AGENDA 3:00 P.M.

CITY OF SEDONA, SPECIAL CITY COUNCIL MEETING WEDNESDAY, SEPTEMBER 13, 2017

NOTES:

- Meeting room is wheelchair accessible. American Disabilities Act (ADA) accommodations are available upon request. Please phone 928-282-3113 at least two (2) business days in advance.
- City Council Meeting Agenda Packets are available on the City's website at:

www.SedonaAZ.gov

GUIDELINES FOR PUBLIC COMMENT

PURPOSE:

- To allow the public to provide input to the City Council on a particular subject scheduled on the agenda.
- This is not a question/answer session.
- The decision to receive Public Comment during Work Sessions/Special City Council meetings is at the discretion of the Mayor.

PROCEDURES:

- Fill out a "Comment Card" and deliver it to the City Clerk.
- When recognized, use the podium/microphone.
- State your:
  1. Name and
  2. City of Residence
- Limit comments to **3 MINUTES.**
- Submit written comments to the City Clerk.

1. CALL TO ORDER/PLEDGE OF ALLEGIANCE/MOMENT OF SILENCE

2. ROLL CALL

3. SPECIAL BUSINESS

LINK TO DOCUMENT =

a. AB 2273 **Discussion/possible direction** regarding strategies for long-term fiscal sustainability.

b. **Discussion/possible action** on future meeting/agenda items.

4. EXECUTIVE SESSION

If an Executive Session is necessary, it will be held in the Vultee Conference Room at 106 Roadrunner Drive. Upon a public majority vote of the members constituting a quorum, the Council may hold an Executive Session that is not open to the public for the following purposes:

a. To consult with legal counsel for advice on matters listed on this agenda per A.R.S. § 38-431.03(A)(3).

b. Return to open session. Discussion/possible action on executive session items.

5. ADJOURNMENT

Posted: _______________

By: __________________

Susan L. Irvine, CMC
City Clerk

Note: Pursuant to A.R.S. § 38-431.02(B) notice is hereby given to the members of the City Council and to the general public that the Council will hold the above open meeting. Members of the City Council will attend either in person or by telephone, video, or internet communications. The Council may vote to go into executive session on any agenda item, pursuant to A.R.S. § 38-431.03(A)(3) and (4) for discussion and consultation for legal advice with the City Attorney. Because various other commissions, committees and/or boards may speak at Council meetings, notice is also given that four or more members of these other City commissions, boards, or committees may be in attendance.

A copy of the packet with material relating to the agenda items is typically available for review by the public in the Clerk's office after 1:00 p.m. the Thursday prior to the Council meeting and on the City's website at www.SedonaAZ.gov. The Council Chambers is accessible to people with disabilities, in compliance with the Federal 504 and ADA laws. Those with needs for special typeface print, may request these at the Clerk's Office. All requests should be made **forty-eight hours** prior to the meeting.

CITY COUNCIL CHAMBERS
102 ROADRUNNER DRIVE, SEDONA, AZ

The mission of the City of Sedona government is to provide exemplary municipal services that are consistent with our values, history, culture and unique beauty.

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CITY COUNCIL AGENDA BILL

Agenda Item: 3a
Proposed Action & Subject: Discussion/possible direction regarding strategies for long-term fiscal sustainability

Department	Financial Services/Fiscal Sustainability Work Group
Time to Present	30 minutes
Total Time for Item	2 hours
Other Council Meetings	N/A
Exhibits	A. Memo with Recommendations for Long-Term Fiscal Sustainability B. Draft Debt Policy C. Recommended Changes to Fund Balance Policy

City Attorney Approval	Reviewed 9/5/17 RLP
City Manager's Recommendation	Discuss the analyses and recommendations of the Fiscal Sustainability Work Group and provide direction on possible next steps.

Expenditure Required	
$ 0	
Amount Budgeted	
$ 0	
Account No. (Description)	N/A
Finance Approval	☒

SUMMARY STATEMENT

The purpose of this meeting is to discuss the recommendations of the Fiscal Sustainability Work Group.

Background: The City Council identified long-term fiscal sustainability to be a Council priority. The attached memo discusses analyses performed by the Fiscal Sustainability Work Group and the recommendations.

Community Plan Consistent: ☐**Yes** - ☐**No** - ☒**Not Applicable**

Board/Commission Recommendation: ☐**Applicable** - ☒**Not Applicable**

Alternative(s): N/A

MOTION

I move to: for discussion and possible direction only.

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Date:	August 31, 2017
To:	Mayor Moriarty & City Council
Through:	Justin Clifton, City Manager Karen Osburn, Assistant City Manager
From:	Fiscal Sustainability Work Group Cherie R. Wright, Director of Financial Services
Subject:	Recommendations for Long-Term Fiscal Sustainability

The City Council identified long-term fiscal sustainability to be a Council priority. A key consideration was the development of a plan for significant capital requirements and to ensure appropriate funding levels are in place.

In order to obtain citizen input and develop recommendations from the public, a work group, referred to as the Fiscal Sustainability Work Group (FSWG), was created. The members of the FSWG include:

Ronald Budnick	Kurt Gehlbach
Doris Granatowski	Lou Harper
Charlotte Hosseini	Kris Kazian
Holli Ploog	Molly Spangler

The members represent both long-term and recent residents of Sedona, several of whom have served on multiple City work groups. In addition, all members of this diverse group have substantial financial and management experience in both the private and public sectors.

Objectives

The objectives of the FSWG are as follows:

- Identify a long-term funding strategy for capital improvements with a specific focus on the next ten years
- Evaluate minimum fund balance requirements
- Recommend any policy changes and develop policies as deemed necessary, with a specific focus on the City's current fund balance policy and development of a debt service policy
- Incorporate the recommendations into the budget process

The work group's approach to these objectives and the recommendations are included in this memo.

Summary of Recommendations

The FSWG unanimously recommends the following:

- Increase the City sales tax rate by 1% to be dedicated to the funding of transportation-related projects and the cost of additional personnel and project management to accelerate the completion of those projects
- Set a sunset on the tax increase of ten years
- Continue to fund other non-transportation-related projects with the current funding sources
- Adopt recommended changes to the current fund balance policy
- Adopt the recommended debt policy

Background

Current Funding Sources – The City does not currently have a funding source identified for a significant portion of non-wastewater capital improvements. The current funding sources[1] available for capital improvements and the approximate annual revenues of each are as follows:

Table 1
Current Funding Sources for Non-Wastewater Capital Improvements

Revenue Source	Annual Revenue
Coconino County flood control monies	Approx. $350,000 to $370,000
Yavapai County flood control monies	Generally $325,000 to $350,000
Development impact fees	Generally $215,000 to $280,000[2]
Community Facilities District assessments	Approx. $170,000 to $200,000
Outside participation	Varies depending on the projects, Highest in last 5 years is approx. $200,000
Donations	Varies each year, Highest in last 5 years is approx. $62,000
Grants and other restricted monies	Varies each year, Highest in last 5 years is approx. $75,000
General Fund surpluses	Approx. $7.8 million in FY 2015 and $6.9 million in FY 2016

Excluding the General Fund surpluses, the total other funding sources are generally $1.3 million to $1.7 million per year.

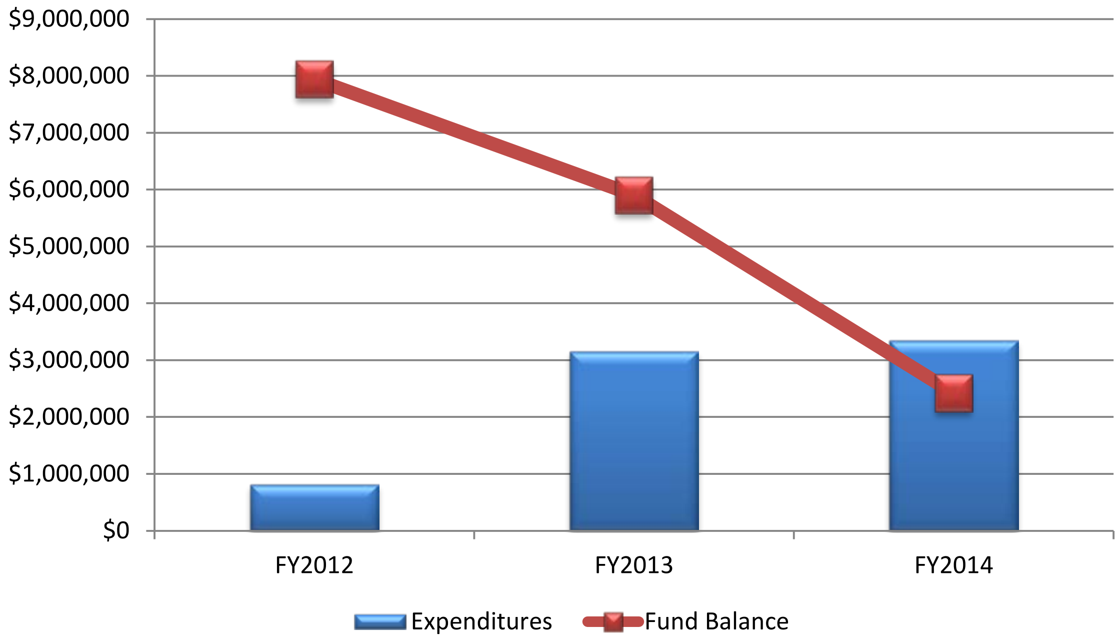
Historical Funding – In 1998, the City Council dedicated one-half percent of the City's sales tax revenues to the payment of non-wastewater capital improvement projects. The City primarily relied on this funding source, along with the other miscellaneous revenue sources previously discussed, until the dedicated one-half percent was repealed in 2010 during the recession. The Council chose to eliminate this dedication to allow more flexibility in balancing its budgetary needs. While the dedication of the half-cent was in place, it generated approximately $1.3 million to $2.1 million per year, for a total of $19.9 million over the twelve-year period.

[1] See Appendix I for additional information on these funding sources
[2] Development impact fees can be significantly higher in years there are significant development projects, such as the construction of the new Marriott and CVS during FY 2017.

At the end of FY 2010, the fund balance of the Capital Improvements Fund was $7.9 million[3]. During this recessionary time, the City did not incur significant capital improvement costs and the fund balance remained relatively stable.

As the economy began to improve in FY 2013, the City began to increase its expenditures related to necessary capital improvements. This resulted in the spending of a portion of the fund balance in the Capital Improvements Fund. The following graph demonstrates the reduction in fund balances as capital improvement expenditures increased.

Chart 1
Capital Improvements Fund
Expenditures & Ending Fund Balances
FY 2012 – FY 2014

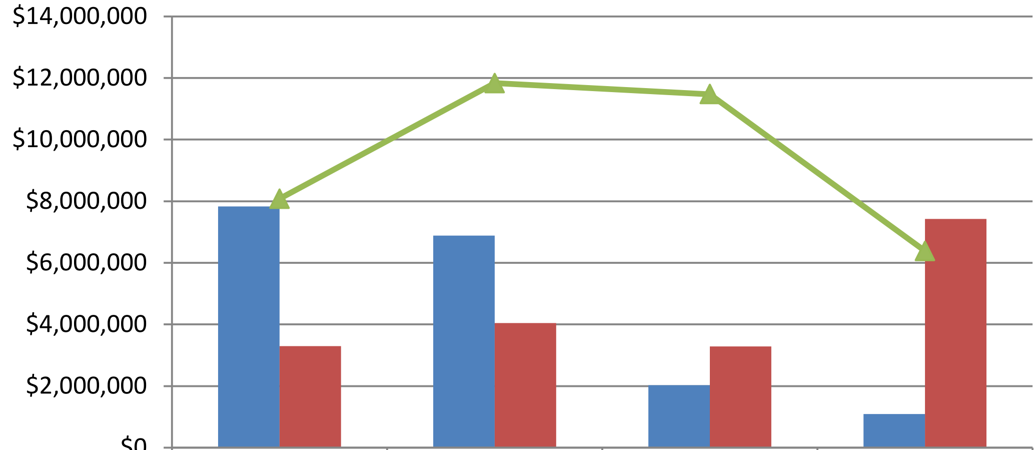


In FY 2014, the City also transferred $1.0 million from the Capital Improvements Fund to cover shortfalls in the Streets Fund for an acceleration of the streets maintenance program.

General Fund Surplus Transfers – Beginning in FY 2015, the City began transferring surpluses[4] in the General Fund to the Capital Improvements Fund as a means to fund capital projects. The following graph demonstrates the increases in fund balances as large General Fund surpluses were experienced coming out of the recession, and the decreases anticipated as these surpluses diminish and the capital needs increase.

[3] Adjusted for prior period correction in subsequent fiscal year.
[4] The surpluses in the General Fund represent the portion of fund balance that exceeds the policy reserve requirements.

Chart 2
Capital Improvements Fund
Transfers, Expenditures & Ending Fund Balances
FY 2015 – FY 2018



	FY2015	FY2016	FY2017 (est)	FY2018 (budget)
Transfers In	$7,834,370	$6,884,446	$2,023,533	$1,089,500
Expenditures	$3,298,416	$4,045,970	$3,289,277	$7,426,669[6]
Fund Balance	$8,077,065	$11,827,244	$11,473,400	$6,381,710

The FY 2015 transfer included surpluses from prior years. The portion relating solely to the FY 2015 activity was approximately $3.1 million.

The FY 2016 transfer included a reduction of the operating reserve from 75% to 50%. If the operating reserve had been maintained at the 75% level, the FY 2016 transfer would have been approximately $3.1 million.

While the City has been able to rely on the accumulated fund balance and significant surpluses from the General Fund to fund capital improvements for the past several years, the City does not anticipate large surpluses in future years. The surpluses have been experienced largely due to the results of recovery from the last recession and the implementation of the destination marketing plan. Another recessionary period could lower the available surpluses significantly. If the economy remains stable, the General Fund surpluses might continue at approximately $2 million to $3 million.

Approach

The FWSG began meeting in November 2016 and has held numerous works sessions through August 2017 for a total of more than 250 man-hours. The following describes the scope and nature of those work sessions.

Future Capital Needs – The FSWG met with each of the project managers and departments with capital infrastructure requests to gain an understanding of the future capital needs of the City over the next ten years. This timeframe was selected since the City's current outstanding debt will be fully paid off in FY 2027, which will free up over $5.5 million in available resources.

[5] The FY 2018 budgeted expenditures are significantly higher due to placeholders for transportation projects in anticipation of the FSWG recommendations for funding of future capital projects.

Assuming no additional debt is incurred, the City will have no debt outstanding in less than ten years.

The work group assessed the necessity of the projects to identify if any appeared to be lower priorities that could be postponed outside the ten-year timeframe or eliminated from the list. In addition, the group toured some of the City's facilities to better understand the conditions and limitations of those facilities. The projects incorporated into the City's ten-year capital improvement plan during the FY 2018 budget process include those projects that the FSWG believed to be important to meet the desires and needs of the community and are summarized below.

Table 2
FY 2018 – FY 2027 Capital Improvement Summary[6]

Fiscal Year	Transportation Projects (excluding other funding sources)	Other Non-Wastewater Projects (paid from surplus)	Wastewater Projects	Projects Paid by Other Funding Sources	Totals
2017-18	$ 2,003,346	$2,172,339	$ 5,077,050	$ 5,024,637	$ 14,277,372
2018-19	5,406,926	3,073,440	5,163,800	1,737,707	15,381,873
2019-20	4,343,040	902,500	1,691,500	925,000	7,862,040
2020-21	5,036,600	75,000	825,000	1,332,830	7,269,430
2021-22	11,368,460	346,200	1,775,000	950,000	14,439,660
2022-23	8,584,360	1,206,950	1,130,000	900,000	11,821,310
2023-24	11,834,900	934,250	1,150,000	1,260,000	15,179,150
2024-25	6,781,200	140,000	50,000	2,198,000	9,169,200
2025-26	5,482,300	-	570,000	1,955,000	8,007,300
2026-27	1,889,600	-	1,250,000	990,000	4,129,600
Totals	**$62,730,732**	**$8,850,679**	**$18,682,350**	**$17,273,174**	**$107,536,935**

The ten-year capital improvement plan did not include certain projects that the FSWG believed should be addressed in future years, including the following:

- City roads not currently maintained – Prior to the City's incorporation, the County had designated certain roads that needed to brought up to a minimum standard before the County would assume maintenance of those roads. Since incorporation, the City has continued this approach.

  There is approximately 0.4 miles of these roads that are not maintained. In addition, there is approximately 1.0 miles of private roads that the City has received requests to take over maintenance. The estimated cost to bring these roads up to the minimum standard is approximately $5 million per mile, not including any potential land acquisition costs.

- Dells land development – The Council has recognized the need for the Dells land use planning. At this time, it is unknown what the approach will be – whether the land will be used for revenue generation, preservation of open space, affordable housing, or other possible uses. As such, there is currently no estimate of the costs to develop the property if that is the route chosen.

- Police facility – The capital improvement plan included approximately $1.6 million for a complete remodel of the police facility with possible expansion into the current court

[6] Expenditures are estimated based on current costs. Costs will likely be higher in later years due to inflation.

offices and attorney offices. The FSWG recommended this approach as an interim solution but anticipates that this may not fulfill the Police Department's needs for the longer term. To construct a new police facility is expected to cost approximately $8 to $9 million.

- Shooting range and training facility – The Police Department submitted a request that was not included in the capital improvement plan for additional improvements and a modern firearms training simulator at the shooting range. The technology of these simulators is used to train officers in judgmental use-of-force and marksmanship; and to inoculate officers to stressful environments for the purpose of enhancing their skills, confidence, and professionalism; and to reduce the risk of negative outcomes. The facilities could be developed and funded with joint participation of other local agencies. The cost of the simulator is approximately $550,000.

- Wastewater Master Plan – The Wastewater Master Plan is not yet complete, and it is anticipated that additional projects will be identified that have not been included in the capital improvement plan.

- Storm Drainage Master Plan – A Storm Drainage Master Plan is scheduled for FY 2020. At this time, it is unknown what projects may be identified in the master plan.

The group also met with Pat Walker, a consultant with more than 40 years of experience in local government and municipal finance. Ms. Walker shared her experience and knowledge with capital planning, establishment of expected service levels, prioritization of projects, funding options, and financial policies.

Historical Capital Improvement Levels – To gain a better understanding of the extent to which the City has been able to complete its capital projects, the FSWG reviewed total historical capital project expenditures, including wastewater projects.

Table 3
Historical Capital Project Expenditures

Fiscal Year	Actual
2013	$3,639,792
2014	5,138,243
2015	5,791,047
2016	9,657,499

The capacity for which the City has been able to complete projects has increased, especially since the addition of two engineering positions in FY 2016.

In addition, the Public Works Director has performed an analysis to quantify the staffing capacity to manage capital projects. The analysis was based on an average of projects large and small. The amount of staff time to manage numerous small projects totaling $5 million is not necessarily equivalent to the staff time to manage one or two large projects totaling $5 million. Based on this analysis, the Public Works Director has indicated that approximately $6 million of non-wastewater projects and $2.5 million of wastewater projects could be accomplished each year, for a total of approximately $8.5 million.

The Public Works Director has estimated that, with existing staff, approximately $2 million of transportation-related projects could be accomplished per year in addition to other capital projects. With an additional associate engineer, the Public Works Director estimated that approximately $5 million of transportation-related projects could be accomplished per year.

Review of Expenditure Levels – Many of the work group members were also part of the Citizens Budget Work Group for FY 2018, which reviewed the operating and capital budget requests. Discussions were held with the FSWG members regarding overall expenditures and the service levels for which current resources have been committed.

The FSWG met with the President of the Chamber of Commerce and members of the Hotel/Motel Association to better understand the commitment of resources to the tourism promotion and destination marketing program. The group has also reviewed an analysis performed of the Wastewater Enterprise Fund to better understand the commitment of resources to the subsidization of the wastewater system.

The FSWG believed the City operates with minimal staff to accomplish the service levels to which current resources have been committed, and they believed the services currently provided are important to meet the desires and needs of the community.

The group also does not recommend halting or reducing pay increases as a means to meet capital demands due to the following factors:

- Current pay levels are not commensurate with the higher cost-of-living in Sedona or the higher costs incurred to commute from other communities.
- The City has experienced numerous instances with difficulty recruiting that have resulted in multiple recruitment attempts and/or increases in pay ranges.
- Sedona does not have a vibrant or growing local labor force from which to recruit the needed technical, engineering, or financial resources and, therefore, relies on recruitment efforts requiring either relocation or perceived unattractive commutes.

The group also believes the Citizens Budget Work Group, in which many of the FSWG members participated, is a valuable check and balance in the budgeting process to continue to ensure costs are justified, reasonable, and achieve the highest priorities of the City.

Consideration of New or Increased Revenues – The group considered many options for new or increased revenue levels as a means for long-term financing of capital improvements. These options are discussed within this memo.

Review of Long-Range Forecasts – The FSWG has reviewed the long-range forecasts and the assumptions used to develop them and provided their input.

Current Outstanding Debt – The current outstanding debt was also reviewed to obtain a better understanding of the obligations and any opportunities for earlier payoff. See Appendix II for additional information on the City's outstanding debt.

Revenue Options Considered

The FSWG considered the following options for new or increased revenue levels:

Table 4
Revenue Options Considered

Revenue Type	Option Considered	Recommended?	Summary Explanation
Property tax	Add a secondary property tax	No	Affects affordability of housing
Property tax	Add a primary property tax	No	Affects affordability of housing
Bed tax	Increase bed tax rate	No	Does not generate enough revenue for capital needs
Transaction privilege tax (TPT)[7]	Add a food tax	No	More impact to residents than visitors and burdensome for lower-income residents
Transaction privilege tax (TPT)	Add a residential rental tax	No	Minimal revenue generated and affects affordability of housing
Transaction privilege tax (TPT)	Increase rate for specific categories	No	Does not generate enough revenue for capital needs
Transaction privilege tax (TPT)	Increase overall rate	Yes	Highest revenue generation and higher proportion generated by visitors

A comparison of TPT rates of other northern Arizona municipalities has been included as Appendix III. Information on current property tax rates and other municipalities has been included in Appendix IV. The estimated impacts of the TPT and Bed Tax options have been included in Appendix V.

Options Not Recommended

With the higher cost-of-living and high cost of housing in Sedona, many of the revenue options were not recommended due to impacts for lower-income residents and impacts on the cost of housing.

Add a Secondary Property Tax – A secondary property tax levy is limited to payment of principal and interest of general obligation (G.O.) bonds. To issue G.O. bonds would require voter approval. A discussion of the statutory limit on the issuance of G.O. bonds is included in Appendix II.

The FSWG is not recommending a secondary property tax for the following reasons:

- The effort to obtain voter approval would likely not be cost beneficial.
- The need for affordable housing within Sedona is a concern.
- If debt financing is desired, excise tax bonds are an easier financing option with likely minimal difference in interest rates in the current interest rate environment.

Add a Primary Property Tax – A primary property tax levy can be used for any other valid municipal purpose. The first establishment of a primary property tax rate would require voter approval.

[7] Commonly referred to as sales tax

The FSWG is not recommending a primary property tax for the following reasons:

- The effort to obtain voter approval would likely not be cost beneficial.
- The need for affordable housing within Sedona is a concern.

Increase Bed Tax Rate – An increase to the Bed Tax rate only requires adoption by Council via an ordinance but must be dedicated to tourism. If this option is pursued, it is recommended that outreach meetings be held with the community to explain the reason for the increase.

While this option would generate a minimal amount of revenue, the taxes would be generated by visitors instead of residents and could be viewed as a replacement of a portion of the bed tax paid to the Chamber that is not legally required to be dedicated to tourism.[8] This option was viewed as undesirable since the revenue generation was not adequate to address the capital needs and addressing the political climate for this type of increase did not seem to be cost beneficial.

The FSWG does recommend, however, the portion of the 55% Bed Tax revenue that is dedicated to product development be viewed as a revenue source for contribution to the Transportation Master Plan projects.

Add a Food Tax – To add a food tax rate would only require adoption by Council via an ordinance. If this option is pursued, it is recommended that outreach meetings be held with the community to explain the reason for the increase.

This option was not recommended as it would have a heavier impact on residents than visitors. Based on an assumption that lower-income residents spend a higher percentage of their income on food, this was viewed as burdensome to those residents.

Add a Residential Rental Tax – To add a residential rental tax would require voter approval. The FSWG is not recommending a residential rental tax for the following reasons:

- The effort to obtain voter approval would likely not be cost beneficial.
- The need for affordable housing within Sedona is a concern.
- Minimal revenue would be generated from this tax.

Increase TPT Rate for Specific Categories – An increase to the TPT rate of existing categories would only require adoption by Council via an ordinance. If this option is pursued, it is recommended that outreach meetings be held with the community to explain the reason for the increase.

Discriminatory increases in certain categories have certain limitations. To discriminatorily increase any hospitality industry[9] category would be limited to the average increase in CPI over the last five years and must be dedicated to tourism. This option would generate a minimal amount of revenue, but the overall taxes would be generated more by visitors than residents. This option could be viewed as a replacement of a portion of the bed tax paid to the Chamber.[10]

[8] Only the 2014 increase in bed tax of 0.5% must legally be dedicated to tourism. The difference between that increase and the 55% of bed tax paid to the Chamber is based on the agreement approved by Council.
[9] The hospitality industry includes restaurants, bars, hotels/motels, liquor stores, grocery stores, convenience stores, and recreational vehicle parks.
[10] Only the 2014 increase in bed tax of 0.5% must legally be dedicated to tourism. The difference between that increase and the 55% of bed tax paid to the Chamber is based on the agreement approved by Council.

This option was viewed as undesirable since the revenue generation was not adequate to address the capital needs.

Any discriminatory increases in construction contracting must be used to offset development fees and, therefore, provides no gain to the City.

<u>Recommended Option</u>

Increase Overall TPT Rate – An increase to the TPT rate only requires adoption by Council via an ordinance. If this option is pursued, it is recommended that outreach meetings be held with the community to explain the reason for the increase.

This option would generate the most revenue, and the overall taxes would be generated more by visitors than residents.

Debt Financing

The City's bond advisor, Mark Reader, Managing Director of Stifel, Nicolaus & Company, Inc., spoke to the group about debt financing options and things to consider if pursuing this avenue for funding capital projects. In addition, Pat Walker talked to the group about debt financing considerations during her presentation. Some of the issues that Pat discussed included the following:

- Cash funding can be the lowest cost of capital. However, if projects are significantly delayed, construction costs could increase significantly and can be more costly than debt financing and earlier completion of the projects when construction costs are lower.
- Cash funding is generally not feasible for large-scale projects that require significant upfront investment.
- Generally, "cash is king," but large capital improvement programs typically include a balance of cash funded projects and debt funded projects. Some of the considerations include:
    - Need for liquidity and cash reserves
    - Need for speed
    - Life of assets
    - Equalizing benefits and costs across time
    - Escalating costs of project
    - Liquidity and cash reserve policies
    - Types of revenues – recurring vs. more volatile sources
    - Types of projects – recurring maintenance vs. projects to address large, one-time needs or growth
    - Market conditions
    - Ratio targets
- Debt financing spreads and evens out capital costs.

The FSWG considered debt financing as an option paired with a lower tax increase.[11] The group is not averse to considering the use of debt financing as a means of managing cash flows of

[11] A debt financing forecast prepared by the City's bond advisor has been included as Appendix VI. The forecast is based on projections provided by City staff of revenue generated by a half-cent sales tax increase. The bond advisor used a conservative estimation of interest rates at 5%. While it is extremely difficult to predict interest rates in later years, based on the current interest rate environment, bond issuances in the early years would likely be at a lower rate of interest. The City's most recent debt refunding in December 2015 was issued at 1.94%.

large construction projects as long as the incoming revenue flows are equal to or exceed the required debt service levels.

However, the group recommends “pay-as-you-go” cash financing for the following reasons:

- A 1% increase in the overall TPT rate is estimated to generate more than $5 million per year (the amount of transportation-related projects estimated by the Public Works Director that could be completed with the addition of one position).
- The duration of the tax increase would be significantly shorter. The group is recommending a ten-year sunset.
- A lower TPT increase, such as 0.5%, would generate lower cash flows and would require debt financing as a means to accelerate the completion of projects. With a 1% TPT increase, the City would still have the flexibility to utilize debt financing if the need arose.
- If cash flows are sufficient, cash financing can provide more flexibility for the timing of expenditures since bond proceeds must be spent within three years of the issuance date. Certain factors may have an impact on expenditure timing, such as staff and/or community lead time that may be needed for project decisions and the potential coordination with other agencies (e.g., Arizona Department of Transportation and National Forest Service).

A projection of revenues generated by a 0.5% increase and a 1% increase has been included as Appendix VII.

Debt Policy Recommendation

The City does not currently have a debt policy. The Government Finance Officers Association (GFOA) recommends that state and local governments adopt comprehensive written debt management policies that reflect local, state, and federal laws and regulations. Development of a policy before a need arises can help ensure the policy is not tailored to the specific needs at that time.

Examples of other cities’ debt policies were used as a resource for the development of the recommended policy. Some of the areas included in the policy are as follows:

- Guidelines for the use of debt financing
- Types of permitted debt
- Maintenance of credit ratings
- Annual reviews for refunding opportunities

The recommended policy has been included in the packet as Exhibit B.

Fund Balance Policy Recommendation

The City’s current fund balance policy was adopted by the City Council in November 2011. The FSWG believes some reserves are higher than necessary and there is an opportunity to free up one-time cash reserves.

The most significant changes recommended are as follows:

- The General Fund operating reserve was reduced from a range of 50% to 75% to a target of 30%. This would free up approximately $3.8 million of the FY 2018 reserve for capital needs. The recommendation is based on the following:

- According to our bond advisor, this liquidity level will be sufficient to maintain our bond rating, excluding potential impacts of other rating factors such as the economy. Liquidity is only one factor in the analysis performed by the rating agencies.
    - GFOA recommends, at a minimum, that general-purpose governments, regardless of size, maintain an unrestricted General Fund balance of no less than two months (or 17%) of regular General Fund operating revenues or regular General Fund operating expenditures, and should be based on the unique circumstances of each government.
    - During the most recent recession, General Fund revenues dropped approximately 14% from the high point before the recession to the lowest point during the recession.
- The Streets Fund balance range was reduced from a range of 10% to 50% to a range of 0% to 10%. Since this fund is subsidized by the General Fund, it did not make sense to increase the subsidies to the Streets Fund just to maintain a fund balance. This would free up approximately $400,000 of the FY 2018 reserve for capital needs.
- The debt service reserve for the Wastewater Fund was reduced from an average of one year of **all** debt service payments to an average of one year of just those debt issuances not covered by bond insurance. This would free up approximately $400,000 for FY 2018 and the remaining approximately $4.1 million in FY 2020 since the remaining debt issuances would be covered by bond insurance.
- Reserves established in the budget process or anticipated to be established have been memorialized in the policy, including the budget carryover reserves, equipment replacement reserves, wastewater major maintenance reserve, and wastewater capital improvements reserve.
- A discussion of when the operating reserves can be used was added. This allows the Council discretion to utilize those reserves to bridge any gaps in recessionary periods.

The recommended redline changes to the current policy have been included in the packet as Exhibit C.

Conclusions

Based on the substantial analysis performed by the group, the FSWG believes the biggest exposure for the City's long-term fiscal sustainability is the magnitude of the transportation-related projects that have been preliminarily determined in the Transportation Master Plan.[12]

To address this concern, the FSWG unanimously recommends a 1% increase in overall TPT rate with a ten-year sunset. The group recommends this increase to be dedicated to the funding of transportation-related projects and the cost of additional personnel and project management to accelerate the completion of those projects.

For other non-transportation-related projects, the FSWG unanimously recommends continuing the current funding strategy utilizing surplus General Fund monies to fund capital projects not covered by other funding sources.

[12] The Transportation Master Plan has not yet been finalized and the projects to be approved by the City Council have not yet been determined.

Other Recommendations

- Recommended changes to the current fund balance policy and a recommended debt policy have been provided.
- The FSWG recommends the portion of the 55% Bed Tax revenue that is dedicated to product development be viewed as a revenue source for contribution to the Transportation Master Plan projects.
- The ten-year capital improvement plan did not include certain projects that the FSWG believed should be addressed in future years. These have been detailed in the Approach section under Future Capital Needs.

Appendix I – Current Funding Sources for Non-Wastewater Capital Projects

Coconino County Flood Control Monies – Coconino County passes through the City's share of the flood control property tax levy to be used for storm drainage projects.

Yavapai County Flood Control Monies – Yavapai County provides a portion of the flood control property tax levy to the City based on submitted and approved storm drainage projects, similar to a grant approval process.

Development Impact Fees – In accordance with state statutes, a fee study was developed by an outside consultant establishing fees for specific categories, including parks and recreational facilities, police facilities, streets facilities, storm drainage facilities, and general government[13]. These fees are one-time charges applied to new development in order that new growth will pay its fair share of infrastructure improvements needed to provide municipal services, and to ensure that existing residents are not unduly burdened to pay for improvements and services needed to accommodate the new development.

Community Facilities District Assessments – The assessments are charged to the timeshare owners in these districts who do not pay bed and sales taxes on the units but use citywide facilities and infrastructure while visiting Sedona.

Outside Participation – Some projects generate a benefit to specific adjacent property owners. The City enters into cost-sharing agreements to recuperate a portion of the project costs from these property owners.

Donations – Some projects are partially or fully funded by donations.

Grants and Other Restricted Monies – When appropriate criteria are met, some projects may qualify for grant funding or to be paid from other restricted funding sources, such as restricted court fees or Racketeer Influenced and Corrupt Organizations Act (RICO) monies.

General Fund Surpluses – In accordance with Council policy starting in FY 2015, any amounts exceeding the required reserves at year-end are transferred to the Capital Improvements Fund.

[13] With the changes in the legislation, the general government fees can only be used to pay existing debt service. The state statutes no longer allow for the assessment of development impact fees to pay for any new general government facilities or any new debt service.

Appendix II – Current Outstanding Debt

Debt Repayments by Fund – The following table details the remaining principal and interest payments of all outstanding debt by fund.

Table 5
Remaining Debt Repayments by Fund

Fiscal Year	General Fund		Development Impact Fees Fund		Wastewater Fund		Totals
	Principal	Interest	Principal	Interest	Principal	Interest	
2018	$1,212,590	$ 214,901	$22,410	$287	$ 3,920,000	$ 480,735	$ 5,850,923
2019	1,218,940	181,673	21,060	139	4,000,000	429,775	5,851,587
2010	885,000	146,470	-	-	1,400,000	3,287,775	5,719,245
2021	900,000	129,301	-	-	1,330,000	3,357,775	5,717,076
2022	920,000	111,841	-	-	1,255,000	3,432,775	5,719,616
2023	935,000	93,993	-	-	1,190,000	3,497,775	5,716,768
2024	945,000	75,854	-	-	1,130,000	3,557,775	5,708,629
2025	970,000	57,521	-	-	4,105,000	377,775	5,510,296
2026	990,000	38,703	-	-	4,290,000	193,050	5,511,753
2027	1,005,000	19,497	-	-	-	-	1,024,497
Total	**$9,981,530**	**$1,069,754**	**$43,470**	**$426**	**$22,620,000**	**$18,615,210**	**$52,330,390**

FYs 2021 through 2025 include payment of the capital appreciation bonds (CABs), which require payment of compounded interest on the maturity date. At maturity, the investor receives a single payment (the "maturity value") representing both the initial principal amount and the total investment return.

Outstanding Debt Balances – The following information details the outstanding debt balances until all the bonds are paid. The final payment is July 1, 2027.

Table 6
Outstanding Debt Balances by Year

As of July 2	City Hall	Capital Infrastructure Projects	Wastewater System	Totals
2017	$805,000	$9,220,000	$22,620,000	$32,645,000
2018	390,000	8,400,000	18,700,000	27,490,000
2019	-	7,550,000	14,700,000	22,250,000
2020	-	6,665,000	13,300,000	19,965,000
2021	-	5,765,000	11,970,000	17,735,000
2022	-	4,845,000	10,715,000	15,560,000
2023	-	3,910,000	9,525,000	13,435,000
2024	-	2,965,000	8,395,000	11,360,000
2025	-	1,995,000	4,290,000	6,285,000
2026	-	1,005,000	-	1,005,000
2027	-	-	-	-

The following details each outstanding debt issue and the opportunities for earlier payoff.

Appendix II – Current Outstanding Debt (cont'd)

Table 7
Outstanding Debt by Bond Issue

Bond Issue	Maturity Dates	Interest Rates	Remaining Principal Payments	Remaining Interest Payments	Redemption
Series 1998[14]	7/1/2020-2024	5.20-5.24%	$6,305,000	$15,245,000	Not subject to call for redemption prior to state maturity dates
Series 2007	7/1/2017-2019	4.0-5.0%	2,530,000	146,478	Eligible to be called for redemption, without premium
Series 2012	7/1/2025-2026	4.5%	8,395,000	3,404,138	Eligible to be called for redemption on or after 7/1/2022, without premium
Series 2014	7/1/2017-2019	0.66%	2,385,000	15,758	Eligible to be called for redemption, without premium
Series 2015	7/1/2017-2019	1.3%	10,220,000	221,390	Eligible to be called for redemption, without premium
Second Series 2015	7/1/2017-2027	1.94%	7,860,000	1,048,473	Eligible to be called for redemption but subject to: 2% premium if prepaid 12/16/2016 through 12/15/2017, or 1% premium if prepaid 12/16/2017 through 12/15/2018. There is no premium for prepayments after 12/15/2018.
	Totals		**$37,695,000**	**$20,081,237**	

Debt Limitations – The Arizona Constitution limits the City's bonded debt capacity (outstanding principal) to a certain percentage of the City's secondary assessed valuation for general obligation (G.O.) bonds. The Constitution states that for general municipal purposes, the City cannot incur a debt exceeding 6% of the assessed valuation of taxable property. Additional bonds amounting to 20% of the assessed valuation of taxable property can be issued for water, lighting and sewer projects, and for the acquisition and development of land for open space preserves, parks, playgrounds and recreational facilities.

The City's bond holdings do not include G.O. bonds and, therefore, are not subject to debt limitation.

[14] The only remaining portion of the bond series are capital appreciation bonds (CABs). CABs offer an investment return on an initial principal amount and are reinvested at a stated compounded rate until maturity. At maturity, the investor receives a single payment (the "maturity value") representing both the initial principal amount and the total investment return.

Pledged Revenues – The City has pledged future excise taxes to repay the excise tax revenue bonds. The pledged revenues include city sales taxes, transient lodging tax (or "bed tax"), franchise taxes, license and permit fees, state shared sales taxes, state shared income taxes, vehicle license taxes, and charges for services. The following schedule summarizes the historical and projected pledged revenue coverage.

Table 8
Historical and Projected Pledged Revenue Coverage

Fiscal Year	Excise Tax Revenues	Principal	Interest	Total	Coverage
2013-14	$18,450,768	$4,405,000	$2,077,929	$6,482,929	2.85
2014-15	20,272,217	4,485,000	1,498,946	5,983,946	3.39
2015-16	22,138,647	5,260,000	808,167	6,068,167	3.65
2016-17 (est.)	24,064,600	5,050,000	791,691	5,841,691	4.12
2017-18 (budget)	25,193,900	5,155,000	695,923	5,850,923	4.31
2018-19 (proj.)	25,889,800	5,240,000	611,587	5,851,587	4.42
2019-20 (proj.)	24,830,000	2,285,000	3,434,245	5,719,245	4.34
2020-21 (proj.)	23,816,700	2,230,000	3,487,076	5,717,076	4.17
2021-22 (proj.)	24,924,100	2,175,000	3,544,616	5,719,616	4.36
2022-23 (proj.)	26,145,300	2,125,000	3,591,768	5,716,768	4.57
2023-24 (proj.)	26,658,000	2,075,000	3,633,629	5,708,629	4.67
2024-25 (proj.)	27,246,900	5,075,000	435,296	5,510,296	4.94
2025-26 (proj.)	27,783,100	5,280,000	231,753	5,511,753	5.04
2026-27 (proj.)	28,392,200	1,005,000	19,497	1,024,497	27.71

The bond covenants require that excise tax revenues be equal to at least 1.50 times the total payments for all bonds secured by a pledge of excise tax revenues. If at any time it appears that the excise tax revenues will not be sufficient to meet this 1.50 coverage requirement, the City must either impose a new excise tax or increase the rates for taxes currently imposed to reach the 1.50 coverage requirement, to the extent permitted by law.

Appendix III – Comparison of TPT Rates[15]

Table 9
Comparison of TPT Rates to Other Northern Arizona Cities

Municipality	Population (2014)	TPT	Bed (Additional)	Restaurant/Bar (Additional)	Retail – Single Item over $5k (Additional)	Residential Rental	Commercial Rental	Contracting	Food	Feed at Wholesale	Utilities	Public Utility Right-of-Way	Wastewater Utility Services	Use Tax
Chino Valley	11,019	4%	4%	0%	0%	**3%**	**3%**	4%	4%	**0%**	4%	**0%**	**0%**	**3%**
Camp Verde	11,097	3.65%	3%	0%	1%	**2%**	**2%**	3.65%	**0%**	**0%**	3.65%	**0%**	**0%**	3.65%
Jerome	451	3.50%	3%	1%	0%	3.50%	3.50%	**3%**	**0%**	**0%**	3.50%	**0%**	**0%**	**0%**
Williams	3,094	3.50%	1%	1%	0%	**3%**	**3%**	3.50%	**0%**	**0%**	3.50%	**0%**	**0%**	**0%**
Clarkdale	4,165	3%	2%	0%	0%	3%	3%	**4%**	3%	**0%**	3%	**0%**	**0%**	**0%**
Cottonwood	11,595	3%	3%	0%	0%	3%	3%	**4%**	3%	**0%**	**1%**	**0%**	**0%**	**0%**
Sedona	10,281	3%	3.50%	0%	0%	**0%**	3%	3%	**0%**	**0%**	3%	**0%**	**0%**	3%
Prescott Valley	41,075	2.83%	2.83%	0%	0%	**0%**	**0%**	2.83%	2.83%	**0%**	2.83%	**0%**	2.83%	2.83%
Flagstaff	68,667	2.051%	2%	2%	0%	**0%**	2.051%	2.051%	**0%**	**2%**	2.051%	2%	**0%**	**1%**
Dewey-Humboldt	3,971	2%	2%	0%	0%	2%	2%	2%	2%	**0%**	2%	**0%**	**0%**	2%
Prescott	40,590	2%	3%	0%	0%	2%	2%	2%	2%	2%	2%	**0%**	**0%**	2%
Tusayan	576	2%	2%	2%	0%	**0%**	2%	2%	**0%**	**0%**	2%	**0%**	**0%**	**0%**

[15] Rates in bold indicate a differing rate than the municipality's standard TPT rate.

Appendix IV – Current Property Tax Rates and Other Municipalities

Table 10
Other Yavapai County Municipalities
with Property Tax Rates

Municipality	Primary	Secondary
Clarkdale	1.7316	
Jerome	0.8754	
Peoria	0.1900	1.2500
Prescott	0.2953	0.0072
Wickenburg	0.5270	

Table 11
Other Coconino County Municipalities
with Property Tax Rates

Municipality	Primary	Secondary
Flagstaff	0.8121	0.8366
Williams	1.5041	

Table 12
Yavapai County
Current Property Tax Rates

Jurisdiction	Primary	Secondary
County/State/College	4.2476	0.7005
School District	2.1914	1.4421
Fire District		2.4470
Special District		0.0616
Total	6.4390	4.6512

Table 13
Coconino County
Current Property Tax Rates

Jurisdiction	Primary	Secondary
County/State/College	1.5707	1.1361
School District	2.1914	1.4421
Fire District		2.4470
Total	3.7621	5.0252

Appendix V – Estimated Annual Impacts of TPT and Bed Tax Options[16]

Table 14
Estimated Impacts of Increase to Overall TPT Rate[17]

Taxpayer	0.5% Increase	1% Increase
Visitor	$1.8M	$3.5M
Resident	$0.9M	$1.8M
Total	$2.7M	$5.3M

Table 15
Estimated Impacts of Adding a Food Tax

Taxpayer	Est. Revenue
Visitor	$0.7M - $1M
Resident	$1.3M - $2M
Total	$2M - $3M

Table 16
Estimated Impacts of Adding a Residential Rental Tax[18]

Taxpayer	Est. Revenue
Visitor	$0
Resident	$70k - $100k
Total	$70k - $100k

Table 17
Estimated Impacts of Increase to Restaurant/Bar TPT Rate[19]

Taxpayer	0.5% Increase	1% Increase
Visitor	$379k	$759k
Resident	$140k	$281k
Total	$519k	$1.0M

Table 18
Estimated Impacts of Increase to Hotel/Motel TPT Rate[20]

Taxpayer	0.5% Increase	1% Increase
Visitor	$581k	$1.2M
Resident	$0	$0
Total	$581k	$1.2M

[16] Based on FY 2017 estimated revenues
[17] Assumes no change in taxable categories
[18] Requires approval of the voters
[19] Must be used for promotion of tourism
[20] Must be used for promotion of tourism

Appendix VI – Debt Financing Forecast

The following forecast assumes 4 bond issuances of $15,000,000 each. Interest rates are projected at 5%, and debt repayments are based on projected revenues of a half-cent sales tax, less an assumed allowance for additional staffing and other minor costs to be paid from the sales tax revenue.

Table 19
Debt Financing Forecast

Fiscal Year	Bond Issuance	Estimated Debt Service
2018-19	$15,000,000	$ 2,615,000
2019-20		2,516,750
2020-21		2,378,750
2021-22		2,508,000
2022-23	15,000,000	2,656,250
2023-24		2,724,500
2024-25		2,790,500
2025-26	15,000,000	2,854,000
2026-27		2,927,250
2027-28		2,983,750
2028-29	15,000,000	2,794,000
2029-30		2,577,500
2030-31		2,940,250
2031-32		3,113,750
2032-33		3,176,500
2033-34		3,243,500
2034-35		3,304,250
2035-36		3,373,750
2036-37		3,441,250
2037-38		3,231,500
2038-39		3,008,000
2039-40		3,156,750
2040-41		3,344,500
2041-42		3,413,750
2042-43		3,479,750
2043-44		3,552,250
2044-45		3,620,500
2045-46		3,404,250
2046-47		3,167,250
2047-48		3,325,750
2048-49		3,525,250
2049-50		3,528,000
2050-51		3,528,000
Totals	**$60,000,000**	**$102,205,000**

Appendix VII – Projection of Sales Tax Revenues

The following projections are based on the assumptions used in the City's long-term forecasts.

Table 20
Projection of Sales Tax Revenues

Year Count	Fiscal Year	0.5% Increase	Cumulative	1% Increase	Cumulative
1	2018-19	$2,844,900	$ 2,844,900	$5,689,800	$ 5,689,800
2	2019-20	2,748,700	5,593,600	5,497,400	11,187,200
3	2020-21	2,609,700	8,203,300	5,219,400	16,406,600
4	2021-22	2,744,400	10,947,700	5,488,800	21,895,400
5	2022-23	2,896,200	13,843,900	5,792,400	27,687,800
6	2023-24	2,963,700	16,807,600	5,927,400	33,615,200
7	2024-25	3,032,700	19,840,300	6,065,400	39,680,600
8	2025-26	3,103,300	22,943,600	6,206,600	45,887,200
9	2026-27	3,175,500	26,119,100	6,351,000	52,238,200
10	2027-28	3,239,000	29,358,100	6,478,000	58,716,200
11	2028-29	3,044,700	32,402,800	6,089,400	64,805,600
12	2029-30	2,831,600	35,234,400	5,663,200	70,468,800
13	2030-31	2,973,200	38,207,600	5,946,400	76,415,200
14	2031-32	3,151,600	41,359,200		
15	2032-33	3,214,600	44,573,800		
16	2033-34	3,278,900	47,852,700		
17	2034-35	3,344,500	51,197,200		
18	2035-36	3,411,400	54,608,600		
19	2036-37	3,479,600	58,088,200		
20	2037-38	3,270,800	61,359,000		
21	2038-39	3,041,800	64,400,800		
22	2039-40	3,193,900	67,594,700		
23	2040-41	3,385,500	70,980,200		
24	2041-42	3,453,200	74,433,400		
25	2042-43	3,522,300	77,955,700		

CITY OF SEDONA

Debt Management Policy

Introduction

The City of Sedona (City) maintains conservative financial policies to assure strong financial health both in the short- and long-term. The City is an infrequent issuer of debt and intends to continue that practice.

This policy sets forth comprehensive guidelines for the financing of capital expenditures. It is the objective of the policies that (1) the City obtain financing only when necessary, (2) the process for identifying the timing and amount of debt or other financing be as efficient as possible, (3) the most favorable interest rate and other related costs be obtained, and (4) when appropriate, future financial flexibility be maintained.

Debt financing, which includes general obligation bonds, special assessment bonds, revenue bonds, temporary notes, lease/purchase agreements, and other City obligations permitted to be issued or incurred under Arizona law, shall only be used to purchase capital assets that cannot be acquired from either available current revenues or fund balances.

Guidelines for Use

Debt financing will not be considered appropriate for any recurring purpose such as current operating and maintenance expenditures. The City will use debt financing only for one-time capital improvement projects and unusual equipment purchases, only when estimated future revenue is sufficient to ensure the repayment of the debt obligation, and when at least one of the following circumstances apply:

1. Other funding options have been explored and are not viable for the timely or economic acquisition or completion of a capital project.
2. A capital project is mandated by federal or state authorities with no other viable funding option available.
3. The capital project or asset lends itself to debt financing rather than pay-as-you-go funding based on the expected useful life of the project and worthiness to future generations.
4. Any City debt issued in support of a capital project will first be reviewed and approved under the auspices of the City's general plan, an approved master plan, or a Community Focus Area (CFA).

The City will primarily rely on current revenue and cash set-asides to finance its capital improvements. The City believes in funding a significant portion of capital improvements on a "pay-as-you-go" basis. The following criteria will be used to evaluate "pay-as-you-go" vs. debt financing:

Factors Which Favor Pay-As-You-Go Financing:

- The project can be adequately funded from available current revenues and fund balances.
- The project can be completed in an acceptable timeframe given the available revenues.
- Additional debt levels could adversely affect the City's credit rating or repayment sources.
- Market conditions are unstable or suggest difficulties in marketing a debt.

Factors Which Favor Long-Term Debt Financing:

- Revenues available for debt issues are considered sufficient and reliable so that long-term financing can be marketed with an appropriate credit rating, which can be maintained.
- Market conditions present favorable interest rates and demand for City debt financing.
- A project is mandated by state or federal government, and current revenues or fund balances are insufficient to pay project costs.
- A project is immediately required to meet or relieve capacity needs, and existing available cash reserves are insufficient to pay project costs.
- The life of the project or asset financed is five years or longer.

Types of Permitted Debt

City debt will be structured to achieve the lowest possible net interest cost to the City given market conditions, the urgency of the capital project, and the nature and type of any security provided. City debt will be structured in ways that will not compromise the future flexibility to fund projects.

City debts will be amortized for the shortest period consistent with a fair allocation of costs to current and future beneficiaries or users, and in keeping with other related provisions of this policy.

Unless specific compelling reasons exist, there shall be no "balloon" bond repayment schedules, which consist of low annual payments and one large payment of the balance due at the end of the term.

At a minimum, the City will seek to amortize bonds with level principal and interest costs over the life of the issue. Pushing higher costs to future years in order to reduce short-term budget liabilities will be considered only when natural disasters or extraordinary or unanticipated external factors make the short-term cost of bonds prohibitive.

The following is a listing if the types of permitted debt and general guidelines as to their use.

A. General Obligation (G.O.) Bonds.
   G.O. bonds provide the investor with its most secure City transaction, because the City's pledge of its unlimited authority to levy property taxes for debt services.

   The sum of all G.O. debt outstanding is governed by the City's statutory legal debt margin but must also conform to limitations on the general credit of the City. Voter approval is required to issue G.O. bonds.

The City will first pursue other options prior to considering an issuance of G.O. bonds.

B. Revenue Bonds

The City may issue bonds secured solely by dedicated revenue streams if doing so will yield clearly identifiable advantages. For the City to issue revenue bonds, a primary objective will be to minimize risk through the use of adequate coverage requirements while remaining in compliance with overall debt management policy objectives. The City will adhere and where necessary take actions to ensure compliance with all outstanding revenue bond covenants.

C. Special Assessment Bonds

The City shall maintain a watchful attitude over the issuance of special assessment bonds for benefit district improvements. While the City's share of any benefit district project may fluctuate, the City will not pay more than 50% of any proposed costs related to a benefit district. Further, each special assessment bond issue will be analyzed to ensure that future special assessments will equal or exceed the annual principal and interest payments of such bonds.

Financing Alternatives

One of the primary decisions made regarding the CIP is whether to use cash on hand or debt financing. The parameters for this decision are defined below within each funding source that is considered appropriate.

Cash Funding

City policy encourages funding capital projects with cash, on a "pay as you go" basis, to the extent possible and practical. As part of the pay-as-you-go strategy, the City will first look for grant and other restricted funding for capital projects. Cash funding is recommended under the following circumstances:

- To finance purchases of assets whose lives are shorter than five years
- To finance recurring maintenance expenditures (i.e., street repair vs. street construction)
- When market conditions are unstable or present difficulties in achieving acceptable interest rates.

Debt Financing

It is prudent policy to use notes and bonds for capital asset funding under the parameters set forth below. No single parameter stands alone; they must all be considered under the current circumstances and in relation to the others. The parameters are as follows:

- Long-term bonds are recommended for projects with useful lives of ten years or longer.
- Special assessment debt funding is recommended for projects where the burden of payment rests more directly on a selected group of taxpayers or beneficiaries.

Capital Lease Debt

The use of lease/purchase agreements in the acquisition of vehicles, equipment and other capital assets shall be considered carefully relative to any other financing option or a "pay-as-you-go" basis.

- Capital lease debt may be considered to finance capital improvements, including vehicles and equipment with an expected useful life of less than ten years. Principal and interest are to be paid from the operating budget or other dedicated resources of the department purchasing the equipment or constructing the capital improvement.
- Certificates of Participation (COPs) are a form of lease obligation in which the City enters into an agreement to pay a fixed amount annually to a third party, usually a nonprofit agency or a private leasing company or trust structure, subject to annual appropriation.

Low Interest Loan

The use of federal and state aided low interest loans will be a valid financing mechanism and should be considered. This method of financing should be used wherever practical to fund a project. Some loans may have additional requirements that can be cost prohibitive.

Credit Enhancements

Credit enhancement (letters of credit, bond insurance, etc.) may be used if the costs of such enhancements will reduce the net debt service payments on the bonds or provide other significant financial benefits to the City.

Variable Rate Debt

The City shall not issue variable rate debt.

Selecting and Retention of Service Providers

The Director of Financial Services shall be responsible for the solicitation and selection of professional services that are required to administer the City's debt program. Examples of those services include:

1. Bond Counsel

   All debt issued by the City will include a written opinion by bond counsel affirming that the City is authorized to issue the proposed debt. The opinion shall include confirmation that the City has met all city and state constitutional and statutory requirements necessary for issuance, a determination of the proposed debt's federal income tax status and any other components necessary for the proposed debt.

2. Financial Advisor

   A Financial Advisor(s) will be used to assist in the issuance of the City's debt. The Financial Advisor will provide the City with objective advice and analysis on debt issuance. This includes, but is not limited to, monitoring market opportunities, structuring and pricing debt, and preparing official statements of disclosure.

3. Underwriters

   An Underwriter(s) will be used for all debt issued in a negotiated or private placement sale method. The Underwriter is responsible for purchasing negotiated or private placement debt and reselling the debt to investors.

Methods of Sale

Each of the three types of bond sales has the potential to provide the lowest cost given the right market conditions. The method of sale that is most advantageous to the City will be determined under consultation with the City's Financial Advisor. The three methods are:

a. **Competitive Sale**. Bonds are marketed to a wide audience of investment banking (underwriting) firms. Their bids are submitted at a specified time. The underwriter is selected based on its bid for its securities. Pursuant to this policy, and within the parameters approved by the City Council, the Director of Financial Services is hereby authorized to sign the bid form on behalf of the City fixing the interest rates on bonds sold on a competitive basis.
b. **Negotiating Sale**. The City selects the underwriter or group of underwriters of securities in advance of the bond sale. The City financing team works with the underwriter to bring the issue to the marker and negotiates all rates and terms of the sale. In advance of the sale, the City will determine compensation for and liability of each underwriter employed and the designation rules and priority of orders under which the sale itself will be conducted (e.g., retail, group net, net designated, etc.). Pursuant to this policy and within the parameters approved by the City Council, the Director of Financial Services is hereby authorized to sign the bond purchase agreement on behalf of the City fixing the interest rates on bonds sold on a negotiated basis.
c. **Private Placement**. The City sells its bonds to a limited number of sophisticated investors, and not the general public.

Disclosure

The City will comply with the requirements of Rule 15c2-12 of the Securities and Exchange Commission (SEC), when applicable. The Director of Financial Services, or his/her designee, will be responsible for filing the annual requirements and any Material Event Notices with Electronic Municipal Market Access (EMMA) as required.

Debt Limits.

The City will fully comply with all debt limitations imposed by the Arizona Revised Statutes (A.R.S.).

Credit Ratings

The City will maintain good communication with bond rating agencies about its financial condition. This effort will include providing periodic updates on the City's general financial condition in accordance with the bond rating agency requirements, coordinating meetings, and presentations in conjunction with a new issuance. The City will continually strive to maintain its bond rating by improving financial policies, budgets, forecasts and the financial health of the City.

Credit enhancements may be used to improve or establish a credit rating on a City debt obligation. Credit enhancements should only be used if cost effective.

Defeasance, Prepayment and Refunding

Annual reviews of all outstanding debt will be undertaken to determine refunding opportunities. Refunding will be considered (within federal tax law constraints) if and when there is a net economic benefit of the refunding or the refunding is essential in order to modernize covenants essential to operations and management.

City staff and the financial advisor shall monitor the municipal bond market for opportunities to obtain interest savings by refunding outstanding debts. As a general rule, debt refundings will be undertaken only if the present value savings of a particular refunding will exceed 3% of the refunded principal.

Some refundings may be executed for reasons other than to achieve cost savings, such as to restructure the repayment schedule of the debt, to change the type of debt instruments being used, or to retire an indenture in order to remove undesirable covenants. Refunding issues with negative savings will not be considered unless a compelling public policy objective is served by the refunding.

Investments of Bond Proceeds

The City shall comply with all applicable federal, state, and indenture restrictions, if any, regarding the use and investment of bond proceeds. This includes compliance with any restrictions on the types of investment securities allowed, restrictions on the allowable yield of invested funds, as well as restrictions on the time period over which some bond proceeds may be invested. The Director of Financial Services, or his/her designee, will direct the investment of bond proceeds in accordance with the permitted investments for each particular bond issue. Investments such as guaranteed investment contracts may be considered when their use is in the best interest of the City and will be selected on a competitive basis.

Federal Arbitrage and Rebate Compliance.

All the City's tax-exempt issues, including lease purchase agreements, are subject to arbitrage compliance regulations.

The City shall comply with all arbitrage rebate requirements as established by the Internal Revenue Service (IRS) and establish a system of record keeping and reporting to meet the arbitrage rebate compliance requirements of the federal tax code. This effort shall include tracking project expenditures financed with bond proceeds, tracking investment earnings on bond proceeds, calculating rebate payments in compliance with tax law, and remitting any rebatable earnings to the federal government in a timely manner in order to preserve the tax exempt status of the City's outstanding tax-exempt debt issues.

Arbitrage service providers maybe used to assist the City with complying with arbitrage regulations.

Issuance & Post-Issuance Compliance Procedures:

Staff will work closely with the City's Bond Counsel, Financial Advisor, and Arbitrage Compliance Specialist to ensure tax exempt bonds remain in compliance with federal tax requirements from the time they are issued until they are no longer outstanding.

Reporting

The Financial Services Department is charged with the responsibility of preparing monthly financial reports. The monthly financial report will include a summary of the City's outstanding debt. If the City has any outstanding G.O. bonds, the monthly financial report will also include a calculation of the City's debt capacity.

On an annual basis, the Financial Services Department will prepare the state required Bonded Indebtedness Report in accordance with A.R.S. §35-501. This report must be filed even if the City has no bond indebtedness or lease/purchase data to report. If the City fails to comply, the City shall not issue any additional bonds or other securities. Furthermore, any person or member of any governing body knowingly omitting or refusing to comply with this request is guilty of a class 2 misdemeanor per A.R.S. §35-502.

The Financial Services Department will also be responsible for preparing all required debt related schedules and footnotes for inclusion in the City's comprehensive annual financial report.

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City of Sedona
Fund Balance Policy

I. Purpose:

To ensure financial stability, the City of Sedona desires to manage its financial resources by establishing fund balance/net asset ranges for selected funds. This will ensure the City maintains a prudent level of financial resources to provide sufficient cash flow for daily financial needs, secure and maintain investment grade bond ratings, offset significant economic downturns and revenue shortfalls, and provide funds for unforeseen expenditures related to emergencies.

II. Definitions:

A. Fund Balance: Fund balance means the difference between fund assets and fund liabilities as reported in a governmental fund. Furthermore, Government Accounting Standard Board (GASB) Statement 54 establishes the following fund balance classifications depicting the relative strength of the constraints that control how specific amounts can be spent:

1. ***Non-spendable fund balance*** includes amounts that are not in a spendable form (inventory, for example) or are required to be maintained intact (the principal of an endowment fund, for example).

2. ***Restricted fund balance*** includes amounts that can be spent only for the specific purposes stipulated by external resource providers (for example, grant providers), constitutionally, or through enabling legislation (that is, legislation that creates a new revenue source and restricts its use). Effectively, restrictions may be changed or lifted only with the consent of resource providers.

3. ***Committed fund balance*** includes amounts that can be used only for the specific purposes determined by a formal action of the government's highest level of decision-making authority. Commitments may be changed or lifted only by the government taking the same formal action that imposed the constraint originally.

4. ***Assigned fund balance*** comprises amounts *intended* to be used by the government for specific purposes. Intent can be expressed by the governing body or by an official or body to which the governing body delegates the authority. In governmental funds other than the General Fund, assigned fund balance represents the amount that is not restricted or committed. This indicates that resources in other governmental funds are, at a minimum, intended to be used for the purpose of that fund.

5. ***Unassigned fund balance*** is the residual classification for the General Fund and includes all amounts not contained in the other classifications. Unassigned amounts are technically available for any valid government purpose. If another governmental fund has a fund balance deficit, then it will be reported as a negative amount in the unassigned classification in that fund. Positive unassigned amounts will be reported only in the General Fund.

B. Net Assets: Net assets are the difference between assets and liabilities as reported in a financial reporting unit such as proprietary funds and fiduciary funds.

C. Fund Balance Range: Fund balance range is the range of amounts this policy has set within which the City means to maintain the undesignated fund balance.

D. Surplus: Surplus is the amount by which the undesignated fund balance exceeds the upper limit of the fund balance range.

E. Shortfall: Shortfall is the amount by which the lower limit of the fund balance range exceeds the undesignated fund balance.

F. Expenditures: Expenditures are all uses of financial resources, budgeted for any purpose, and include operating and capital expenses, debt service, and transfers to other funds.

G. Operating Expenditures: Operating expenditures are uses of financial resources for personnel, supplies, services and materials, and indirect cost allocations, and exclude capital expenses, debt service, and transfers to other funds.

III. Fund Balance Range:

Fund balance ranges are established for each governmental fund type, which contains operating expenses, as well as, the proprietary funds. The amounts set for each fund are based on the predictability of revenues, volatility of expenditures, and liquidity requirements of each fund and may need to be reviewed periodically.

The calculation of the various fund balances to proposed expenditures would be established as part of the budget preparation process taking the previous year's ~~revised~~ estimated actual expenditures and the established fund ratio to determine the ensuing budget year's fund balance requirements.

IV. Designations for Proprietary Funds:

Unrestricted net assets in proprietary funds do not necessarily represent resources available for appropriation. This is due to the fact that capital assets are included in proprietary funds and are offset in unrestricted net assets. Since it is not likely the organization will sell the capital asset in order to fund operations, its value is not available for appropriation. In order to take this into account when calculating the ratio related to the fund balance range, staff will ~~identify the portion of unrestricted assets that does not represent resources available for appropriation and consider the amount "designated"~~ adjust the net assets to follow the same basis of accounting used for the General Fund.

V. Funds:

A. General Fund: The General Fund is considered to have a high level of risk to operations due to its dependence on revenue streams that are susceptible to economic downturns and revenue reduction impacts from outside agency actions. In addition, the General Fund is the main funding source when responding to unexpected events or emergencies. The fund balance for the General Fund consists of several balances for multiple purposes. These balances are ~~depicted~~ identified below.

1. ~~General Fund Balance: The unassigned fund balance range for the General Fund shall be not less than 50% and not more than 75% of the total adopted budgeted operating expenditures of the General Fund budget.~~ Operating Reserve: The operating reserve will be maintained to:

   a. Insulate General Fund programs and current service levels from large and unanticipated one-time expenditure requirements, a revenue reduction due to a change in state or federal legislation, adverse litigation or any similar unforeseen action
   b. Temporarily insulate General Fund programs and current service levels from slower revenue growth that typically occurs during an economic recession

   The Council may use this reserve to either maintain current General Fund services and programs or transition expenditure growth to match lower revenues during the first 18 to 24 months of a recession. For purposes of this policy, lower revenues trigger the Council's assessment of use of this reserve when ongoing revenues fall 3% or more for two consecutive quarters compared to the same quarters of the prior year or the financial forecast estimates that ongoing revenues will fall 3% or more for the next fiscal year. Ongoing revenue is defined as revenue typically received every year. One-time revenue is defined as revenue not received annually or significant revenue in excess of routine levels (i.e. significant construction-related revenues, fluctuating grants and donations, "windfall" revenues, etc.).

   The operating reserve range for the General Fund shall be not less than 30% of the total adopted budgeted operating expenditures of the General Fund budget.

2. ~~General Fund Capital Accumulation Fund: The assigned fund balance range for the GF Capital Accumulation Fund shall be any current accumulation plus fund~~

~~balance requirements for immediate replacements. This restricted fund balance range is an accumulation of the City's 3% sales tax after all current bonded debt service is satisfied. The fund balance requirement for this fund should not fall below $100,000 with no upper limit.~~ Budget Carryover Reserve: A reserve will be set aside for any budget carryovers and will not be considered part of any surplus.

3. Equipment Replacement Reserve: An equipment replacement reserve will be established and based on an annual allocation of equipment costs over the useful life of the asset. This reserve will be used to fund the replacement of such equipment.

~~3.~~4. The City may establish additional committed, assigned, or unassigned fund balances in any amount as deemed necessary.

B. ~~Highway User Revenue Fund (HURF): The restricted fund balance range for the HURF shall be not less than 10% and not more than 50% of the total budgeted revenues of the HURF.~~ Streets Fund: The fund balance range for the Streets Fund shall be not less than 0% and not more than 10% of the total budgeted expenditures. The transfers from the General Fund to bridge the gap between revenues and expenditures will be budgeted based on maintaining a zero fund balance. If actual Street Fund results exceed 10% of the total budgeted expenditures, the difference will be considered a surplus up to the total amount of the General Fund transfer. The portion of Streets Fund monies from the City's share of Highway User Revenue Fund (HURF) monies are restricted and cannot be transferred.

C. Grants & Donations Funds: The fund balance in this fund is restricted to the purposes for which the monies were received. Balances will automatically carryover to the following fiscal year.

D. Enterprise Funds: Currently, the City's only Enterprise Fund is the Wastewater Fund. Once the sales tax subsidy to the Wastewater Fund is eliminated, the reserve levels will be reevaluated. The fund balance for the Enterprise Funds consists of several balances for multiple purposes. These balances are identified below.

1. Operating Reserve: The operating reserve will be maintained to guard against service disruption in the event of unexpected temporary revenue shortfalls or unpredicted one-time expenses.

   The ~~fund balance~~operating reserve range for the Enterprise Funds, including maintenance, operations, and administration shall be not less than 25% (90 days) and not more than 33.3% (120 days) of the total budgeted operating expenses of the Fund.

2. Debt Service Reserve: ~~This shall be in addition to a separate fund balance with a target~~ The debt service reserve shall be equal to the average of one year of the remaining enterprise fund debt service repayment requirements for any debt

issuances that do not have specified reserve requirements and are not covered by bond insurance.
~~For the purpose of calculation, this reserve shall be in addition to all other required reservation of net assets including, but not limited to, amounts restricted for debt service, amounts reserved for replacement of capital assets, amounts set aside for resource development, and/or required bond covenants.~~

3. Budget Carryover Reserve: A reserve will be set aside for any budget carryovers and will not be considered part of any surplus.

4. Equipment Replacement Reserve: An equipment replacement reserve will be established and based on an annual allocation of equipment costs over the useful life of the asset. This reserve will be used to fund the replacement of such equipment.

5. Major Maintenance Reserve: A major maintenance reserve will be established and based on an annual allocation of major maintenance costs over the life of the anticipated maintenance need. This reserve will be used to fund the maintenance costs as needed.

6. Capital Improvements Reserve: A capital improvements reserve will be established and maintained based on the higher of the estimated ensuing fiscal year's "pay-as-you-go" projects or an average of the "pay-as-you-go" projects over the next five years in accordance with the City's Capital Improvement Plan.

7. Sewer Extension Reserve: A sewer extension reserve will be maintained by contributing a maximum of 10% of the excess revenue over expenditure. The reserve will be used to fund future system extensions.

8. The City may establish additional committed, assigned, or unassigned fund balances in any amount as deemed necessary.

~~C.~~E. Capital ~~Projects~~ Improvements Fund: The Capital ~~Projects~~ Improvements Fund was created to account for resources designated to construct or acquire ~~general fixed~~ capital assets and major improvements. Occasionally, these projects may extend beyond a single fiscal year. Therefore, although no specific reserve requirement is established for the Capital ~~Projects~~ Improvements Fund, at a minimum, the fiscal year-end ~~assigned and unassigned~~ fund balance, coupled with estimated revenues for the ensuing fiscal year, must be sufficient to fund ~~all outstanding~~ the "pay-as-you-go" capital fund obligations for the next fiscal year. This will follow the City's ~~5-Year~~ Capital Improvement Plan.

F. Development Impact Fee Funds: The fund balance in this fund is restricted to the purposes for which the monies were received. Balances will automatically carryover to the following fiscal year.

G. Art in Public Places Funds: The fund balance in this fund is restricted to the purposes for which the monies were received. Balances will automatically carryover to the following fiscal year.

H. Internal Service Funds: Currently, the City's only Internal Service Fund is the Information Technology Fund. The fund balance for the Internal Service Funds consists of several balances for multiple purposes. These balances are identified below.

1. Budget Carryover Reserve: A reserve will be set aside for any budget carryovers and will not be considered part of any surplus.

2. Equipment Replacement Reserve: An equipment replacement reserve will be established and based on an annual allocation of equipment costs over the useful life of the asset. This reserve will be used to fund the replacement of such equipment.

3. The City may establish additional committed, assigned, or unassigned fund balances in any amount as deemed necessary.

VI. Assignment of Fund Balances

The City Manager is authorized to assign fund balance for specific purposes in accordance with the intent of the City Council and assigned fund balances can only be spent as authorized in the City's Purchasing Policy.

VII. Use of Reserves

It is the intent of the City to limit use of the Operating Reserves to address unanticipated, non-recurring needs. Reserves shall not normally be applied to recurring annual operating expenditures. Reserves, however, may be used to allow time for the City to restructure its operations in a deliberate manner (as might be required in an economic downturn), but such use will only take place in the context of an adopted long-term plan.

~~VI.~~VIII. Surplus:

If it is determined there is a surplus (an amount in excess of the upper limit of the fund balance range for any fund), the funds may be designated or appropriated at the next budget cycle for the following purposes in order of priority:

A. Eliminate shortfalls in related funds. Any General Fund surplus shall be transferred to cover shortfalls within ~~HURF~~Streets, Capital Improvement or any other fund initiated by the City to provide City services. Any Utilities Operating Fund

(Enterprise) surplus shall be transferred to the respective Utilities Capital Improvements Fund.

B. Reduction or avoidance of debt. If there is short- or long-term debt within the fund, the surplus may be applied to reduce or eliminate the debt if financial analysis proves this to be advantageous for the City. If a borrowing is scheduled, the surplus may be used to reduce the principal amount the City needs to obtain if financial analysis proves this to be advantageous for the City.

~~C. Applied to a replacement program. Surplus funds may be used to supplement or enhance a capital replacement program such as vehicle, personal computer, or heavy equipment replacement, or any other capital replacement program initiated by the City.~~

~~D.~~C. One-time capital needs. Since a surplus does not represent a recurring source of revenue it should not be used to fund a recurring expense; however, if a one-time capital expenditure has been identified, but not already funded through an appropriation, the surplus may be appropriated for this use.

~~E.~~D. Tax, fee, or rate stabilization. Surplus funds may be designated for stabilization in order to avoid raising taxes, fees, or rates related to the fund in subsequent years. For instance, a surplus in the Enterprise Fund may trigger reevaluation and possible reduction of the sales tax subsidy provided to the Enterprise Fund in the future.

~~F. A Sewer and Extension reserve may be maintained by contributing up to 2% excess revenue over expenditure.~~

~~VII.~~IX. Shortfall:

If it is determined there is a shortfall (an amount below the lower limit of the fund balance range for any fund), the fund balance is to be replenished as quickly as possible through the following mechanisms in order of priority:

A. With exception of ~~the HURF, Proprietary Fund, and Fiduciary Fund~~ funds with legal restrictions as to the use of funding sources, a distribution of surplus from other related funds as delineated under “Surplus” category.

B. An appropriation during the next annual budget process of at least 20% of the lower limit of the fund balance range until the lower limit has been reached.

C. If ~~this~~ A. or B. is financially infeasible, a written plan shall be forwarded by the Director of Financial Services to the City Manager for Council approval in order to restore the fund balance to an amount within the range within a practical time frame. This plan may require reduction of services, increases in taxes, fees, or rates, or some combination thereof.