

City of Birmingham

Mayor Randall Woodfin

Transition Team

Transparency & Efficient Government Committee

Finance Overview Subcommittee

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Executive Summary

At first glance, the financial condition of the City of Birmingham seems to be in order. The City fund balances were over \$344M as of June 30, 2017, which included \$89M in the Birmingham Fund, \$130M in capital funds, and \$33M in debt service reserves. The bond ratings are all A or higher. Not bad at first glance, plus the downtown has seen a resurgence of people working, living and eating over the last decade. Avondale, Woodlawn and other neighborhoods have investments in retail shopping, housing, restaurants and bars that are bringing people back to our city. The creative class is growing and investing in our communities. UAB and Children's Hospital continue to attract the best and brightest to our city.

But look beyond the city center, and you see a city at a tipping point. Population and home values are down. Crime rates and poverty are up. Job growth is declining. None of this is new information to anyone, but then dig into the finances of the city, and you see stagnate revenues, increasing operational expenses, massive pension liabilities, and the underfunding of our infrastructure for decades. We must acknowledge that we did not just get into this position, it has happened over decades of leadership (both public and private) that either made short-term decisions or failed to communicate a long-term strategy.

As with any large organization, it is almost impossible to understand its overall financial condition in a transparent way. We are required to report finances using massive financial statements that are designed and interpreted only by financial professionals. Such convoluted systems made it easier to fall into our financially precarious situation. But, it doesn't have to be this way. Birmingham can create a transformative and comprehensive plan that is accessible to its residents and government employees. Such a plan can create the community buy-in necessary to put Birmingham on a secure path forward. The plan must first draw a picture of where we are today and where we could be over the next few years.

The challenge now is to develop a plan that is not only transformative but also comprehensive. It must create a vision that weaves the fabric of our city together and links to a financial plan that will show how, when and where we are going to begin to invest back into our city. A good plan does not need to be thick to be right; it does not require more reports to be thorough, it must be innovative, it should make people a little nervous, it must set priorities, and be realistic.

In conclusion, if you agree that the city is at a tipping point and that now is the first time in a generation that the leadership, energy and optimism are all moving in the same direction. Then we ask that you read our report to learn a little bit more and then work with the city leadership to help Birmingham reach its potential.

Report Process and Overview

Mayor Woodfin asked the Transparency and Efficient Government Committee (T&E) to provide an executive review of the following city departments: HR, IMS, Communications, City Clerk, Mobile Equipment, Law and Finance. The Co-chairs, Allen & Colman of T&E formed subcommittees and assigned roles and responsibilities for each department. The Finance Department was assigned to the Finance Subcommittee (FS) and we were asked to provide 1) an executive review of the state of the finances and 2) a review of the overall operational efficiency of the Finance Department (FD). Because of the size and complexity of the City's pension plans the T&E Chairs assigned the review and analysis of the pension plans to another sub-committee which will work closely with the FS.

The goal of the FS is to provide a report of the current state of the city's finances along with data that will allow the city to begin to address issues, leverage opportunities and improve the overall finances of the city. After the T&E began work, the city engaged an outside consultant, Crowe Horwath, to focus on item 2). The FS will be working with the consultant to share information that may be helpful to their work. We are aware that the city has analyzed parts of the finances in the past. The FS continue to review any relevant reports made available to us, but we will use this opportunity to bring a fresh perspective. We must analyze, challenge and ask difficult questions about the finances of our city; have unbiased opinions and bring an open mind to the process.

The committee hopes that this report will be used to:

- Build a better understanding of the city's financial position
- Align revenues and expenses with the plans of the Mayor and City Council
- Give city leaders the tools they need to manage for our future
- Begin the process of encouraging innovation by everyone at the city

Strategy and Areas of Focus

For our city to grow and truly prosper as a community, we must find ways to ensure that every dollar is providing maximum value. The process of benchmarking, analyzing, challenging, and improving everything we do in the City FD will not be easy, but it is the essential element of rebuilding our city. We must be willing to "tear off the bandages" and put the real issues on the table.

The FS began by requesting any relevant information. The FD and other Departments continue to share more data daily. The FS has reviewed the budget vs. actual cost reports, budgets, departmental data, prior audits, CAFR reports, depreciation schedules, fund balance reports, bond offerings and much more. We started by doing a review of FTE costs, budgeted vs. actual expenses, overtime expenses, departmental comparisons, capital expenses, debt structure, and deferred maintenance expenses. Also, we will attempt to map out how the independent boards, commissions and authorities associated with the city have an impact on our financial structure.

To assist with the high-level analysis, we compared Birmingham's finances to similarly sized cities. We have collected data from other cities that we will use to benchmark our budgets and staff sizes. We will summarize this benchmark data into a report that will show how we compare with select data points.

At the conclusion, we would like to have a clear, understandable, analysis of the city's budget that will shed light on priorities for the coming years and have some ideas about how to present a model for 3 year forecasts of revenues and expenses for the City, examples of a process on how the city can begin to implement innovative ideas to the City leaders, and research opportunities with new or existing public/private partnerships.

Opportunities and Challenges

Birmingham has seen redevelopment in our city center with new housing, retail and business. We have seen our local citizens invest in Birmingham and transform communities with grassroots investments. At the same time, we now have over 9,000 tax delinquent properties, and our population continues to slowly decline. These conditions are not a sustainable model for any organization. The city will only grow if it finds ways to upgrade our housing stock, raise the quality of our educational systems and create an environment for business that has jobs for our citizens. Each of these areas will require some level of investment by the City and public/private partnerships.

We have other challenges in-front of us. Like other cities, healthcare and pension expenses continue to rise, repair and maintenance costs are increasing, and shortages in the labor market are growing. Such factors put significant financial strains on our budget. Historically, the City has had a diversified employment base and less volatility than some of our other southern cities have seen. Now we have less room for error and changes in the economy.

Looking Forward - 3 Year Forecasts

Jamais Cascio, a fellow at the Institute for Ethics and Emerging Technologies, stated that Foresight is a core principal of planning, because “You can’t predict the future, but you can hear its footsteps approaching. Think and prepare. Be ready to change when plans aren’t working. Don’t count on stability.” City governments must have a long view into the future. Forecasts are projections of revenues and expenses; they should not try to get into the same level of detail that a one-year budget would have. A 3-year forecast uses good historical data, combined with input from various users, to create a model that should have multiple variable assumptions that can be modified easily. Assumptions include variables like tax growth, personnel costs, maintenance costs, capital replacement and debt services payments.

Transparency of Financial Information

The FD of the City of Birmingham has won many awards of recognition for providing significant amounts of data to the City leaders and taxpayers. However, sometimes more is not better. A part of this exercise is to research and look at new ways we can present the financial information to the City in a way that residents, business owners, investors and elected officials can understand.

It is essential that we can show our stakeholders a picture of where we are and where we want to go. However, the need to engage the community is largely in opposition with the complex financial information that we are required to provide the public. We must research best practices and quickly find new tools that effectively communicate intricate ideas and data in a way that’s accessible to stakeholders at all levels of financial literacy.

The good news is that we are not the first city to deal with most of these issues. The Government Finance Officers Association www.gfoa.org has a library of Best Practices and Advisories available on almost every topic. The Finance Director has been working closely with GFOA to implement many best practices. But he needs the Mayor, Council, Department Heads and all employees of the city to assist in researching, implementing and following through with the best practices. In addition to GFOA the FC was elated to see that the City already has an open data portal at www.data.birminghamal.gov powered by OPENGOV. The portal already has 40 different data sets related to almost all departments. We need to do a review of what resources the city already has and find ways to make them accessible to departments and Birmingham residents.

Having the data is the first step, but the real power is when we begin to layer the data to learn more about how to connect different departmental functions to work together effectively and efficiently.

Introduction and Overview of the City's Finances

The City of Birmingham is a massive organization by any standards. As of June 30, 2017, the City had revenues into the General Fund (GF) of over \$410M, operating expenses of \$395M, debt service of \$16.6M, and capital of less than \$1M. In addition to the GF, the City has over 50 other Governmental and Special Revenue Funds that allow for the tracking of debt service, capital funds, grants income and many other revenues. The City employs over 4,200 full-time people and hundreds of part-time employees and operates 40 police and fire stations, 19 libraries, 24 recreation centers and over 2,700 acres of parks and 1,500 miles of streets.

Overview of Financial Reporting

The City Finance Department (FD) tracks all revenues and expenses with separate fund types. See Exhibit A for a list of the various fund types and how they are grouped. The following are the primary types of funds:

- General Fund
- Major Funds: Debt Service, Capital, Birmingham Fund and other larger funds
- Other Government Funds: Special lodging taxes, federal grants, governmental appropriations, etc.
- Capital Improvements: Various capital projects

The attached Exhibit B, Combined Summary Fund Balance Reports summarizes revenues, expenses, debt service, capital, other fund sources and ending fund balances for the City. Note that some smaller fund balances were consolidated for this report.

When reviewing the financial statements of the City, you will see various Fund Balance reports called “Combining the Revenues, Expenses and Changes in Fund Balance.” These reports are a critical tool to understand the financial condition of the City. The Fund Balance report shows where the city allocates revenues and expenses, how much money remains at the end of a reporting period, and how the City allocated proceeds from any debt, capital leases and fund transfers. Generally, the fund balances should be positive, which would imply that the City is not spending more money than it has available. The Fund Balance reports should be used in partnership with the budgets vs. actual reporting, balance sheets and other financial reports.

Financial Overview of the City

Total **revenues** to the City are \$492M, capital expenditures of \$77M and \$50M in debt service. When the public hears about the “city budget” typically they are referring to the General Fund (GF) budget alone. In addition to the GF the City also receives and distributes an additional \$82M in funds that are either dedicated funding sources for specific debt, i.e., Regions Park (PACE) or the BJCC or funds that have specific restrictions from the grantee, i.e., Community Development Block Grants (CDBG) and HOME funds.

During FY 2017, the cities Operating Budget ended with a \$2.5M deficit, and from 2008 to 2017 the City mostly operated with a year-end budget deficit. The City was able to pay for this deficit by borrowing from reserves, raising taxes or issuing new debt. See Exhibit D, Summary of Changes in Fund Balances 2008-2017 for details.

A deficit does not always reflect a bad financial condition, as you will see from 2008 to 2017 the City invested over \$447,000,000 in capital in our City. Therefore, the financial condition of the city must be looked at comprehensively, and readers should be looking to see if these investments are providing a long-term return to the City.

Revenues

The City has multiple sources of revenues ranging from sales, use and occupational taxes, business licenses, permits, grants, fees, and intergovernmental funding. This chart summarizes some of these taxes over the last decade and shows that revenues have grown at 1% on an annualized basis. See Exhibit C for a more detailed breakout of these taxes.

Because of the cities stagnant revenue growth, the GF is almost completely reliant on local tax revenues to support the cities basic operational responsibilities. This reliance puts us at risk if we have any changes in the economy, changes to our employment base or the real estate market. A deeper dive into these revenues revealed the following:

Sales and use tax are up. The food and restaurant industry has seen steady growth over the last four years, growing from \$25.3M in 2013 to \$28.4M; revenues from Building and Construction related items are up, but we should be reminded this fluctuates with the building cycles, and business licenses have remained relatively flat. Cities across the country are seeing the impact of internet shopping on local sales tax revenues and it should be noted that the city does have a concentration of retail sales from the Summit Shopping Center.

The **City Lodging** taxes which according to the HVS 2016 Lodging Tax Report are the 3rd highest in the country are primarily paid to the BJCC and the PACE Board and are used for debt service payments. The net revenues to the GF is only \$1.9M (We collect \$2.7M but make a payment of \$833,000 to the Convention and Visitors Bureau).

Business Licenses income has declined by \$11M since its peak of \$85.7M in 2015 to \$74M in 2017. The majority of this decline is due to the 2016 cut in business licensing fees for professionals.

Occupational taxes are up almost \$17M to \$89M from the post-recession low in 2010.

Property taxes are down and have not fully recovered to a 2008 level, a little good news is that we do see a trend of rising property taxes collections of \$54.8M, \$58.5M to \$59.1M in 2015, 2016 and 2017 respectively. A much more detailed analysis of the property tax revenues should be undertaken to better understand why our property tax revenues have been flat.

Other revenues; the City received \$13.4M of intergovernmental funds for fees and taxes that are collected by the State and County; they include taxes on fuel, liquor, banking and other industries. The City received \$6.5M in HUD grants toward Community Development (CDBG), housing and homeless programs (HOME), and other grants and programs. These other funds are critical to most of our social programs, so it is critical that we make these programs a model for success both locally and nationally.

The City collected over \$18M for **Charges for Services**, but this title can be misleading. Over 82% of this revenue is direct reimbursement for costs associated with the E911 Center, Advanced Life Support, reimbursements from the Birmingham Housing Authority and proceeds from the Birmingham Parking Authority. City-owned facilities collected \$1.7M in rent and concessions. The City also received \$4M in fines and forfeitures and \$8.5M in investment earnings.

Expenses

While revenues to the GF have grown at a rate of only 1% (see Revenues), the total expenses of the City have increased by 2.84%. This creates a problem that impacts the GF every year. In 2018, the City General Fund Budget of \$428M allocated 84% to City Departments and 16% to other expenditures; which we will discuss later. The expenses of the City are broken down between departments and functions, for example, the Public Works Department has a Public Safety function.

The largest single expense is personnel costs, which include salaries, healthcare, pension and other benefits. In 2017 the city spent \$294M or 69% of the GF budget on personnel costs. If you remove Other Expenditures (\$70M), then personnel costs are 83% of our total departmental budgets. The city contributes over \$40M towards the City healthcare program for current and retired employees of the City.

Employee Counts

The FC compiled summary data from the Comprehensive Annual Financial Report (CAFR) for the FYE 2017 related to the employee by function/program. The FC looked at 28 cities that were related by size or geographic region to Birmingham. See the attached appendix which looked at Full-time employees and did not include part-time/seasonal employees. The quantity of cities surveyed helps minimize variability in how city departments divide roles and responsibility. Additionally, we removed any outliers before drawing comparisons and kept our report on general trends so that city specifics would not be as pertinent. Based on the data provided, we then selected ten of the most similar cities and compared their city revenues, expenses, and department budgets. The appendix shows FTE data from all cities as well as data on Birmingham's part-time and temporary staff.

The FC acknowledges cities variations and that it is difficult to compare cities based only on a single source of data and we filtered out any obvious groups that we knew were not relevant. For example, some cities included airports, utilities, public education and transportation. After we removed the obvious variations, we then compared them by departments per capita based on the most current population data. On average, Birmingham has more city employees per 10,000 residents than any other city that we looked at. This seems to be consistent across departments. Departments such as the Parks and Rec Department and Public Safety may be higher than other cities, because Birmingham has a low population density for the relative size of the city.

Overtime

In addition to our high staffing ratios, we also have paid over \$20M in overtime (OT) expenses in 2017. Over the last three calendar years total OT has grown 70%. The Police, Fire, Public Works and Parks and Recreation make up over 90% of the OT expenses. In addition to actual OT number, the city went over the budgeted OT amount by \$15M.

This is a significant issue that must be addressed immediately. Overtime alone is not a problem, and it should be expected and accounted for in any budget, but if it is not managed properly, it will lead to burnout and low morale for employees. The City must determine the cause of the OT and work to solve the problem.

Once the City gets OT under control then it should use some of these funds towards employee recruitment and retention that will allow us to attract and keep the best employees.

Utilities and Other Expenses

The city paid \$17.2M for power, sewer, water, and gas to operate in 2017 which was a 10% increase over the 2016 amount. The largest consumers of our utilities are street lights and parks and recreations. The city entered into a lease/purchase agreement with Trane for \$61M in August of 2016 which has quarterly lease payments of \$6M beginning in August 2018 and will then drop to \$4M in 2019. Trane should give regular status reports and projected savings to the FD so that they can monitor the impact on the budget before the 2019 budgeting process is completed. The FC has not seen this agreement, but we are hopeful that it is a net gain to the GF and it should help reduce some emergency repair and maintenance expenses. The FS looks forward to seeing the most recent updates from Trane.

Capital Assets and Infrastructure

Besides normal operating expenses (like those listed above), it's essential also to understand the capital assets that keep Birmingham running effectively. Municipal governments are large and complex organizations that are

dependent on one another to work efficiently. The city owns and operates over 1,000 vehicles that are on the road daily. The city provides repair and maintenance to 100 facilities from police and fire stations, libraries and recreations centers. It maintains over 20,000 street/traffic lights, 500 miles of roadways, and over 2,700 acres of parks!

Repair and Maintenance Funding

To keep our city running and our employees safe, we need to have a better process and fund allocation for the repair and maintenance of the City's assets. We cannot use the lack of funding as an excuse. The City must develop a Comprehensive Asset Maintenance Plan (CAMP) that will be coordinated with a comprehensive 5-year Capital Plan. The CAMP should provide paths for general repairs, maintenance, major repairs, and replacements for the various assets types.

Capital Expenditures

The City has over 4,500 separate items on its depreciation schedule as of FYE 2017 with an original value of \$725M and a current book value of \$300M. Governmental entities are in the business of owning land and building for 50+ years. The Police, Fire and Public Works departments must have a reliable and efficient fleet of vehicles. All of this requires planning and collection of current information. GFOA recommends that governments establish a system for assessing their capital assets and then appropriately plan and budget for any capital maintenance and replacement needs. The first step is to establish a database with essential information defining: asset description, location, physical dimensions (if needed), "As-built" documents, warranties, condition rating, maintenance history, replacement costs, operating cost information, usage statistics, date placed in service, original value, original useful life etc.

Budget Development Process

The process of developing a budget is well documented and detailed, but it appears to be very difficult to see the entire process in a comprehensive way that would allow the FD to be able to provide data and feedback that would allow all city employees to have a meaningful impact on the budget process. The FS reviewed the Budget Request Documentation for the 2017 Budget, and we saw a significant amount of information in various formats related to goals, objectives, staffing requests, and capital needs. The FS did not observe the budget process, but we can only assume that the Budget Department has a significant challenge in preparing a comprehensive budget that is reflective of the needs of all departments and prioritizes the city needs based on money and needs.

Debt and Lease Obligations of the City

Currently, the city has \$441M in bond and warrants outstanding and additional \$78M in lease obligations. See the attached Exhibit E for a detailed listing of all long-term obligations that the FS could compile from all the financial reporting. The City also has over \$135M of debt that is through conduit entities like the PACE Board, BJCC, and Crossplex Village. These conduit debts are funded by special revenue or from taxes set aside by the City. However, it is important to note that if these organizations do not pay off these debts, then the City could be obligated to step in and pay the debt. It is important to monitor these entities and ensure that the special revenues are sufficient.

Conclusion

In conclusion, this report was the beginning of a process. The next step is to bring stakeholders together to discuss this report's findings and find ways forward to communicate this information to the public. Much more work must be done in a short period of time.