Review of the Submitted Budget for Fiscal Year 2001

March 2000

City Auditor's Office

City of Kansas City, Missouri

10-2000

March 1, 2000

Honorable Mayor and Members of the City Council:

The submitted budget continues to strengthen the city's financial condition in the short term. For the first time in many years, a budget has been proposed that uses no carryover to fund ongoing operations. The budget provides for an adequate fund balance, while maintaining infrastructure spending. The backlog of deferred maintenance is decreasing.

While substantial progress has been made, many tough choices remain. Building the city's long-term financial strength will require continued strong direction from the mayor and City Council. A structural imbalance – where recurring expenditures are greater than recurring revenues – remains because major changes in the structure of revenues and expenditures have not been made.

We recommended such changes in last year's budget review. Among our recommendations were that a fee-based solid waste system be developed, general fund support for parks and indigent health care be reduced, and enterprise operations be required to make payments in lieu of taxes or negotiate long term lease or sale of the operations. These policy issues are currently being debated throughout the community, and action on these policy choices may be undertaken sooner or later. Absent these types of changes, the prospects are not good that the budget can continue to be balanced appropriately, as it has been this year.

Our review of this year's budget emphasizes financial management issues. One concern is the city's decreasing financial flexibility. More and more operating revenues are restricted in their use, the city's debt portfolio already exceeds established benchmarks, and development incentives account for increasing percentages of our tax base and debt portfolio. Decreased flexibility reduces the ability of the mayor and City Council to alter current spending priorities and limits their ability to address future priorities. Enduring infrastructure needs, an inadequate police capital planning process, and a lack of accountability for economic development incentives also need to be addressed if the city wishes to continue its budgetary progress.

This report proposes several initiatives to deal with these lingering concerns.

We appreciate the assistance of management staff in providing information for our analysis.

Mark Funkhouser
City Auditor

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Introduction

Objectives

This review of the city manager's submitted budget for fiscal year 2001 was conducted pursuant to Resolution 911385. The resolution directs the city auditor to annually review and comment on the city manager's budget.

This year our review focused on major challenges to the city's financial condition.

This is our tenth budget review.

Scope and Methodology

Our review was performed in accordance with government auditing standards for non-audit work. The work included:

- Updating analyses from prior budget reviews.
- Reviewing audits and other reports issued by the City Auditor's Office.
- Requesting information from the city manager on the status of recommendations from last year's budget review. The city manager's response is in Appendix A.
- Reviewing the city manager's submitted budget.

Introduction

Actions undertaken in recent years have allowed the city to make significant progress in addressing major budgetary issues. Improvements to the city's capital budgeting have created a process that is inclusive and fiscally responsible. The city manager's submitted budget is in balance while maintaining an adequate fund balance and not using carryover to fund ongoing expenditures. Steadily increasing infrastructure spending has lessened the backlog of deferred maintenance.

Despite these improvements, long-term financial management issues and trends continue to be a concern. A structural imbalance remains, with city expenditures predicted to outpace revenues in the coming years. Financial flexibility has been undermined by increases in the proportion of operating revenues that are restricted in use, increases in debt service, and increases in general fund transfers. Infrastructure funding is still too low to address important capital issues, and police capital planning is not currently addressed through the city's capital budgeting process. Furthermore, the city lacks proper procedural mechanisms for strengthening the accountability of economic development incentive use.

Significant progress in addressing major budgetary issues has been made. The mayor, Council and city manager have developed and implemented a number of sound financial management practices. As a result, the city's financial condition has been strengthened. A budget has been proposed that uses no carryover to fund ongoing operations and provides for an adequate general fund balance. The balanced budget has been achieved while still meeting the city's commitments and plans with regard to capital spending and deferred maintenance. City spending on capital projects continues its upward trend, and the backlog of deferred maintenance has decreased. In addition, the revamped capital budgeting process now critically reviews, evaluates, and prioritizes submitted proposals in a comprehensive and fiscally responsible manner.

While these accomplishments should be lauded, the city must address five major long-term concerns if it is to ensure that this progress continues and is enhanced in coming years. These long-term concerns include:

The long-term structural imbalance remains. While the submitted budget for fiscal year 2001 provides a balanced budget in the short term, it does not eliminate the city's long-term structural imbalance. Financial forecasts for fiscal years 2002 and 2003 forsee annual revenue growth rates of 2.9 percent, while expenditures are expected to increase by 4.6 percent in 2002 and 3.5 percent in 2003. As a result, annual deficits of $8.1 to $11.5 million are predicted for those fiscal years. This structural imbalance will limit the mayor and Council's ability to fund future priorities, sustain increases in funding for current priorities, or respond to unforeseen emergencies without tax increases. We recommend that the growth rate of expenditures not exceed the annual rate of inflation.

Long-term financial flexibility is threatened. The trend toward increases in restricted operating revenues, debt payments and general fund transfers leaves the mayor and Council with fewer available resources to allocate on other spending priorities. In the last decade, the percentage of operating revenues that are restricted in their use has grown dramatically, from 18 to 44 percent. The amount of operating revenue needed to service the city's debt exceeds the 10 percent level considered acceptable by financial experts, and the city's debt portfolio exceeds recommended benchmarks established by the Community Infrastructure Committee (CIC). Meanwhile, general fund transfers are increasing, as dedicated revenues fail to keep pace with the costs of providing the programs they are meant to fund. To address these concerns, the city manager should continue to implement a policy that no new services be undertaken unless an ongoing revenue source is identified, and explore the potential for enhancing revenues where earmarked revenue sources do not generate funds equal to current expenditures. The manager's office should also continue work on developing a comprehensive revenue policy.

Further increases in infrastructure spending are needed. The Council, CIC, community surveys and prior budget reviews all have suggested greater emphasis on capital spending as a means for improving the city's financial condition. While progress has been made, nearly $325 million is still required to remove the current backlog of deferred maintenance, and $65 million is needed annually to sustain current infrastructure. The city manager should continue to increase infrastructure spending by $5 million annually through fiscal year 2006.

Police capital planning should follow the city budgeting process. Although police facilities are city assets, police capital has not been included in the city's capital budgeting process. Consequently, police capital projects have not been reviewed to ensure consistency with other citywide planning efforts, and project cost estimates have not been developed and reviewed in a rigorous manner. The CIC process that was adopted in 1997 has provided a comprehensive, inclusive and fiscally responsible vehicle for managing capital planning and spending. Police capital planning should be included in this process.

Managing development incentives is a growing financial challenge. The use of development incentives such as tax increment financing, super tax increment financing, Chapter 353 tax abatement, and Chapter 100 bonds has grown dramatically in recent years. While the long-term effects of development incentives are unknown, increasing reliance on the incentives poses significant threats to the city's financial flexibility. TIF sites could potentially account for up to $2.5 billion of the city's real property tax base. Future revenue growth capabilities are diminished when the city cannot generate full tax revenues on such a substantial portion of its tax base. Additionally, current and projected TIF and Chapter 100 bonds account for 18 percent of the city's debt portfolio. Further approvals of TIF and Chapter 100 bonds will decrease the city's capacity for issuing debt for other purposes. The current reorganization of the economic development process should continue to formulate policies that increase accountability. The city should also consider setting limits on the amount of incentives approved annually.

Analysis

Significant Progress Made in Addressing Major Budgetary Issues

In recent years, the city has reversed negative trends on several major budgetary issues, instituted better financial management practices and generally placed itself in a better position to address the Council's funding priorities and concerns. Most notably, the city manager's proposed budget is balanced without using carryover funds and while maintaining an adequate fund balance; infrastructure spending continues to increase; and the process for capital budgeting has improved.

The Submitted Budget Is Balanced Without the Use of Carryover Funds

Maintaining a balance between ongoing revenues and expenditures was the highest policy priority identified during the annual City Council priority sessions in the fall of 1999. This year's submitted budget does not use carryover funds for ongoing expenditures.

In last year's budget review, we recommended that the city manager prepare a resolution for consideration by the mayor and Council that adopts the Government Finance Officers Association (GFOA) guidelines requiring balancing the budget without use of the general fund balance. In addition, we recommended that the resolution limit the use of one-time revenues for ongoing expenditures. The submitted budget is consistent with our recommendations. It does not use the general fund balance to balance the budget and limits the use of one-time revenues to fund ongoing expenditures.

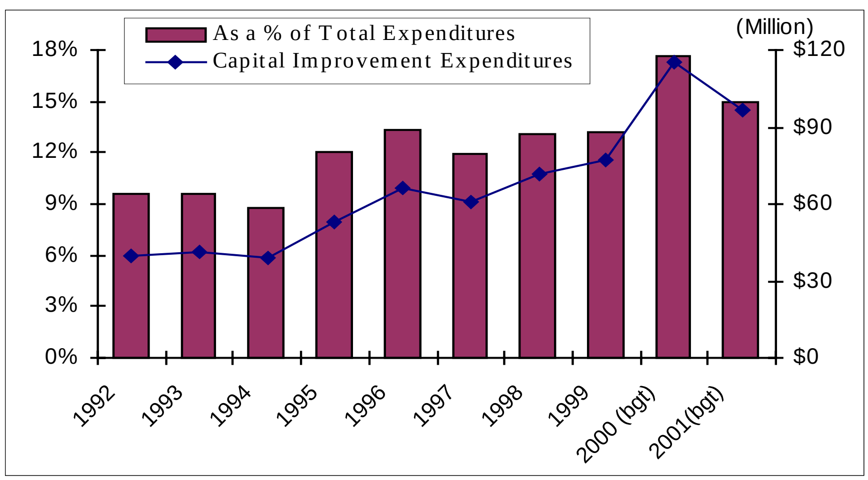
The General Fund Balance in the Submitted Budget Is Adequate

The fund balance provides a financial cushion in the event of loss or decline of a revenue source, economic downturns, unanticipated emergencies, and uneven cash flow. It helps the government over the tight spots without substantial tax increases or service reductions. The financial health of a city is in part determined by the level of fund balances that it maintains. Our budget reviews for 1996 and 1997 recommended that the city manager build the general fund balance to 8 percent of expenditures. The Council also identified achieving and maintaining an 8 percent general fund balance as one of the funding priorities in the 1999-2000 budget. The city has achieved this goal in fiscal year 2000. It is estimated that the general fund balance can be maintained at 8 percent through fiscal year 2003 without the need for additional resources. Maintaining a healthy fund balance provides capabilities for the city to meet its future needs.

The Balanced Budget Meets the City's Commitment to Infrastructure

The mayor, Council and Community Infrastructure Committee (CIC) have expressed the need for a strong commitment to additional funding for the city's infrastructure. That commitment has been realized by generally increasing expenditures on capital improvements every year since 1994. In addition, the percent of total expenditures spent on capital improvement has increased from a low of 8.8 percent in fiscal year 1994 to almost 15 percent in the submitted budget. (See Exhibit 1.) Furthermore, increases in infrastructure spending have allowed the city to decrease its deferred maintenance backlog by an estimated $95 million between 1999 and 2000.

Exhibit 1. Capital Improvement Expenditures



Sources: Adopted Budgets 1990-2000; Submitted Budget 2001.

The Capital Planning and Budgeting Process Has Been Improved

The CIC recommendations adopted in 1997 provide a sound mechanism for reviewing, evaluating and prioritizing capital project proposals. Its implementation has created a process that checks projects for consistency with citywide planning goals, rigorously analyzes the accuracy of cost estimates, and includes input from community stakeholders. Furthermore, the Public Improvement Advisory Committee's (PIAC) finance policies require that debt issuance be reviewed for its impact on the city's debt capacity and tax base and that projects be monitored for progress prior and after completion.

The Long-Term Structural Imbalance Remains

The structural imbalance remains a long-term problem. The city manager forecasted that expenditures and transfers out will grow at a faster rate than revenues through the next five years. When revenue sources are inadequate to fund the ongoing cost of services, the city's current and long-term flexibility are limited. This makes it difficult to address priorities or to react to unforeseen problems.

Long-Term Operating Expenditures Exceed Operating Revenues

Although the submitted budget is balanced, long-term operating expenditures continue to exceed operating revenues. As a result, a structural imbalance remains. A structural balance is a balance between operating expenditures and operating revenues over the long term, not just during the current operating period.[1]

What Is a Structural Imbalance?

As anyone who prepares a budget understands, whether it involves a large corporation, a small business, or a household, revenues must keep pace with expenditures over the long run to ensure viability. If selected expenses increase, then other expenses must decrease or revenues must be increased to achieve balance. If expenses increase without a corresponding cut in other expenditures or increase in revenue, balance will be lacking. If any budget is out of balance for too long, and if options to borrow, avoid expenditures, and take other evasive maneuvers are exhausted, collapse can be the only result.

Source: *Philadelphia: A New Urban Direction*, Office of the City Controller, Philadelphia, Pennsylvania, 1999, p.90.

Expenditure growth is expected to exceed the revenue growth in the next two years. While the submitted budget for fiscal year 2001 provides a balanced budget in the short term, it does not eliminate the city's long-term structural imbalance. Financial forecasts for fiscal years 2002 and 2003 foresee annual revenue growth rates of 2.9 percent, while

[1] *Recommended Budget Practice: A Framework for Improved State and Local Government Budgeting* (National Advisory Council on State and Local Budgeting, 1998), p. 23.

expenditures are expected to increase by 4.6 percent in 2002 and 3.5 percent in 2003. This results in an anticipated imbalance of $8.1 million in 2002 and $11.5 million in 2003. (See Exhibit 2.)

Exhibit 2. Imbalance (In Millions)

	2001	2002	2003
Revenues	$450.2	$463.0	$476.2
Expenditures			
Ongoing	450.2	471.1	487.7
One-time	7.8	-	-
Carryover Used	7.8	-	-
Imbalance	0	($8.1)	($11.5)

Source: Submitted Budget 2001.

Long-term revenues and expenditures trends continue to raise concerns. The five-year financial forecast projected an average annual revenue growth of 3 percent and an average annual expenditure growth of 4.7 percent over the next five years. Since the revenue growth rate is smaller than the expenditure growth rate, the gap between revenues and expenditures will continue widening. Therefore, the imbalance will remain and increase.

The structural imbalance will be eliminated when:

- Current revenue and current expenditures are in balance;
- The fund balance is maintained;
- Maintenance expenditures are not deferred; and
- Expected revenue growth is equal or greater than the expected expenditure growth in coming years.

Imbalance Limits Ability to Address Priorities

A long-term structural imbalance limits the City Council's ability to address other priorities or respond to unforeseen problems. The structural imbalance limits the city's current and long-term flexibility, making it difficult to sustain increases in funding for Council priorities. In times of slowing economic growth, a structural imbalance threatens a city's financial solvency and its ability to respond to unexpected emergencies such as natural disasters. The imbalance can also cause public officials to defer maintenance since, in the short run, that is one of the ways the city can reduce expenditures.

Recommendation: Expenditure growth rate should not exceed the inflation rate.

The city should adopt a policy to ensure that its budget should not increase more than inflation. The administration must justify any expansion of spending effort with a corresponding increase in revenue or a decrease in spending elsewhere in the budget.

Decreasing Financial Flexibility Is a Growing Concern

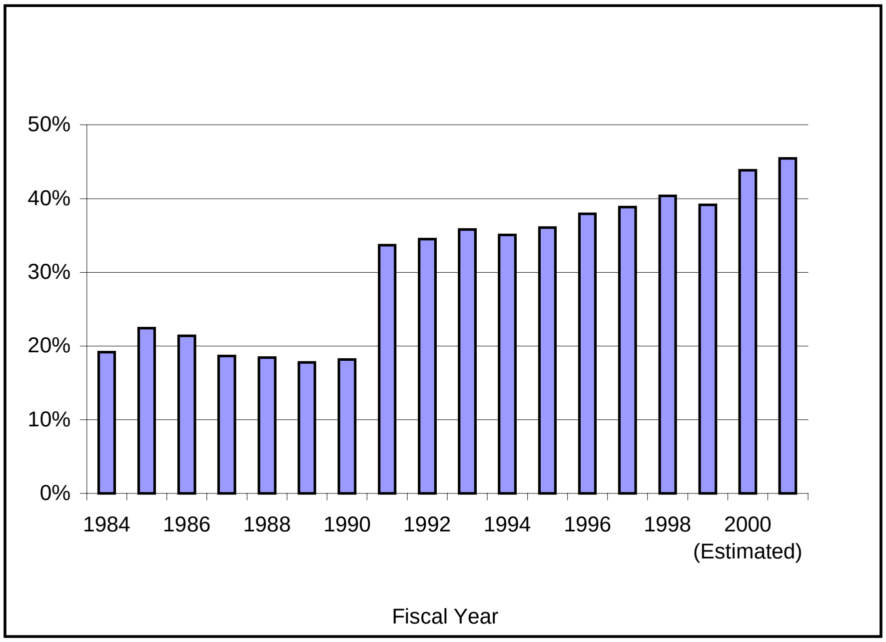
The city's financial flexibility is decreasing, reducing the ability of the mayor and City Council to address future priorities or respond to unforeseen problems. Restricted revenues represent a large and increasing portion of operating revenues. General fund transfers have also increased sharply. These trends raise concerns about the city's future financial flexibility. While the budget process has improved substantially over the past several years, we expect that it will be difficult for the city to continue to reduce the structural imbalance, increase infrastructure spending, and address public safety concerns and other priorities. We recommend the city manager adopt a revenue policy to promote sound financial management practices.

Financial Flexibility Has Decreased

Long-term financial trends indicate the city's financial flexibility has decreased. A growing proportion of the city's operating revenue is restricted in use, limiting the ability of the mayor and Council to alter spending priorities in response to changing needs. Increasing debt service reduces flexibility in the short term by allocating funds to repayments and in the longer term by reducing the city's capacity to borrow for additional needs. Increasing general fund transfers also pose a threat to financial flexibility; when dedicated revenues do not keep pace with the cost of the programs they are intended to provide, there is more pressure on the general fund to support these services.

Over 40 percent of operating revenues are restricted in use. Restricted revenues increased from 18 percent of operating revenues in fiscal year 1989 to an estimated 44 percent in fiscal year 2000. (See Exhibit 3.) These are revenues earmarked for specific uses by state law, bond covenants, city ordinances, or grant requirements. The growth in restricted revenues resulted from new revenue sources approved by voters such as increased hotel/motel and restaurant taxes to finance the expansion of Bartle Hall, increased debt service funds, and increases in the number of projects financed using tax increment financing (TIF). As a growing proportion of revenues is restricted, the mayor and Council have less flexibility to respond to changing priorities and unforeseen problems.

Exhibit 3. Restricted Revenues as a Percent of Operating Revenues

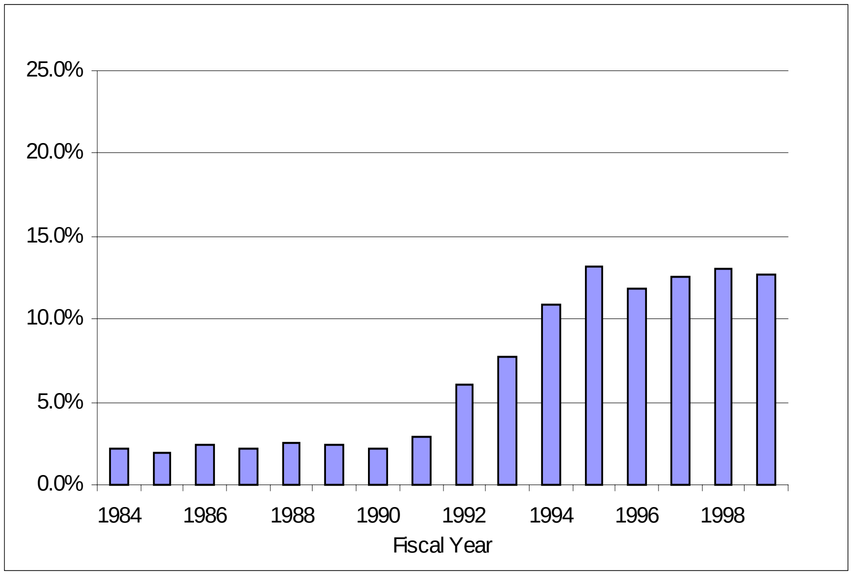


Sources: Adopted Budgets, 1984-1998; Submitted Budget 2001.

Debt service remains high. Debt service as a percent of operating revenue has increased since fiscal year 1989, but has remained fairly stable since fiscal year 1994. Debt service funds are established to account for revenues and expenditures used to repay the principal and interest on debt. Debt service remains below the 20 percent warning level, but since fiscal year 1994 has been above the 10 percent level considered acceptable by financial experts.[2] (See Exhibit 4.) A high level of debt service limits short-term financial flexibility and reduces borrowing capacity in the longer term.

[2] *Evaluating Financial Condition: A Handbook for Local Government* (Washington, D.C: ICMA, 1994), p. 88.

Exhibit 4. Debt Service as a Percent of Operating Revenues



Sources: Comprehensive Annual Financial Reports, 1984-1999.

The city exceeds the Community Infrastructure Committee's recommended debt limit. The CIC identified the city's debt position as a potential weakness.[3] The committee recommended establishing a consolidated debt cap, based on the average of three financial ratios often used by credit rating agencies.[4] They proposed a cap of 120 percent for fiscal years 2002 through 2006 and a cap of 110 percent by fiscal year 2007. The Finance Department calculates the city's debt score in fiscal year 2001 at about 147 percent, and estimates that the city will not achieve the CIC benchmark until fiscal year 2004 even if no new debt is authorized.[5]

General fund transfers are increasing. Transfers from the general fund have also increased over the past several years. Net transfers out amounted to about $25 million in fiscal year 1999, about 7 percent of the general fund. (See Exhibit 5.) Parks and Recreation Department programs, TIF projects and the Convention Center accounted for the bulk of the transfers. Increasing general fund transfers reduce financial flexibility, as dedicated revenues do not keep pace with the cost of providing the programs they are intended to provide.

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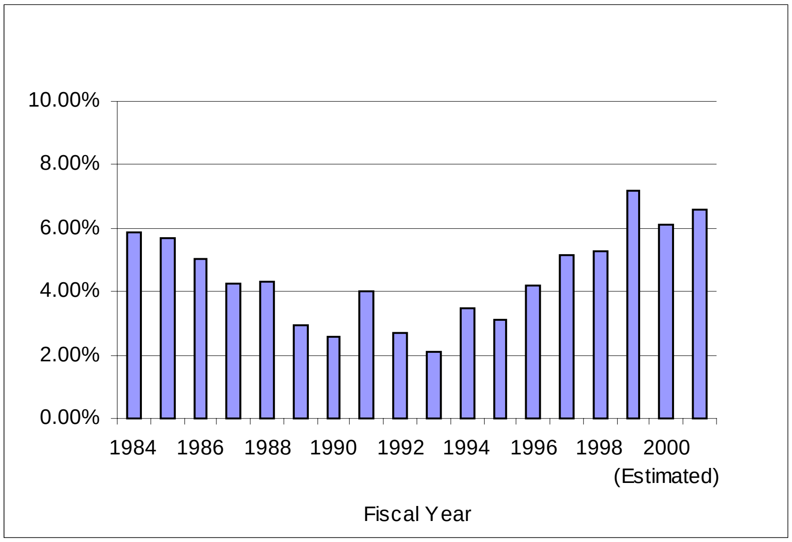
[3] *"Closing the Gap", A New Focus on Capital Improvements*, Community Infrastructure Committee, 1997, pp. 12-17.
[4] The CIC's consolidated debt cap calculation averages debt per capita, debt as a percent of market value, and debt as a percent of general municipal expenditures.
[5] *Financial Report for the Month Ended December 31, 1999*, Finance Department, Kansas City, Missouri.

Exhibit 5. Net General Fund Transfers Out as a Percent of the General Fund



Sources: Adopted Budgets, 1984-1998; Submitted Budget 2001.

In fiscal year 1999, general fund transfers to the east park, west park, zoo, and community centers funds amounted to $11.2 million. Transfers to the convention and tourism fund accounted for $2.3 million. Parks and Recreation Department programs and the convention center receive dedicated revenue from taxes and service fees; however, the revenue from these sources do not cover their operating expenses.

In addition, general fund transfers for TIF projects totaled $4.2 million in fiscal year 1999. These transfers reimburse the economic activity taxes for approved TIF and Super TIF projects. Under TIF, 50 percent of the local economic activity tax increment generated by the project is available to reimburse eligible development costs. Under Super TIF, all of the economic activity tax increment generated by the project is available to reimburse eligible development costs. General fund transfers for TIF and Super TIF have increased from about $356,000 in fiscal year 1995 to an estimated $5.2 million in the submitted budget.

Interfund transfers should be explained in the budget. According to the International City/County Management Association (ICMA), "clear descriptions of transfers may reduce the temptation to balance one fund at the expense of another fund without identifying and resolving underlying problems."[6] In his transmittal letter for the preliminary

[6] Robert L. Bland and Irene S. Rubin, *Budgeting: A Guide for Local Governments* (Washington, D.C.: ICMA, 1997), p. 201.

budget, the city manager said that he would implement a policy that no new services be undertaken unless an ongoing revenue source is identified and explore the potential for enhancing revenues where earmarked revenue sources do not generate funds equal to current expenditures. We support these actions.

In our *Review of the Submitted Budget For Fiscal Year 1999*, we recommended that the city manager proceed with his plan to perform a comprehensive fee analysis. We said he should use the study to develop a revenue policy that details expected general fund support for activities with dedicated funding sources and establishes appropriate cost recovery levels for fee supported activity. We recommended the policy be submitted for City Council consideration. In a memorandum on the status of prior recommendations, the city manager said that the Office of Management and Budget had completed an analysis of fees and had begun to develop a comprehensive revenue manual. We continue to believe that a revenue policy is needed.

Recommendations: Develop a comprehensive revenue policy.

The city manager should complete the comprehensive revenue policy and submit it for City Council consideration.

The city manager should establish a policy to identify revenue sources before undertaking new services. The policy should include a mechanism to determine whether general fund support is appropriate and at what level.

The city manager should review current programs where dedicated revenue sources do not cover operating costs, consider the appropriate level of subsidy within the context of the overall revenue policy, and develop recommendations to enhance revenues or reduce expenditures.

The city manager should explain reasons for interfund transfers in future budget documents.

Further Infrastructure Spending Still Needed

In recent years, the Community Infrastructure Committee, prior budget reviews, Council priorities and local surveys have all expressed a need for greater attention to capital spending as means for improving the city's financial condition. For instance, infrastructure and deferred maintenance ranked among the Council's highest policy and funding priorities in 1999, and respondents to the 1999 Kansas City Business

Survey conducted by the City Auditor's Office ranked street maintenance as the second most important city service. While significant progress in addressing these concerns has been made, a substantial number of infrastructure needs are still unmet, and infrastructure funding levels are still too low to address critical capital issues.

Maintenance Backlog Has Decreased, But Is Still Significant

The city's level of deferred maintenance has decreased since 1998, due to an increased emphasis on funding capital improvements. (See Exhibit 6.) Maintenance backlogs have decreased in street resurfacing, traffic signals and signs, boulevards, and parks. The backlog of needed bridge maintenance, however, remains unchanged.

Exhibit 6. Deferred Maintenance by Category (In Millions)

Category	1998	1999	2000
Street Resurfacing	$31	$23	$10
Traffic Signals & Signs	29	29	17
Bridges	150	150	150
Boulevards	20	19	15
Parks & Recreation Facilities	8	8	8
Parks	128	114	50
Buildings	44	77	75
Total	$410	$420	$325

Sources: Five Year Capital Improvements Plan Reports, 1998-2000.

While significant progress has been made, approximately $325 million is needed to eliminate the backlog of deferred maintenance in the five-year capital improvement plan, with $65 million needed annually to sustain the current infrastructure. The proposed budget for street preservation is adequate at $11.7 million. Minor bridge repair, however, is underfunded; the $6.5 million proposed for minor bridge rehabilitation equals the fiscal year 2000 level. It was estimated that the city will need $15 million annually for 10 years to address the backlog and $9.5 million per year to fund the bridge program adequately.[7]

Efforts should continue. The Community Infrastructure Committee recommended that the city strive to increase resources devoted to deferred maintenance and capital improvements by $5 million annually through fiscal year 2006. The Council adopted the recommendation by resolution.[8] We recognize the progress made thus far in addressing the

[7] *Review of the Submitted Budget for Fiscal Year 2000*, Office of the City Auditor, Kansas City, Missouri, March 1999, p. 16.
[8] Resolution 971326, October 21, 1997.

problem of deferred maintenance, and support the continued implementation of the CIC's recommendation.

Recommendation: Increase infrastructure spending by $5 million annually through 2006.

The city manager should continue to increase the level of city funding devoted to deferred/capital maintenance purposes by $5 million per year through fiscal year 2006.

Police Capital Needs Should Be Addressed Through the City's Process

Strong capital planning and budgeting is an important element of sound financial management – capital projects are costly and significantly affect operating costs. The mayor and City Council adopted a comprehensive approach to capital budgeting in 1997, based on Community Infrastructure Committee recommendations. Planning for police capital needs should occur within the existing city capital process.

City Capital Budgeting Process Promotes Sound Planning

The city's capital budgeting process is designed to be orderly, inclusive, comprehensive, understandable, and fiscally responsible. The City Council adopted the CIC recommended process, which describes the roles of the mayor, City Council, and city manager, and outlines the planning process, including financing and implementation policies.

Key elements of the city's capital budgeting process include:

- **Public input.** The Public Improvements Advisory Committee (PIAC) seeks public input on capital proposals and develops a balanced five-year capital improvement program.

- **Priority setting.** The PIAC reviews, evaluates, and prioritizes project proposals to ensure that projects are consistent with citywide planning, such as Forging Our Comprehensive Urban Strategy (FOCUS). Maintenance backlogs are given high priority, and balance between types of projects and geographic areas is required.

- **Long-term cost estimates.** Policies establish rigorous cost estimation, including anticipated annual increases, necessary extension of city services to the area, costs of financing, and short-term and long-term annual maintenance and operating costs for projects likely to have an impact on the operating budget.

- **Funding guidelines.** Sources of funds for operating and maintenance must be identified. Financial policies set guidelines for pay-as-you-go and debt financing.

- **Inclusion in budget process.** The PIAC recommends changes to the capital improvement program before the annual budget is adopted. The City Council reviews the proposed capital budget as part of its annual budget deliberation.

Police Capital Needs Should Be Integrated into City Process

Although police facilities are city assets, police capital has not been included in the city's capital budgeting process. A comprehensive and disciplined process helps ensure that capital planning relates to the overall financial position of the city; coordinates with other citywide planning efforts and priorities; addresses the effects on operating expenditures; and maintains oversight and accountability.

The proposal for police capital projects currently before the Board of Police Commissioners was not developed in accordance with the city's capital planning process. The PIAC has not reviewed or been involved with the public safety capital improvement proposal. The proposal was developed without systematic citizen involvement in planning or prioritization of the projects being proposed. The proposed projects have not been assessed with regard to the city's overall financial position or to ensure consistency with other citywide planning efforts. Full costs, including potential increases in operating costs, have yet to be estimated.

Recommendation: Use the public safety plan process to assess police capital needs and integrate those needs into the city process.

The budget includes funding to develop a comprehensive public safety plan. The city should use this planning process to identify police capital needs and then work within the established city capital budgeting process.

Managing Development Incentives Is a Growing Financial Challenge

Development incentives such as tax increment financing (TIF), Chapter 353 tax abatement, and Chapter 100 bonds represent a large and growing segment of city expenditures. TIF has quickly become one of the largest city expenditures and is expected to continue to grow. Although the long-term revenue effects of funding development through incentives are not known, the size and sharp growth in the use of incentives reduces the city's financial flexibility. The city should establish financial policies to control current and future incentive expenditures.

Development Incentives Are Substantial

Development incentives such as TIF, Chapter 353 tax abatement, and Chapter 100 bonds represent a large and growing segment of city expenditures and account for a significant portion of the city's tax revenues. In addition, TIF sites represent a large share of the city's total assessed real property base and debt obligations.

City expenditures for TIF have increased 140 percent in three years. City expenditures for TIF projects are expected to reach more than $21 million in fiscal year 2001, a 6 percent increase over the last fiscal year and a 140 percent increase over fiscal year 1998. (See Exhibit 7.) The city approved 37 TIF plans between 1982 and 1999. By approving the plans, the city is committed to reimburse eligible costs over the projects' lifetimes. We estimate that these reimbursements will cost the city more than $1.5 billion over the life of the projects. These reimbursements represent a significant portion of the city's tax revenues.

Exhibit 7. TIF and Super TIF Expenditures

Fiscal Year	Expenditures
1998	$ 8,900,601
1999	14,030,055
2000 (budget)	20,080,542
2001 (budget)	21,316,826

Source: Submitted Budget 2001.

The property taxes and economic activity taxes that would be paid if the developments occurred without abatement or incentives are also substantial. The Finance Department estimates that revenue foregone by Chapter 353 abatement and Chapter 100 bonds totals close to $4.8 million in fiscal year 2001. (See Exhibit 8.)

Exhibit 8. Foregone Revenue by Development Incentives

Development Incentives	Foregone Revenue
Chapter 353 abatement	$3,077,000
Chapter 100 bonds	1,692,000
Total	$4,769,000

Source: Finance Department records.

TIF plans represent a large portion of the city's property base. By the end of fiscal year 2000, the total original assessed value of TIF sites was about $141 million. The assessed valuation added to the redevelopment plans was about $136 million. Thus the total assessed value of 37 TIF plan sites was about $277 million. The total value of assessed property for all city taxable real property was $3.3 billion in fiscal year 1999. Therefore, TIF sites currently represent roughly 8 percent of the city's real property tax base. However, once all 37 plans have been constructed and their anticipated assessed values realized, TIF's share of the city's real property base is expected to climb astronomically. According to the approved TIF plans, total assessed real property value of all 37 TIF plans will reach $2.5 billion when they are completed.

TIF's share of city debt is substantial. City debt includes general obligation bonds, revenue bonds, and lease purchase and other limited obligations. At the end of fiscal year 1999, the city's total outstanding debt was $936 million. TIF-related bonds represented 9 percent ($84 million) of that total, and 61 percent of the lease-purchase and other limited obligation bonds.

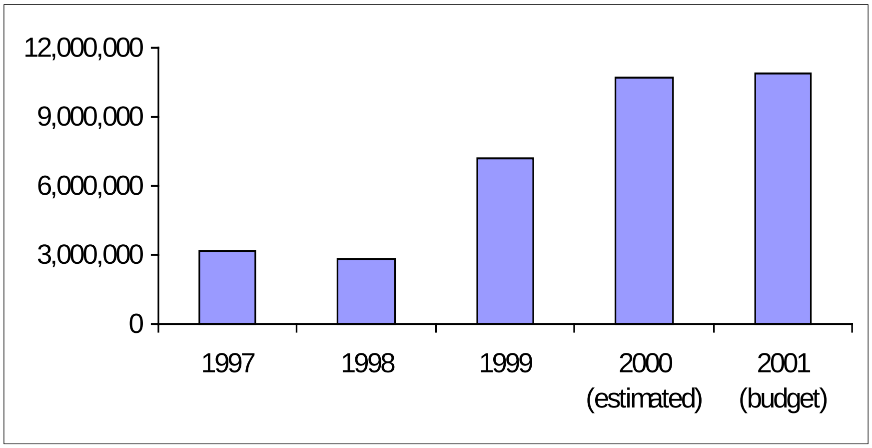
Through the end of fiscal year 2000, the city had $515 million bonds authorized but not yet issued. In addition, $221 million in potential TIF-related debt is backed by the city but not yet issued. Together, the city has committed to $736 million in bonds that have yet to be issued, 30 percent of which are TIF-related bonds.

TIF Growth Reduces Financial Flexibility; Long-term Revenue Effects Unknown

The growth in incentive expenditures reduces the city's financial flexibility. Inter-fund transfers to TIF and Super TIF funds have increased. The portion of transfers-out from the general fund to TIF funds has also been growing. However, the long-term effects to city revenue streams are not clear.

General fund transfers have increased and reduce financial flexibility. Inter-fund transfers into TIF and Super TIF funds have increased from about $3 million in fiscal year 1998 to almost $11 million budgeted in fiscal year 2001. (See Exhibit 9.) Revenues were transferred to TIF from the general, capital improvements, sales tax debt, and convention and tourism funds. The city collected these revenues, but is unable to reallocate them.

Exhibit 9. Total Transfers into TIF and Super TIF Funds



Source: Submitted Budget 2001.

The portion of general fund transfers to TIF or Super TIF funds has grown from about 7 percent in fiscal year 1998 to close to 28 percent in fiscal year 2000. (See Exhibit 10.) TIF's increasing portion of general fund transfers reduces the city's financial flexibility.

Exhibit 10. General Fund Transfers to TIF Funds

Fiscal Year	Transfer to TIF and STIF Funds	Total Transfers Out of General Fund	As a Percent of Total General Fund Transfers Out
1998	$1,223,075	$18,884,647	6.5%
1999	4,198,443	27,468,523	15.3%
2000 (Est.)	6,337,667	22,952,436	27.6%
2001 (Bgt.)	5,208,888	22,999,409	22.7%

Source: Submitted Budget 2001.

Long-term impacts of incentive development are unknown. The long-term revenue effects of funding development through incentives are not known. However, the city manager has initiated a study of the effects of TIF on future city revenues as recommended by this office. The city manager, in his status report on the recommendations from the city auditor's review of the submitted budget of fiscal year 2000, noted that the preliminary findings of the study are being reviewed.

Policies Should Establish Accountability

The current reorganization of the city's economic development process will increase accountability in the process of reviewing development proposals. The city should continue to develop policies to establish accountability in the use of development incentives to achieve public goals.

Reorganization of economic development process will increase accountability. The plan for reorganization of the city's economic development process announced by the mayor in December 1999 expanded the role of City Plan Commission (CPC) in reviewing proposed incentive projects. Expanding the role of the CPC is consistent with recommendations we made to encourage accountability in the use of TIF and increase the city's ability to use TIF to achieve public goals.[9] The CPC's increased role will help ensure that proposed incentive developments conform to the city's overall general plans, and will help assure full public review and comment.

The city should continue to develop accountability policies. The city should continue to develop policies to establish accountability over current and future incentive expenditures. As development incentives represent a substantial and growing portion of city expenditures and reduce the city's financial flexibility, the city should examine the impact of each project on the city's overall financial health and flexibility when reviewing development proposals. The city should continue monitoring the outcomes of incentive projects to ensure they achieve the intended goals and conform to the public goals of the city's overall plans. The city should also consider setting a limit for the amount of development incentives to be approved each year, such as a percent of the total property tax base, a percent of the total economic tax base, or a percent of total general fund transfers or restricted revenues.

Recommendation: Monitor the outcomes of incentive projects and consider limits on the amount of incentives awarded annually.

The city should continue monitoring the outcomes of incentive projects to ensure they achieve the intended goals and conform to the public goals of the city's overall plans. The city should also consider setting a limit for the amount of development incentives to be approved each year, such as a percent of the total property tax base, a percent of the total economic tax base, or a percent of total general fund transfers or restricted revenues.

[9] *Performance Audit: Tax Increment Financing*, Office of the City Auditor, Kansas City, Missouri, September 1998.

Recommendations

1. The city manager should develop a resolution for consideration by the mayor and City Council that would establish a policy of holding the rate of growth of expenditures to not more than the rate of inflation.

2. The city manager should complete a comprehensive revenue policy and submit it for consideration by the mayor and City Council.

3. The city manager should develop a resolution for consideration by the mayor and City Council establishing a policy requiring that no new service be undertaken by the city without identifying a revenue source sufficient to cover the cost of the service.

4. The city manager should review current programs for which dedicated revenue sources do not cover operating costs and consider the appropriate level of subsidy within the context of the overall revenue policy.

5. The city manager should provide in the budget document clear explanations of the reasons for interfund transfers.

6. The city manager should continue to increase the level of city funding devoted to deferred/capital maintenance purposes by $5 million per year through fiscal year 2006.

7. The city manager should work with the Board of Police Commissioners to integrate police capital needs into the city's capital budgeting process.

8. The city manager should develop a resolution for consideration by the mayor and City Council that would set a limit for the total amount of development incentives awarded by the city. The limit could be expressed in terms of a percent of total property tax base, a percent of total economic activity tax base, or a percent of total city revenues or expenditures.

Appendix A

City Manager’s Report on the Status of Prior Recommendations

Office of the City Manager

RECEIVED
FEB - 9 2000
CITY AUDITOR'S OFFICE

DATE: February 8, 2000

TO: Mark Funkhouser, City Auditor

FROM: Robert L. Collins, City Manager

SUBJECT: **Status Report on the Recommendations from the City Auditor's Review of the Submitted Budget, March 1999**

This memorandum is in response to your request for information on the status of the recommendations from your review of the Submitted 1999-00 Budget.

1. **The city manager should prepare for consideration by the Mayor and City Council a resolution calling for the development of a variable–rate-pricing system for solid waste collection based on volumetric or unit-based pricing.**

   Status: The Department of Environmental Management fully agrees with the concept of a solid waste user fee and has spoken with the Law Department to consider the legality of such a concept. It has been determined that a solid waste user fee would take a vote from the public since many of them consider solid waste services to be covered by earnings tax. A vote by the public has not yet been scheduled.

2. **The city manager should prepare for consideration by the Mayor and City Council a resolution calling for the development of payments-in-lieu-of-taxes to be paid by city enterprise operations, similar to the taxes that would be paid by these operations if they were private enterprises.**

   Status: No action on this recommendation was taken during fiscal year 1999-00. However, as part of the City Competitiveness and Efficiency program proposed in the submitted 2000-01 budget, this topic and other revenue maximizing alternatives will be examined.

3. **The city manager should prepare for consideration by the Mayor and City Council a resolution establishing a task force to examine the feasibility of selling or leasing city assets such as the water system and airports.**

   Status: The Public-Private Partnerships report presented to Council in September 1999 recommended the establishment of a "Competitive Review Committee" that would identify and evaluate those services that should be subject to competitive review. As part of its review, the Committee should identify and justify to the City Council those instances where privatization should be used.

A consultant has been hired to start the process of the departments reviewing their operations and developing competitive business plans. These plans would identify the core services provided currently, the cost of these services, and strategic plans for improving the efficiency and effectiveness of the service delivery. This work will continue in 2000-01 as part of the City Competitiveness and Efficiency program.

4. The city manager should prepare for consideration by the Mayor and City Council a resolution adopting Government Finance Officers Association guidelines that would require balancing the budget without use of the general fund balance, and would limit the use of one-time revenues for ongoing expenditures.

Status: The Mayor and Council's Action Plan includes a goal of eliminating the current $15 million "structural imbalance" over the next two years. Their objective is to secure a balanced City budget for the 2001-02 fiscal year. Furthermore, during their budget priority setting sessions, the Mayor and Council stated that their top priority was the elimination of the structural imbalance.

The submitted 2000-01 budget eliminates the structural imbalance by balancing on-going revenues with on-going expenses. All carryover is used only for one-time purposes in the nine general funds.

5. The city manager should prepare for consideration by the Mayor and City Council a resolution establishing that the city will not enter into projects of a regional nature that do not have adequate regional funding, and that the city will aggressively seek funding from other jurisdictions for existing regional operations.

Status: Regional funding has generated much discussion over the past year, especially around the issue of extending the Bi-State Cultural Tax. The submitted 2000-01 budget addresses this issue most directly with the reduction in the general fund subsidy to Truman Medical Center. Additionally, the Mayor has initiated an effort to involve the philanthropic community more directly in the funding of some city services.

I plan to bring to Council for their discussion and adoption a resolution that would require all new and expanded services to identify an on-going revenue source. Moreover, as part of the City Competitiveness and Efficiency program proposed in the submitted 2000-01 budget, this topic and other revenue maximizing alternatives will be examined.

6. The city manager should prepare for consideration by the Mayor and City Council a resolution that outlines a process for phasing out general fund support for the Parks and Recreation Department.

City Auditor Mark Funkhouser
February 8, 2000
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Status: The submitted 2000-01 budget incorporates the following recommendations from the Parks and Recreation Board of Commissioners:

- Increases park and recreation fees, generating an additional $433,565;
- Eliminates 10.6 full-time equivalent positions in the Parks and Recreation Department;
- Reduces, changes, or eliminates programs totaling $925,000; and
- Utilizes carryover from various Park funds totaling $459,966.

I will continue to discuss with the Board various ways acceptable to both the City and the Board for reducing the subsidy, including program changes and/or elimination and increasing the amount of revenue generated from dedicated Park taxes and fees.

7. The city manager should prepare for consideration by the Mayor and City Council a resolution that establishes a task force to develop a plan to phase out general fund support for indigent health care.

Status: In the fall of 1998, the Health Department met with the Safety Net Providers (TMC, Children's Mercy, Rodgers Health Center, Swope Parkway Health Center, Cabot Clinic, Kansas City Free Health Clinic, Northland Health Care Access, and MAST) to develop a plan to phase out the general fund portion of the indigent health care subsidy. The group reached a consensus that the best strategy would be to increase the health levy and use that increase to replace the general fund subsidy.

The Safety Net providers formed a task force to work on increasing the health levy. The first phase was having the Missouri legislature raise the cap for the Kansas City health levy from $.50 to $1.00. That was accomplished in 1999. The second phase is going to the voters with a health levy increase. The Safety Net Providers Task Force is currently working on this phase. Steps in this phase include conducting a survey of Kansas City residents, hiring a consultant, working with the City Council to decide when to place the issue on the ballot and conducting a campaign for passage of the increase. In the interim, City staff have recommended keeping the Safety Net Providers whole by level funding with an incremental decrease in general fund support made up by the increased collections in the health levy fund.

The Safety Net Providers also met with the Mayor's staff to discuss long-term indigent health care funding strategy. In addition to increasing the health levy, this strategy includes lobbying Jefferson City for changes to Medicaid, including indigent health care in the tobacco settlement and approaching the private sector and philanthropic community. The Health Department has worked with the Safety Net Providers from the beginning and will continue to be involved.

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8. The city manager should undertake a study of the impact of TIF and STIF on future city revenues.

Status: This study has been initiated and preliminary findings are being reviewed.

9. The city manager should prepare for consideration by the Mayor and City Council a resolution that endorses the process for evaluating and deciding on TIF projects recommended in our September 1998 audit of the TIF Commission and establishes a detailed plan for implementing the process.

Status: In December of 1999, Mayor Kay Barnes announced her plan for the reorganization of the Economic Development Corporation. The purpose of the reorganization is to improve coordination between the EDC and City Development Department in the review of development proposals, including Tax Increment Financing (TIF) projects. Recommendations outlined in the plan are based in part on ideas generated through the Mayor's Economic Development Roundtable meetings. The staff from these two groups is currently working to develop an administrative process that will be used to implement the plan. The Community Impact assessment tool will continue to be an integral part of the review. The reorganization plan creates an expanded role for the City Plan Commission and incorporates FOCUS guidelines in the review of proposed TIF projects.

10. The Mayor and City Council should consider adjustments to the submitted fiscal year 2000 budget to fund the additional civilian positions requested by the Police Department to begin implementing the recommendations in our September 1998 report, Opportunities for Civilianization.

Status: No funds were provided in the adopted fiscal year 1999-00 budget to fund additional civilian positions. The submitted 2000-01 budget includes $384,159 for partial year funding to add 21 civilian positions to the Police Department over the next two years and move the 21 officers currently in those positions from behind their desks and onto the streets protecting the public.

Robert L. Collins

RLC:emm

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