will result in a decline in average household spending. Per capita tax revenues (adjusted for inflation) are projected to decline steadily throughout the forecast period. Without changes to the current revenue system, the City is unlikely to be able to close the projected fiscal gap.

Closing the Gap

Structural fiscal gaps generally require concerted action, and our short and long-term models suggest that Aurora's case is no different. A successful outcome will likely require measures that address both expenditures and revenue. Any useful package of expenditure and revenue adjustments will include:



1. Decisions that materially affect expenditure patterns;
2. A continued focus on increasing the efficiency and effectiveness of existing programs and services;
3. Selecting and adopting new revenue measures to appropriately broaden the sources of local revenues; and
4. Long-range economic development strategies that help accentuate positive economic and demographic trends.

No single solution is likely to cover the entire gap. However, a well-conceived package of solutions that addresses both expenditures and limitations of the City's revenue structure should be sufficient to keep the City on positive financial footing now and into the future.

Aurora has a strong record of financial management, strong bond ratings, and has earned national recognition for its services. The City has maintained adequate fund balances and balanced its budgets through programmatic budget cuts, including staff reductions. Consequently, the City is well prepared to address the findings and opportunities identified in the study.

The City has already overcome significant fiscal challenges, mostly through expenditure reductions and transferring costs to other funds. Over the last five years, the City implemented ongoing programmatic budget adjustments totaling approximately \$32 million and eliminated more than 166 positions. These reductions have reduced GF spending for non-Public Safety services by more than 14 percent since 2002. During this same period, the City's population grew by more than 20,000, with attendant service demands. Given these factors, the City should carefully consider whether additional budget reductions are feasible or desirable. One tool to consider is the use of independent evaluations of service standards and operational practices for the largest components of the City's budget, such as Police and Public Works.

Charges for Services/Utilities. Among revenue options, charges for services are the second largest City revenue source, and nationally they are growing in importance. Driven by demand, they are appealing because of their market-based nature. The City of Aurora should investigate the appropriate use of utilities to provide services, which has been adopted in other large Colorado cities, including Colorado Springs for street lighting and Fort Collins for transportation services. This method is easy to administer – fees can be charged per parcel or per foot of frontage on the right-of-way of a public street and collected through current utility bills. Using this approach, the City could generate \$4.5 million per year with a charge of roughly \$6 per month for all current water utility customers.

The City should also ensure that inflation does not erode its fees and other charges by regularly indexing these charges. The City should also ensure that services, when appropriate, are billed at full cost, calculated to include all City costs, including capital, salary and benefit costs, and indirect costs.



Changes to the Tax Structure. Aurora should also pursue adjustments to the current tax structure. Fifty years ago, goods accounted for two-thirds of total consumption, and services were one-third. Today, nearly two-thirds of consumption is services and one-third is goods, however, most services are not subject to the sales tax. To be equitable, it would be logical to tax services in the same way as goods.

Likewise, it makes sense to apply similar levels of tax to different methods for delivering similar services. For example, cable television subscribers pay franchise fees, while satellite television subscribers do not; regular telephone line users pay an occupation tax while cellular phone subscribers do not.

Services consumed by non-residents could also be subject to higher excise tax rates, after carefully considering the impact of these taxes on business, consumer, and employment choices. The lodger's tax is an example of a source that captures revenue from non-residents. Taken together, it is likely that a package of changes to the City's tax structure could generate between an additional \$5 and \$10 million per year.

Changes to Development Related Charges. In many instances, the most critical need for City services is connected with new development. Many years ago, in recognition that services outside the City core are more costly to provide, the City adopted an ordinance that new development should not "create any additional cost or burden on the then-existing residents of the city to provide such public facilities... (Section 46-301 (B))." The City has various options for determining appropriate charges for services, facilities, and infrastructure provided in newly developing areas. These options include traditional impact fees, an excise tax, and new fees for services in these areas. Given the City's many prospects for new development, these tools may be critical to the overall health of the City's finances. Each of these options should be assessed based on the reasonableness of the charge for the services, the importance of the service, and the impact on the City as a whole. Such assessments should be conducted with the active participation of the development community.

As an example of the revenue potential associated with such measures, it is estimated that a \$25 per month per dwelling unit excise tax in newly developing areas could generate approximately \$700,000 per year based on the expected number of new homes and other dwellings that are built each year. As the number of new dwelling units expands each year, the revenue generated by such a tax would expand accordingly. This tax could provide an important source of operational revenue for ongoing services.

Grow the Existing Sales Tax Base. The City should also pursue strategies that will grow the existing revenue base. Given its heavy reliance on sales and use tax revenue, attracting new and retaining existing retail is an important strategy. Studies have shown that local residential employment and personal income growth have a moderate to strong correlation to sales tax activity and receipts. Consequently, the City should consider continuing to pursue strategies that attract and retain high wage employers and high value housing. At the same time, the City should continue to encourage local retail development that meets the needs and desires of the local and regional households. In all



ATTACHMENT 1

of these activities, the costs and benefits associated with these strategies and with specific development proposals should be carefully evaluated.

Other Alternatives. The City should pursue strategies that grow its fees and other non-tax revenues. Non-profit corporations, which consume City services like fire and police protection, street maintenance and snow removal, do not pay City property taxes that support these services. Voluntary contributions should be considered to cover these costs, but absent voluntary contributions, charges for services can be pursued as well. Other options, such as advertising on City websites, have provided as much as \$1 million a year to some cities.

There are a variety of other revenue sources that also bear investigation, and these are discussed in greater detail on the attached table as well as in the final report. Because there are literally thousands of variations on many of these revenue alternatives, we have provided a representative sampling from which other alternatives may be derived.

As the City evaluates all of these options for closing the projected gap, it should recognize the benefits of moving forward promptly before the issues become more problematic. In addition, the City should take great care to provide an effective program for public education and input to ensure the development of a community consensus to address these critical issues.





City of Aurora

Assessment of Revenues and Alternatives

April 6, 2006

Public Financial Management

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Introduction

- The goal of this meeting is to update the Joint Committee on the findings and potential solutions identified in the structural revenue study
 - This is a DRAFT of the study's findings and potential solutions that is presented for the Joint Committee's review and feedback
 - Specific issues may require further clarification or additional research
- The information included in this presentation was also provided to the rest of Council
- At the next joint meeting (April 18), staff will present a package of options for Council's consideration
 - These options will represent concrete steps that can be taken to address the issues identified in this report
- At the Spring Workshop (April 28/29), staff will ask for Council's direction on further steps to be taken



Agenda

This presentation is divided into several sections

- Study overview
 - City Perspective: Mike Trevithick, Budget Officer
 - Consulting Team: Dean Kaplan, The PFM Group
- Five-year budget model: Corinne Kuhar, The PFM Group
- City service needs and FMP II: Deputy City Managers
- Long-term revenue model: Phyllis Resnick, New West Economics
- Closing the gap: Randy Bauer, The PFM Group
- Overview of next steps: Mike Trevithick, Budget Officer



Study Overview





City Staff Overview

- The purpose of study is
 - To address City’s “revenue capacity” in comparison to likely service needs
 - To identify solutions that bridge the gap between revenues and anticipated expenditures
- The City has a history of balanced budgets and strong financial management – the study is a pro-active approach to ensure that we continue this trend
- The study shows that Aurora’s ability to continue providing high-quality services in all areas of the City depends on The City’s ability to diversify its revenue sources
 - Changes in the economy accompanied by an aging population and changes in household spending patterns limit the efficiency of current revenue sources
 - At the same time, service needs continue to grow as the City seeks to restore services cut during the recent downturn and extend services to newly developing areas



Consulting Team

- The PFM Group:
 - Dean Kaplan, Managing Director, Philadelphia, Engagement Manager
 - Randy Bauer, Senior Managing Consultant, Des Moines, Project Manager
 - Corinne Kuhar, Consultant, Philadelphia, Model Developer
- New West Economics:
 - Jeff Romine, Economist, Regional Economic Analysis and Forecasting
 - Phyllis Resnick, Economist, Public Finance
 - Bill Kendall, Senior Consulting Economist, Economic Forecasting





The Study

- Started with an analysis of revenues and spending
 - Evaluated multiple revenue and spending scenarios
 - Useful for discussing trends
- The budget models show that a structural gap will develop absent action by the City to close the gap
- The gap is not a deficit – it is the difference between current revenues and anticipated service needs
- Aurora is not alone in facing this problem
 - Municipalities throughout the country are facing similar issues
 - The causes are primarily related to the economy, the cost of services, and other long-term factors
- The challenge is manageable
 - The challenge is how to realign revenue and expenditure trends
 - The solution requires a combination of approaches
 - The City's reserves, bond rating, past budget balancing, and strong overall financial management create a firm foundation for addressing this challenge





Key Issues

Identified throughout the report

1. The City relies heavily on volatile sales and use taxes
2. The City will experience significant gaps between current revenues and the cost of meeting anticipated service needs
3. Economic growth over the next 20 years will likely be considerably slower than the 1990s
4. The City cannot grow itself out of the gap with its current revenue sources



These Issues are not Limited to Aurora

- Other cities throughout the country are facing similar gaps
 - Fort Collins, CO: Budget projection shows the General Fund gap increasing from \$8.4 million in 2007 to nearly \$15 million in 2013
 - Minneapolis, MN: Five-year forecast projects a \$120 million gap over the next five years to maintain current services
 - Tacoma, WA: City forecasts a \$14 million gap for FY 2007-08 growing to \$28 million in FY 2011-12



Background

- Aurora enjoyed strong population and revenue growth through the 1990s
- Changes in the economy and the 2001 national recession created budget challenges
- Strong management maintained the City's financial standing
- Long-range economic factors and household spending patterns point to moderate revenue growth that won't repeat the performance of the 1990s



Factors Limiting Revenue Capacity

- Key factors that drive the local economy and revenue expectations are mixed
 - Sales and use tax revenues are inherently volatile – the City experienced three straight years of flat or negative growth
 - Consumers are buying fewer goods and more services
 - Wage and salary growth, employment levels, and housing price growth have recently been below national levels
 - Residential development activity is expected to continue, but slow
 - Personal income growth won't reach as high as the late 1990s
 - The population will age, resulting in slower workforce growth and lower participation rates
 - The share of owner-occupied households is projected to decline
 - Economic growth over the next 25 years will likely be slower than that of the middle to late 1990s
- Consequently, per capita tax revenues (adjusted for inflation) are projected to steadily decline

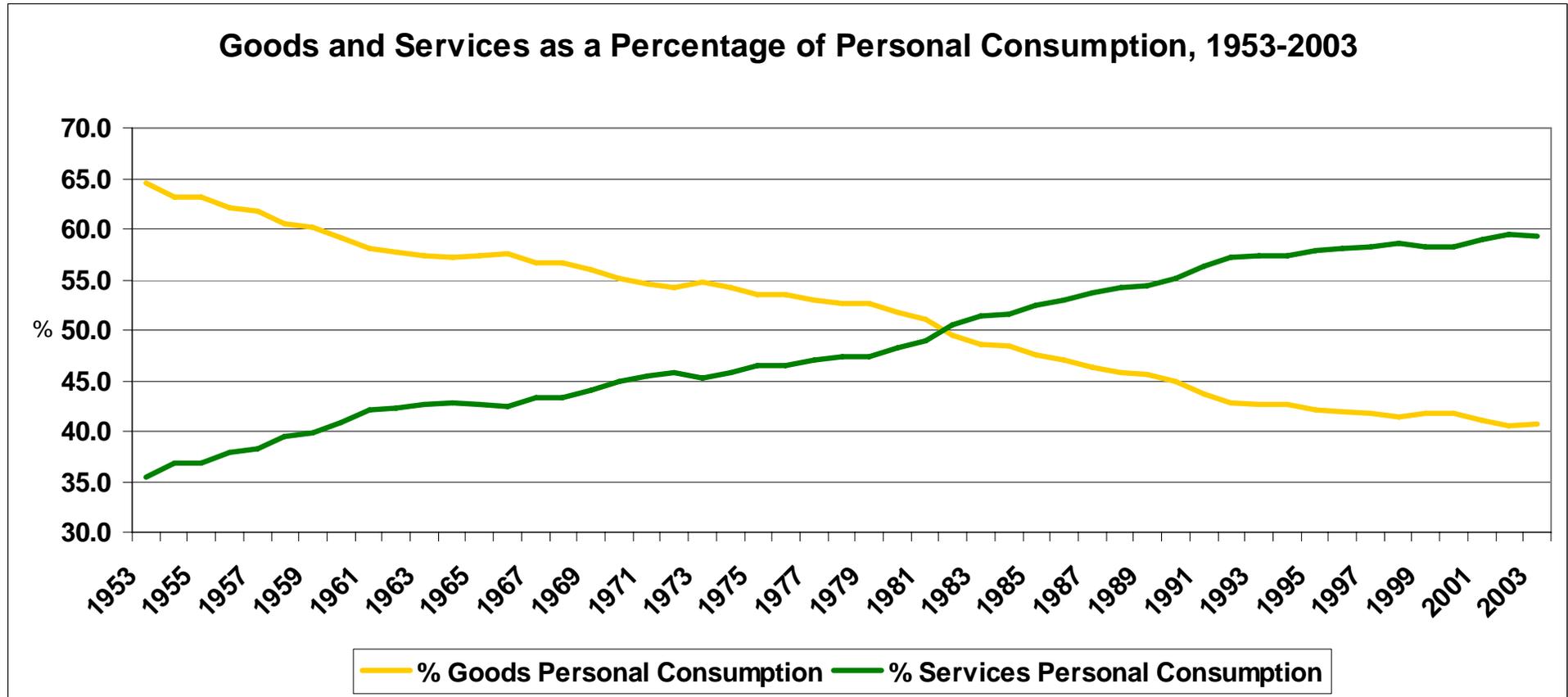


Key Issue #1: Aurora relies Heavily on Sales and Use Taxes

- Two-thirds of General Fund revenues are from sales and use taxes
 - This is typical for cities in Colorado
 - The rest of the country is much less reliant on sales tax and much more reliant on property taxes
- Sales tax is cyclical – makes revenues vulnerable to downturns
- Existing sales tax base is eroding



Consumption of Services is Growing



Source: Bureau of Economic Analysis



Aurora Managed Well Through the Last Downturn



- Maintained its AA credit ratings with stable outlook
- Utilized real budget cuts and staffing reductions rather than accounting gimmicks or one-time fixes
- Maintained fund balances
- Received national recognition for its services and its management efforts



Five-Year Budget Model





The Five-Year Model

- A simulation based on reasonable assumptions
- Not a budget forecast, and any forecast of a revenue-expenditure gap is not a budget deficit
 - The City will balance its budget as required by its Charter
 - The City has a variety of methods for dealing with any projected gap
- We developed multiple scenarios to give the City a sense of the range of potential outcomes using different revenue and spending assumptions



Key Issue #2: Service Needs vs Revenue Capacity

- The results show that, under every reasonable set of assumptions, the City will experience significant gaps between current revenues and the cost of meeting anticipated service needs
 - A gap exists under both optimistic and pessimistic revenue assumptions
 - Other factors that affect the gap include:
 - Increases in the general cost of doing business including compensation, utility charges, and fuel costs
 - Costs related to mandatory Police staffing levels;
 - Service needs in the existing City; and
 - Service needs in newly developing areas



Revenue Forecasting Methodology

- Starting Point for Revenues: Economic assumptions in Colorado state forecasts (Legislative Council and OSPB)
- Ran multiple revenue scenarios:
 - Started with state economic assumptions
 - Optimistic based on 1992-97 employment growth, most recently the five strongest years of growth in the Colorado economy
- Revisions:
 - Our professional judgment is that the state's assumptions are slightly optimistic
 - We adjusted the control scenario down slightly to match the City's budget forecast for 2006 through 2010



Scenario #1

- Revenue projections based on City's 2006 budget forecast
- Expenditure projections include operating costs for the following groups of items:
 - “Mandated costs”
 - Police 2 per 1000 staffing needs (all years)
 - Funding for other mandated costs (gas, electricity, etc.) based on past history (all years)
 - Gradual funding to restore and maintain key services and programs
 - Gradual restoration of fleet replacement funding to match historical levels
 - Staffing to restore maintenance functions and related services in Parks, Public Works, and Information Technology
 - Staffing and operating costs to restore normal hours of operation in Libraries, Recreation, and Cultural Services
 - A gradual increase in the transfer to the Capital Projects Fund
 - Pay increases between 3 and 4 percent per year
 - Plus an 8 to 12 percent increase in City benefits funding per year



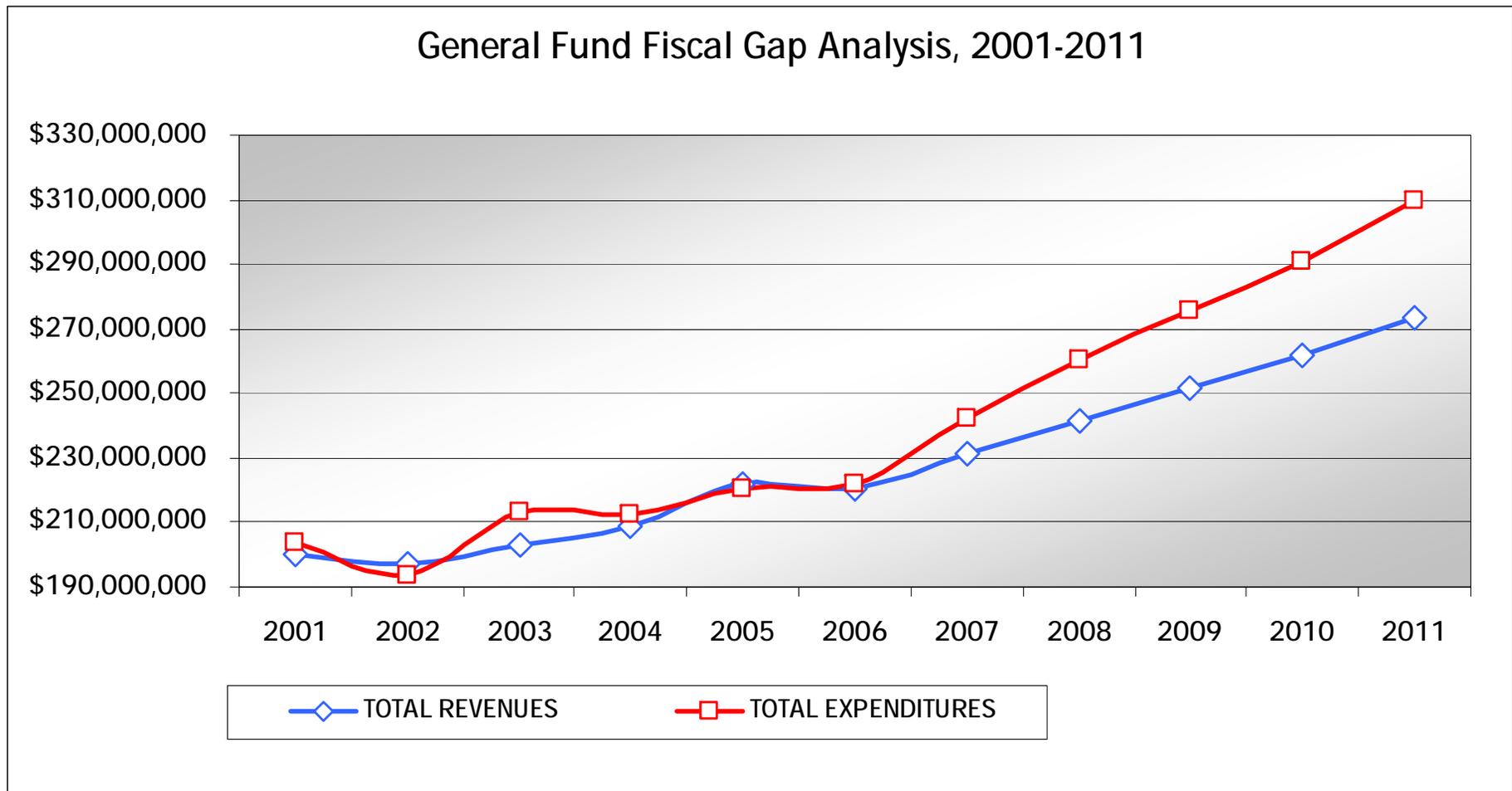
Scenario #1: Additional Service Needs

- Projections include operating costs for the following services:
 - Major service needs in newly-developing areas
 - Fire Station #14 at Eagle Bend – EMS only (2006)
 - Fire Station #15 at Murphy Creek (2006)
 - One additional ladder truck (2007)
 - Fire Station at Windler / Delweb (2008)
 - Police District 3 civilian staff and dispatchers (2007)
 - New Police District 2 station (2010)
 - Public Safety Complex, Phase I (2011)
 - Del Mar Pool Renovation and Expo Rec Center addition (2010 & 2011)
 - North and Southeast Maintenance Facilities (2009 & 2010)
 - Other service needs
 - Additional dispatch FTE (2006)
 - Open Courtroom 10 (2008)
 - Other court and legal staff (2007 - 2011)
 - Additional street lighting (all years)



Scenario #1: Projected Gap

- This scenario forecasts a revenue-expenditure gap that starts at \$10.7 million in 2007 and reaches \$35.6 million by 2011.





Scenario #2: Mandated costs plus minimal additional services

- Revenues match assumptions in Scenario #1
- Expenditures are only for “mandated costs” plus the City’s most critical additional needs including:
 - Fire Station #14 at Eagle Bend – EMS only (2006)
 - Fire Station #15 at Murphy Creek (2006)
 - Additional dispatch FTE (2006)
 - Restoring some Parks and Public Works maintenance staff (2007)
 - Additional street lighting (all years)
 - A partial restoration of fleet replacement funding (\$1 million per year)
 - Pay increases that average 3 percent per year



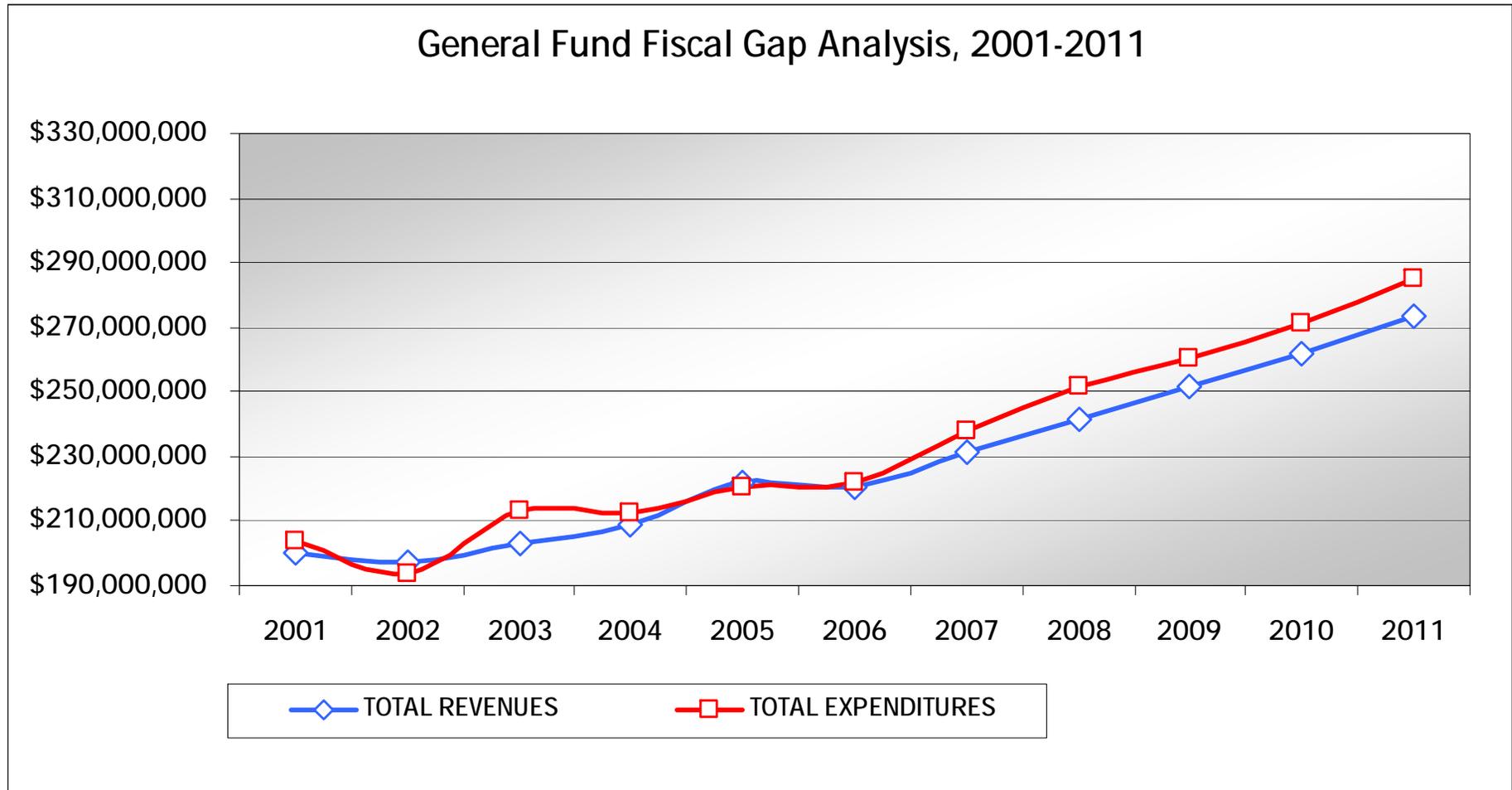
Scenario #2: Items not funded

- Scenario excludes funding for most additional services and other costs including:
 - No increase in capital funding
 - No funding for fire, transportation, or other services in newly developing areas (except Stations #14 and #15)
 - No additional court and legal services
 - No restoration of library, recreation, and cultural services
 - No funding to restore other services cut in prior years



Scenario #2: Projected Gap

- This scenario forecasts revenue-expenditure gap that starts at \$6.7 million in 2007 and reaches \$11.6 million by 2011.





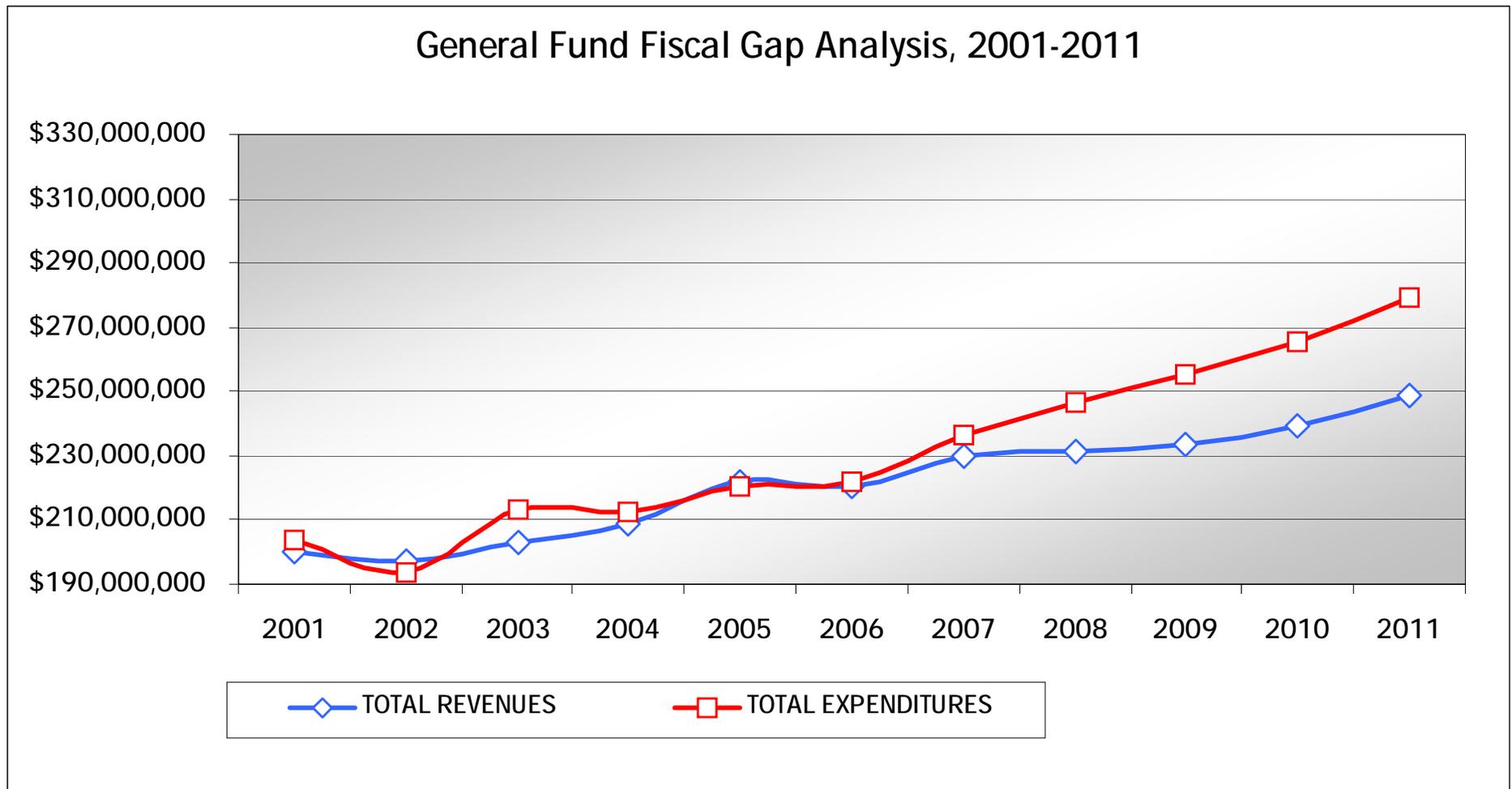
Scenario #3: Recession

- The forecast assumes that the City experiences an economic downturn similar to the one that occurred earlier this decade
 - Many economists see this as a realistic possibility as early as 2007
- Expenditure projections match Scenario #2
 - This reflects the assumption that the City would fund only its most critical needs under such circumstances



Scenario #3: Projected Gap

- This scenario forecasts a revenue-expenditure gap that starts at \$6.3 million in 2007, with the gap increasing to \$30.2 million by 2011.





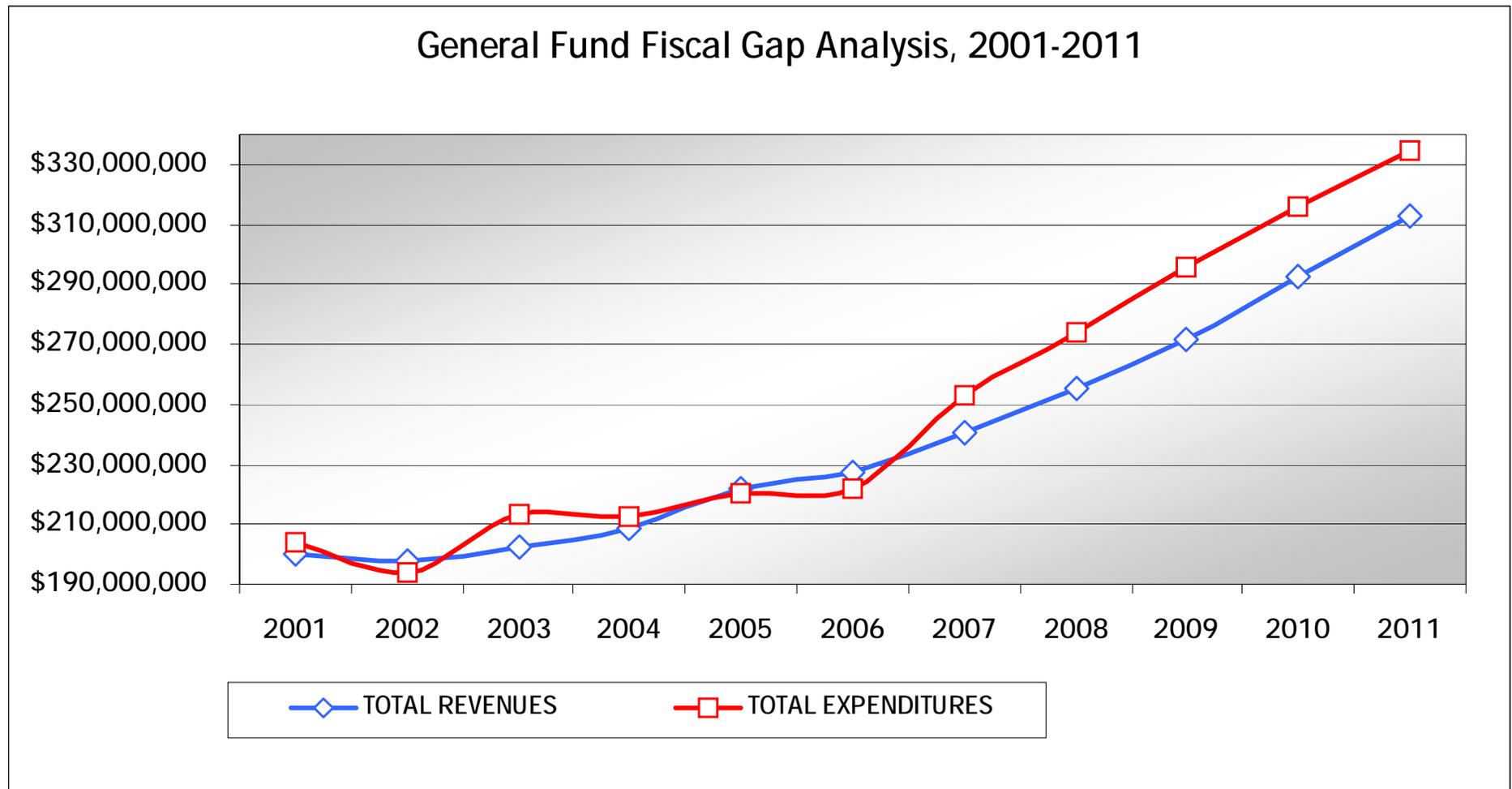
Scenario #4: Optimistic

- The revenue forecast assumes that sales tax grows by an average of 6 to 9 percent per year
 - Data indicates this assumption is extremely optimistic
- Expenditure projections generally match Scenario #1, but also include:
 - Operating funding for additional parks, libraries, recreation centers, and other facilities including a Community Events Center, additional athletic fields, an Eastern Tier Library, the Signature Park, new median construction, and a new animal shelter
 - Full funding for other operating expenses including increased book stock acquisition and immediate full funding for fleet replacement needs
 - Immediate full funding for the transfer to the Capital Projects Fund
 - Pay increases that include an inflation adjustment plus a 2 percent increase for merit (4.0 to 4.5 percent per year)



Scenario #4: Projected Gap

- This scenario forecasts a revenue-expenditure gap that starts at \$12.5 million in 2007, with the gap increasing to \$22.0 million by 2011.





Capital Scenarios

- A portion of any required capital funding can be generated by increasing the City's transfer from the General Fund to the Capital Projects Fund or by increasing revenues from some other source
- However, for purposes of these scenarios, we assumed that 100% of the cost would be financed through the issuance of general obligation bonds
- If the City issued bonds for \$100 million for Public Safety and Transportation needs, the annual financing cost would be approximately \$9.2 million (3.5 mills) for 15 years
- If the City issued bonds for the entire \$281 million (revised) cost of all FMP II projects, the annual financing cost would be approximately \$21.6 million (8.5 mills) for 20 years



Major Cost Categories

Top 10 General Fund Expenditure Categories

Account	2007	2008	2009	2010	2011	% of GF Total in 2007
Reg-FT New Hire Salary	\$59,581,083	\$61,368,516	\$63,209,571	\$65,737,954	\$68,367,472	24.6%
Reg-FT Career Salary	\$55,992,911	\$61,454,048	\$66,249,594	\$72,366,758	\$76,045,408	23.1%
Transfer to-Capital Projects	\$17,928,027	\$20,307,735	\$22,828,239	\$25,450,535	\$29,692,555	7.4%
Reg Insurance-Health	\$13,074,136	\$14,643,033	\$16,107,336	\$17,395,923	\$18,787,597	5.4%
Supplies-General Operating	\$7,447,045	\$7,744,927	\$8,070,214	\$8,409,162	\$8,762,347	3.1%
Electricity	\$6,863,318	\$7,549,650	\$8,340,015	\$9,231,026	\$10,419,131	2.8%
Reg-Pension Contrib-New Hire	\$5,946,673	\$6,485,073	\$6,668,826	\$6,921,179	\$7,183,626	2.5%
Transfer to-ACLC	\$5,550,213	\$5,550,213	\$5,550,213	\$5,550,213	\$5,550,213	2.3%
Transfer to-Recreation Other	\$5,112,193	\$5,272,429	\$5,439,074	\$5,612,385	\$5,792,628	2.1%
Int Svc Chg-Risk Management	\$5,095,792	\$5,605,371	\$6,165,908	\$6,782,499	\$7,460,749	2.1%
Top 10 Total	\$182,591,391	\$195,980,993	\$208,628,988	\$223,457,634	\$238,061,726	75.5%
Total GF Expenditures	\$241,927,036	\$258,092,052	\$272,851,825	\$290,487,164	\$309,010,841	-



City Service Needs and the Facilities Master Plan, Phase II

Provided in a separate document





Long-Term Revenue Model



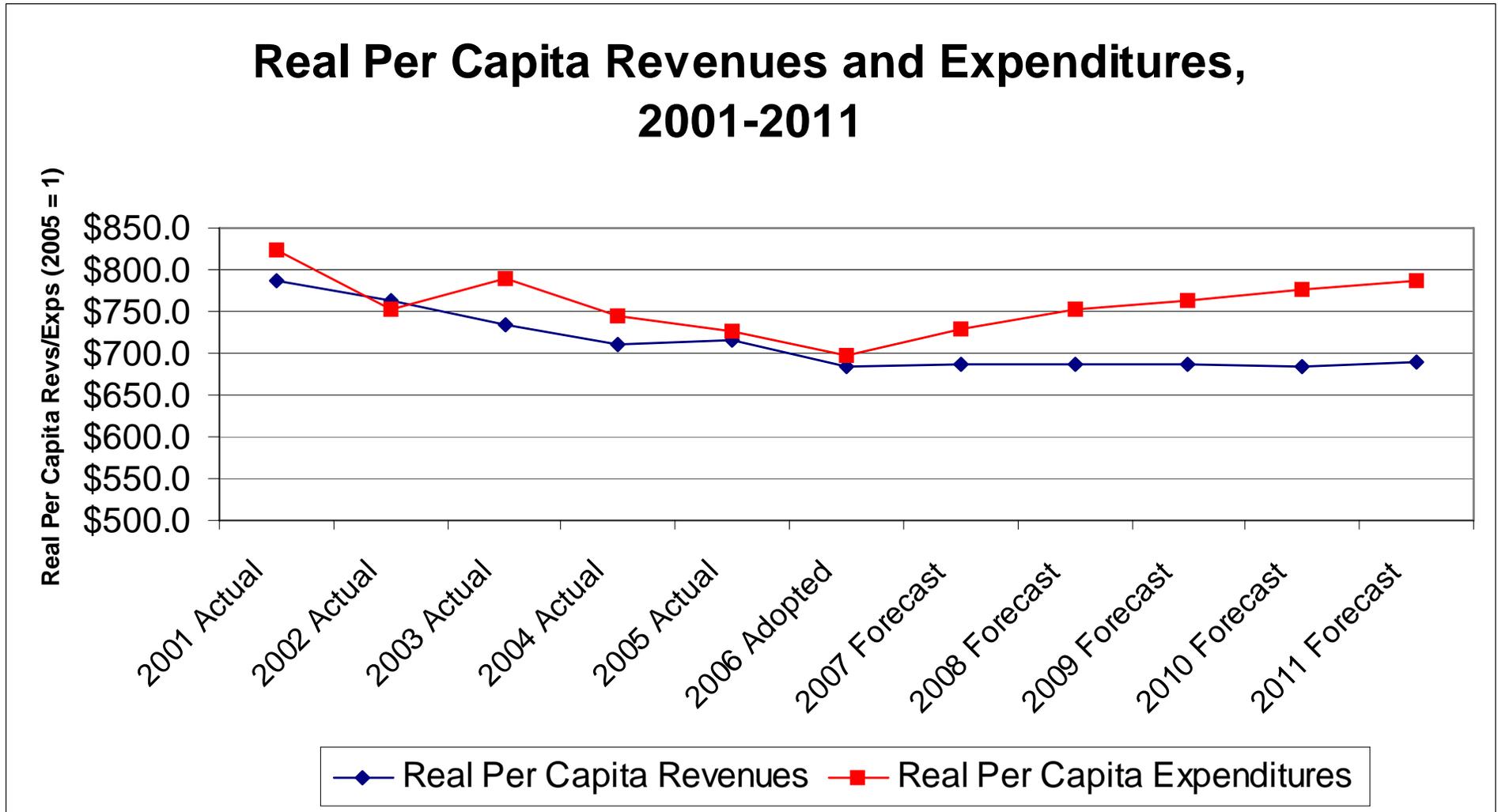


Key Issue #3: Slower Economic Growth

- Economic factors and household characteristics drive the future outlook
 - The conclusions noted here are not set in stone – these factors can change over time
 - Greatest variability is in the economy – swings in the economy from late 90s to today demonstrate this variability
- Economic growth over the next 20 years will likely be considerably slower than the 1990s
- Revenue growth will remain at lower levels due to:
 - Slower economic growth
 - Decreasing per capita tax collections
 - Aging population
 - Increased spending on services



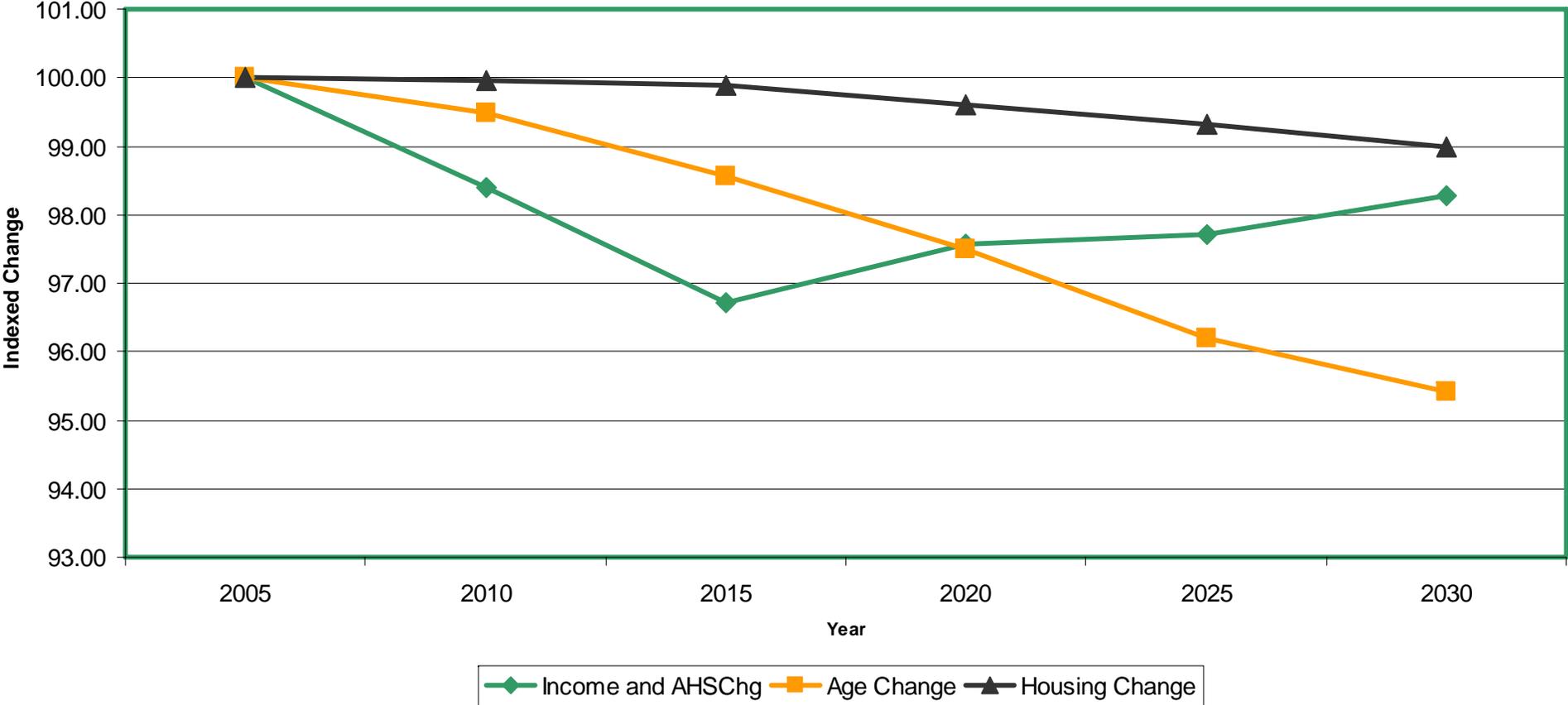
Future Outlook: Taxes Per Capita





Factors Affecting Long-range Forecast

Change in Household Expenditure



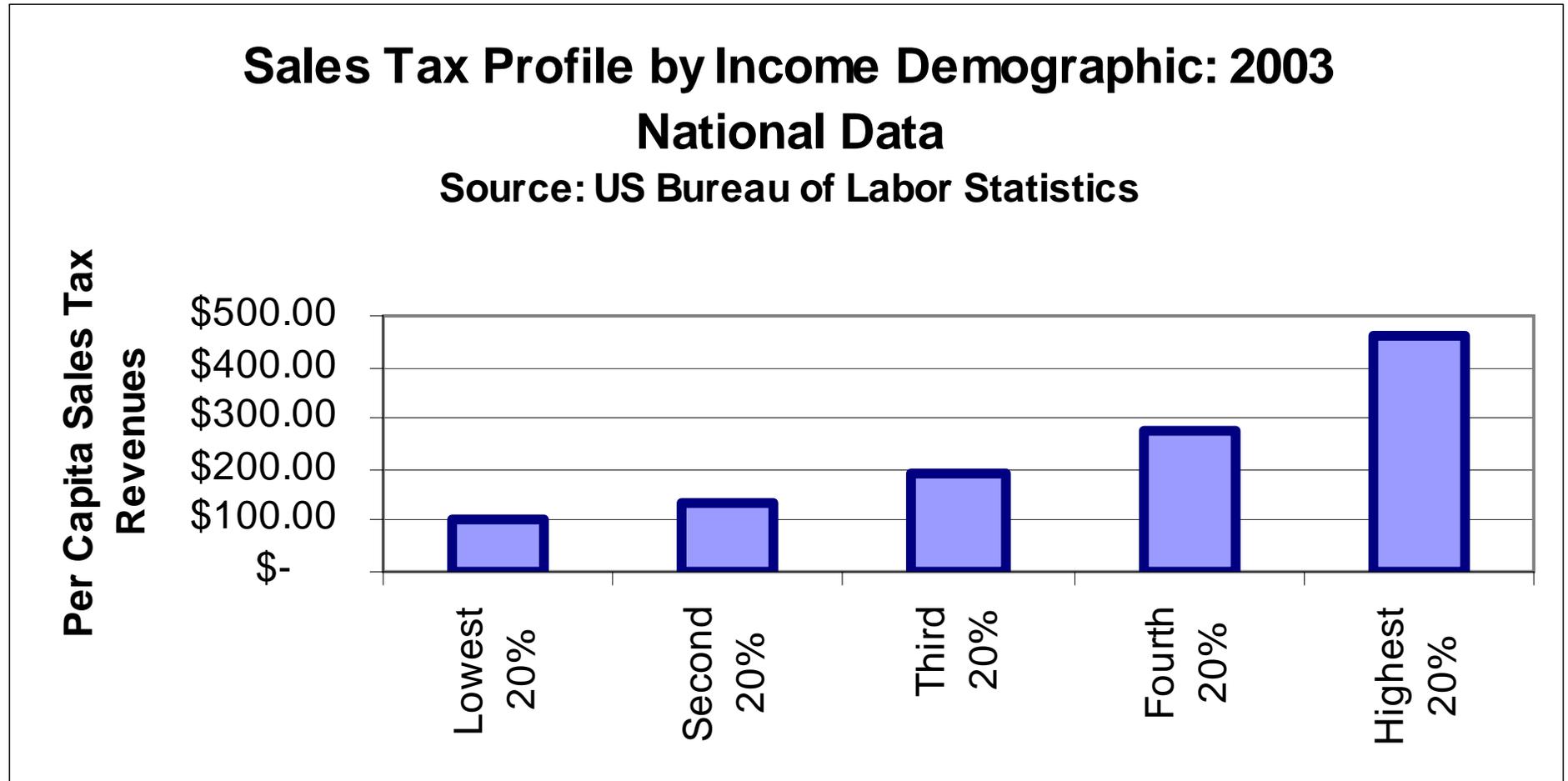


Why do These Factors Matter?

- City is sales tax dependent
- Sales tax revenue driven by household consumption patterns
- Consumption patterns driven by:
 - Income changes (and interest rates)
 - Aging of resident population
 - Household composition changes

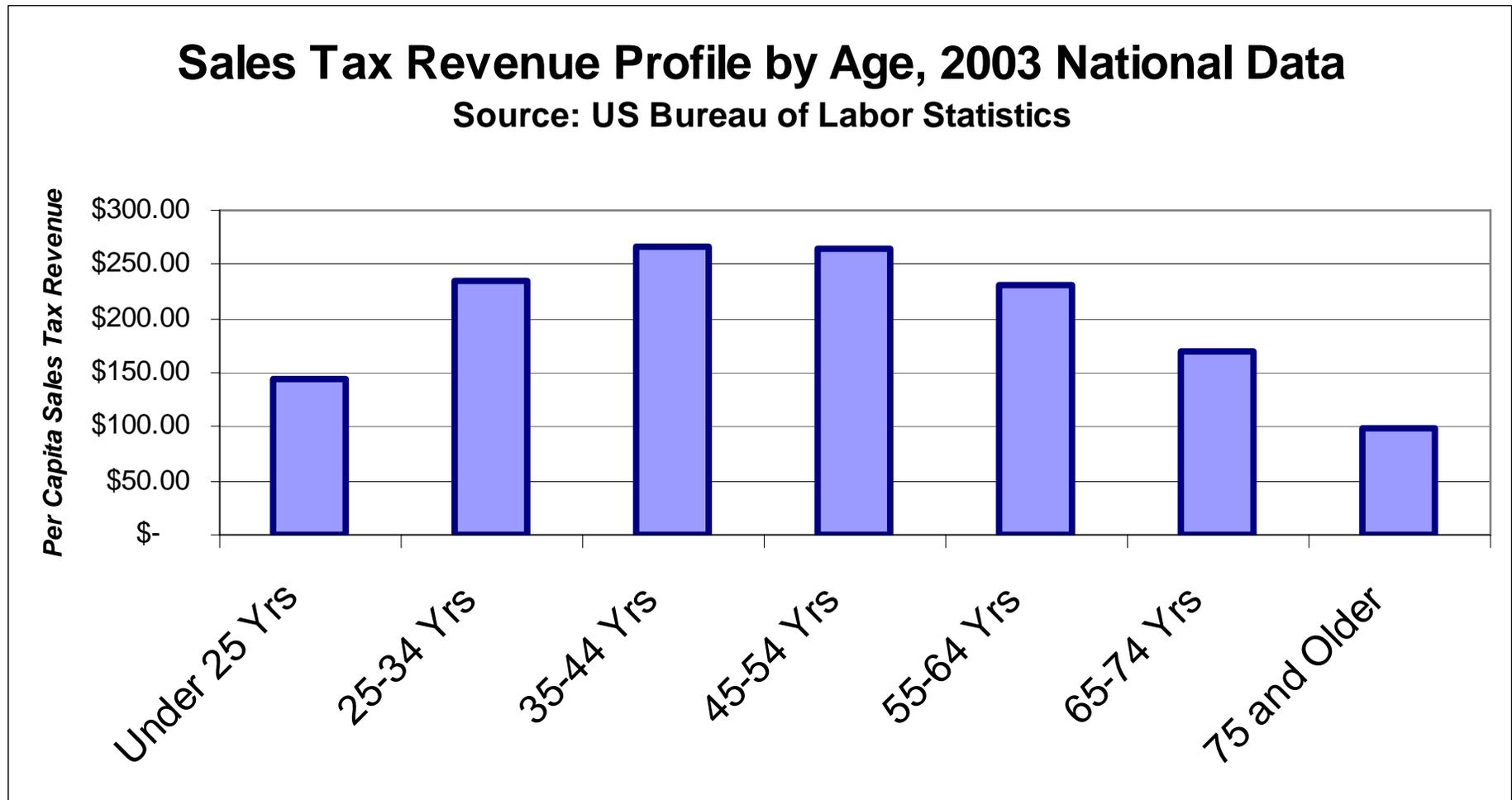


2003 Taxable Expenditures by Income Level





2003 Taxable Expenditures by Age Group





Key Issue #4: The Gap is Structural

- The City cannot grow itself out of the gap with its current revenue sources
- The forecasted decline in household spending limits the City's ability to generate additional revenue from current sources
- Growing out of the gap requires a repeat of the late 1990s
 - Unprecedented economic growth
 - Significant growth in local economy activity
 - Reverse of long-term trends
 - And a significant increase in retail development
- Nothing in long-term forecast suggests such convergence



Closing the Gap





Expenditure Strategies

- Aurora has already made significant cuts
 - The City reduced its GF budget by over \$32 million and eliminated or transferred more than 166 positions
 - Non-Public Safety services cut by 14.6 percent since 2002
 - Population has increased by 20,000 since 2002
 - Additional cuts are likely to affect service levels
- The City has limited funding for compensation, benefits, and other fixed costs for the past three years
 - Furloughs in 2004, no pay increase in 2005, less than 2% in 2006
 - Creates issues with recruitment and retention
- The City may wish to consider whether to explore changes in service levels or patterns of providing service
 - Review of service standards and revisions to Council goals
 - Operational changes



Revenue Strategies: Guiding Principles

- Diversity
- Materiality, sufficiency, and reliability
- Economic efficiency
- Simplicity and ease of administration
- Broad base and low rates
- Equity



Revenue: Additional Considerations

- There is no perfect tax or fee – deadweight losses will occur
- Extensive use of a tax or fee exposes its defects
- Incremental change generally creates fewer economic problems
- Existing taxes and fees have generally been factored into market decisions
- Prospects for business and consumer flight should be considered



Revenue Strategy: Bonding for Capital Projects

- Appropriate method for spreading capital costs over the asset's useful life
- Aurora's debt profile can accommodate additional bonding
 - Overall debt is an average 3% of market value of all property in Aurora - roughly \$2,350 per capita
 - Stable ratings and recent upgrade by Moody's
- Without bonding, the City faces two possibilities:
 - A limited portion of the City's capital needs would be funded even if the CPF transfer returns to 100% of use taxes plus 4% of all other GF revenue or
 - The projected annual gap would be significantly higher if the City chose to fund capital projects on a pay-as-you-go basis



Revenue Strategy: Service Charges

- Reasons for growth in use of service charges
 - Economically efficient
 - Defensible
- Aurora shows slightly less use than other Colorado cities
 - Currently second-largest revenue source behind sales and use taxes
- Service charges expanding in other Colorado cities
 - Fort Collins, Colorado Springs have transportation-related service charges



Potential for Service Charges

- Appropriate for services where users directly benefit
- Examples from other cities include transportation and street lighting
- Easy to administer
 - Assess per parcel or per foot of frontage
 - Can be collected through utility bills
- Applies to non-property taxpayers as well

Service charge potential -- \$4.5 million for public lighting
(\$6.50 per account / per month)
Up to \$15 million for street overlay (\$17.50 per acct/month)
Does not require an election



Revenue Strategies: Sales Taxes and Services

- Equity issues – goods broadly taxed, services are not
 - Focus on consumer services – pet grooming, landscaping, beauty salons
 - Be aware of cross border competition
- Equity issues – similar goods treated differently
 - Cable television versus satellite television
 - Cellular phone service versus land line service
- Avoid extending taxation to business services
 - May create flight risks



Revenue Strategies: Excise Taxes and Services

- Export tax base
 - Non-residents consume city services as well
 - Police and fire protection, roads and maintenance
- Options
 - Increase lodger's tax
 - Increase rental car tax
 - Increase sales tax on prepared food
- Other municipalities have done each of these

Overall services tax potential -- \$5-10 million

Requires an election



Revenue Strategies: Charges for New Development

- Addresses immediate demands for services
- Service demands often precede revenue generated by development – creates timing issues
- Unique aspects of non-contiguous development creates budget pressures as well
- Extensive use of exactions, development, and impact fees in high growth areas around the Country
- Development-related charges are consistent with principles in City code
- Must be mindful of potential revenue loss that will occur if rate of growth is impacted



Assessing Charges for New Development

- City has utilized, to some extent, impact fees and exactions for transportation and parks
- Impact fees elsewhere also used for fire and police protection, libraries, general government
- Impact fees are generally one-time charges to support capital costs – also need revenue for ongoing operating costs
 - Examine new development services charge to replace urban services fee concept



Development Charges to Consider

- Excise tax on new development
- A new development services fee to cover ongoing operating costs
- Additional impact fees
- Special districts
 - Especially in outlying or non-contiguous areas
 - Prefer districts contract with City for services



Assessing Charges for New Development

- Develop overall City strategy, taking into account:
 - Reasonableness of the charge for the services
 - Other revenue generated by growth (e.g. retail sales)
 - Importance of the services
 - Impact on the City as a whole
 - Timing considerations

Example of revenue potential – A \$25 per month fee on each new dwelling unit could generate \$700,000 in the first year and \$3.5 million per year after five years

Depending on choices, may or may not require an election



User Fees – Maintaining Adequacy

- Determine which services will be charged full cost and which will be subsidized, as well as level of subsidy
- Review cost accounting methodologies to ensure all costs (capital, non-productive time, indirect costs) are considered
- Index fees and charges to account for inflation

Revenue potential – up to \$500,000 if indexed for inflation

Up to \$1 million with a more comprehensive review

Does not require an election



Other methods to enhance revenues

- Development strategies to grow the revenue base (Smart Growth)
 - Retail, high-wage jobs, high-end housing
 - Very much a long-term strategy
 - Meant to address demographic factors that drive revenue
- Non-profit corporation payments in lieu of taxes or fees
 - Aurora has a significant non-profit and government presence
- Market-based revenue options
 - Advertising
- Others (see Attachment 4)



Fiscal Analysis Notes for Development

- Revise the current fiscal model
 - Current model is out-of-date
 - Data, assumptions, and relationships need to be refined to current community conditions
 - Simplify and summarize information to focus on key concerns and issues
 - Outcomes should show impacts in short and long-term
 - Revenues should reflect the diversity and conditions of the community
 - Output data should be focused on about 10 key variables
 - Revised model should be focused on local conditions and information needs (no “black box models”)
- Continuously monitor and update core information in the model and review at multiple steps in process



Final Points

- Any plan will likely require effort on both revenue and expenditure sides of budget
- Seek ways to broaden the revenue base
- Benefits-based revenues are sound in principle and easier to defend
- Border community competition is an issue
- An extensive education and outreach campaign will increase the chances for success
- Need strong support from local officials



Overview of Potential Solutions

- The study outlined a significant number of options for bridging the projected gap between current revenues and projected service needs
- The options are categorized into several groups
 - This presentation focused on those sets of options that are most likely to generate adequate revenues to bridge the expected gap
 - A complete list of all options is provided as an additional attachment
- The study emphasized the importance of implementing a package of solutions that diversify Aurora's revenue sources
 - Staff will develop a “menu” of options to address the anticipated revenue / services gap and will present this menu on April 18
 - Council's choices from this menu will form the basis for future implementation steps and for budget development in 2007

FINAL DRAFT
Structural Revenue Study
Staff Review and
“Menu of Options”

City of Aurora
Spring Workshop
April 28-29, 2006

Overview

■ Service Issues

- Were discussed during Budget Update
- REM: We are trying to bridge a \$36 million gap over five years

■ Revenue Options For Consideration

- Includes several NEW options, including those requested by M&F / PEDR
- Criteria
- Operating budget options
- Capital budget options
- Options not recommended

Our Favorite Idea



*Shop Aurora
We Won't Fleece You!*

Revenue Strategies: Criteria

- Diversity
- Materiality and sustainability
 - Sustainability addresses both sufficiency and reliability
- Other criteria
 - Economic efficiency
 - Simplicity and ease of administration
 - Broad base and low rates
 - Equity
- Is voter approval required?
- Are there other (significant) barriers to implementation?
 - Legal – revenue options that require changes in federal law or the State Constitution are excluded from the staff list of options
 - Legal - included items that required state law change
 - Public acceptance is another key variable

Summary of Options

- In total, staff identified options that could generate more than \$56 million above current revenues
 - Fees for services can generate approximately \$39.0 million in additional revenue
 - Items requiring voter approval can generate approximately \$16.9 million in additional revenue
 - Dollar figures are (very) preliminary estimates – exact revenue potential of these items must still be determined
 - Some items, such as services fees or excise taxes for new development, may be mutually exclusive
- A detailed summary of options as revised by M&F / PEDR is presented in the backup materials (Tab 18)

Revenue Options: Fees for Services

(Only Council Authorization Required)

<u>Item</u>	<u>Annual Revenue (First Year / After 5 Years)</u>
Service fees for street lighting	\$4.5 million / \$4.5 million
Service fees for transportation maintenance	\$15.0 million / \$15.0 million
Index fees	\$0.2 million / \$1.0 million
Increase charges to enterprise funds (NEW - includes charges for Parks Water)	\$2.0 million / \$5.0 million
New fees for code enforcement	TBD / \$1.5 million
Increase recreation and cultural service fees	TBD / \$3.0 million
Vehicle impact fees (requires change in State law)	TBD / TBD
Service charges for new development <u>OR</u>	TBD / \$3.5 million
(NEW) Use urban services extension fee	\$0.5 million / <\$1.7 million
Public improvement fees (PIF)	TBD / TBD
(NEW) Increase fee for use of right of way	<u>\$3.8 million / \$3.8 million</u>
TOTAL:	\$26.0 million first year \$39.0 million after five years

Revenue Options: Requires Voter Approval

<u>Item</u>	<u>Annual Revenue (First Year / After 5 Years)</u>
Sales and excise tax on services / differential rates	\$5.0 million+ / \$5.0 million +
Increase lodger's tax	\$1.1 million / \$1.1 million
Increase occupational privilege tax	\$5.8 million / \$5.8 million
Gas tax (requires change in State law)	TBD / TBD
Excise tax on new housing units	\$0.7 million / \$3.5 million
(NEW) Local tax on insurance premiums	\$1.5 million / \$1.5 million
Operating levy tied to bond issues	<u>TBD / TBD</u>
TOTAL:	\$14.1 million + first year \$16.9 million + after five years

Revenue Options: Special Districts and Other Options

■ Items

- IGA's with metro districts
- Overlay districts
- (NEW) Establishing districts to support existing rec centers
- Advertising / naming rights / sponsorships
- Non-profit payments in lieu of taxes (PILOTs)
- Increase E-911 surcharge (requires change in State law)
- Additional tax auditors
- Public / private partnerships

■ Revenue potential for all these items is TBD

- Dependent on specific implementation approach and other factors

Most Likely Capital Revenue Options

- Increasing GF transfer to CPF - match ordinance
 - Gradual increase generates \$16.2 million over 5 years
 - Immediate increase generates \$31.0 million over 5 years
 - Depends on higher GF revenue and is not adequate by itself
- Exactions
 - Are a current and anticipated revenue source for several transportation projects - need an overall exaction policy
 - Will not reduce City share of cost on projects included in study since potential revenue was already taken into account
- Impact fees
 - Already assessed for Parks and Transportation capital needs
 - Existing fees should be reviewed
 - Should also consider developing a plan to add fees for public safety, libraries, recreation, and general government

Additional Capital Revenue Options

- Securitize existing revenue stream
 - Already utilized for Open Space
 - Should examine other possible options (e.g. Adams County Road and Bridge Tax and (NEW) cable franchise fee)
- Bond issues
 - \$100 million would require \$9.2 million (3.5 mills) for annual financing cost over 15 years
 - \$281 million would require \$21.6 million (8.5 mills) for annual financing cost over 20 years
 - Staff recommends developing one or more bond issues to present to voters in 2008 or 2009
- Public / private partnerships
 - Utilized successfully for two recreation centers
 - Recommend pursuing additional opportunities as available

Less Likely Capital Revenue Options

- (NEW) Fee to issue conduit bonds - not a major source
 - There is room to go higher, but need to keep fees competitive
- Special districts for financing capital needs
 - Limited application, but may be useful for specific projects
 - Public improvement fees should not be used if they effectively increase sales tax rate in a particular area to a level that is not competitive
 - TIFs work best with intergovernmental cooperation
 - Should evaluate further in conjunction with specific projects
- Asset sales
 - Limited applicability – there are probably no significant assets the City wants to sell outright
 - Sale and leaseback of other assets (e.g. the sewer system-NEW) creates debt service cost and may face other obstacles

Options Not Included

- Increasing general property tax - given margin of disapproval for property tax proposal last November
- Local income, payroll, and real estate transfer taxes which are constitutionally prohibited
- Increasing sales tax rate – current rate is relatively high and the mental health district election issue creates uncertainty
- Extending sales tax to groceries – likely to be controversial even though revenue potential is high
- Internet sales tax – current national effort requires cities to give up control over collection and determination of what is taxed
- Any source not likely to generate substantial revenue (more than \$250,000 per year) – e.g. parking taxes and fees

Options Not Included (2)

- Increased telephone franchise tax – land lines are already at a competitive disadvantage and utilization has declined, reducing the value of this revenue source
- Increasing fines and surcharges – already done; although concept of a specific surcharge for the Aid-to-Agencies program may still be discussed

Next Steps

- Council review at Spring Workshop
- Council direction at May 15 Study Session
- Consideration of any 2007 ballot issues in June
- Consideration of other proposals as part of 2007 budget process

Questions for Council – May 15

1. Which of the identified options does Council wish to pursue?
2. Are there any other options that Council wishes to pursue?