

## Memorandum

To: Finance Committee

From: Baker Kurrus

Date: March 10, 2019

Re: City finance and our recommendations

I reviewed Little Rock's 2018 budget in great detail during the last year. By mid- 2018 it appeared to me and others that the sales tax revenue projection was not being met. The property tax revenue projection also appeared to be uncertain. On August 21, 2018, the city board approved a series of budget adjustments based on anticipated revenue shortfalls of \$3,538,482. A copy of that budget amendment is attached. It shows projected revenue shortfalls in almost all categories.

This left the revised 2018 general revenue projection at about \$205,400,000.

Also attached is a summary of 2018 sales tax collections. The original 2018 budget projected sales tax growth of 3.1%. The actual growth was 1%. This summary affirms the need for the budget adjustments and also portends a very troubling future if the trend continues.

After the budget amendment, Little Rock's 2018 general operations showed a projected operating deficit of about \$6,605,682. The budget amendment reflects transfers in to the operating budget from non-recurring sources of \$2,674,972. These are explained to some limited extent in Note 6 to the amendment, but I do not fully understand them. The operating deficit was also reduced by eliminating a \$1,000,000 transfer out of the operating fund to the city's contingency fund. The resulting overall projected net loss in the operating fund was therefore \$2,930,910. The unaudited actual loss in the operating budget for 2018 will probably be about \$3,200,000. This is more than was projected after the amendment, but is also subject to audit and adjustment as the 2018 year is closed out.

Although the final actual general revenue numbers for 2018 are not yet audited, it appears that the total for Little Rock fell short of even the revised budget projection. I do not have the breakdown of 2018 actual revenues, but based on some of the information I have it appears that our general revenues were around \$197 million. The takeaway here is that 2018 was a loss year to the tune of over \$3,000,000. The loss would have been about \$5,000,000 without the Note 6 adds. This is a serious matter.

As we move to 2019, we need to examine our revenue and expense projections carefully, especially if we are considering adding substantial additional expenses on the heels of a loss year.

The 2019 budget projects general operating revenues of \$210,623,272 versus my estimate for 2018 actual revenues of \$197 million. We need more information about this. I must be missing something,

because I would be very surprised if Little Rock projected an increase of 6.5% in revenue based on our actual experience from the past few years.

One of the unpredictable elements of Little Rock's 2019 budget is the entry for vacancy savings of \$5,500,000. This is the amount of savings that could result from having vacancies in positions which are budgeted for 2019. In some recent years Little Rock had unusually large numbers of vacancies, which did result in a lot of avoided expense. During early 2018 the police department had a number of vacant positions. However, by late fall the department was almost fully staffed. By December 31, 2018 the department had 43 vacant positions. Of that total, 26 of the vacancies were for uniformed personnel. I do not know if the mayor's current proposal is to add 25 new positions or 25 new officers to the 2018 year-end number. Little Rock has not been fully staffed with uniformed officers for any length of time in the last few years. Some vacancy savings is to be expected in any large organization. If Little Rock is going to add 100 police officers as promised, the department must presumably first get to full staffing under its current budget. The 2018 vacancy savings in the police department was about \$3,000,000. If Little Rock simply staffs up to the current authorized levels by filling open positions, that would be a budget add of something in the range of \$3,000,000. If Little Rock adds 25 more entry level positions, (which may or may not be what the city needs), the costs would be substantially less the first year, say \$1,000,000, but would quickly grow toward the average cost of an officer.

A couple of other trends need to be noted.

Seventy-five percent of Little Rock's 2019 general budget is the cost of personnel. Most of these costs are going up by at least three percent (3%) over last year. (Union personnel received a basic pay increase of 2.5%, plus a step increase of 1.8% if eligible. I do not know how many employees are on the final step of their pay grades, but 3% increase is a conservative estimate, I believe.) We can rest assured that the other expenses in our city will generally go up and will reach the projected budgeted amounts. In short, there is absolutely no extra money in the current budget for any additional expenses for 2019. Any slippage in revenue will cause the budget to go quickly to a deficit, as it did last year. More importantly, Little Rock will have increasingly complex financial problems if it does not find a way to grow its primary revenue sources, sales taxes and property taxes, at rates which equal or exceed the rates of increase for its personnel.

As we have looked for additional revenue, I have drawn several conclusions.

Most of the city's smaller revenue categories are not likely to increase. Franchise fees for traditional telephone usage are dropping, and the other franchise fees are largely weather-dependent. We are at or near the top in business license fees. Charges for services like golf and the zoo are not the answer.

Before we make any strong recommendations I think the finance committee needs to know the following:

1. We need the backup on the 2019 revenue projection. For example, the 2018 property tax bills should have been rendered in the last two weeks, but I have not received mine yet. What is the property tax revenue projection for 2018, and does it match the budget projection based on the assessor's actual tax book numbers?
  
2. What is the basis for the sales tax projection? It almost surely is not an increase of 6.5% as I have estimated, but we do need to know if this projection is likely to eventuate.
  
3. The mayor promised another 100 police officers, which presumably means uniformed officers. Has there been any needs assessment or other study which indicates that additional police officers are necessary, especially if the full number of currently allocated and budgeted positions are filled? Is there a plan to fill all of the uniformed positions, and was this the assumption which was used to calculate the police budget?
  
4. Little Rock is obligated to build another fire station in southwest Little Rock. Twelve new firefighters will be needed to staff this station by the end of 2019, and a full year of funding will certainly be needed by 2020.
  
5. There is a discussion about additional costs to Little Rock for its use of the regional detention center. We need to plan for that expense, which I think will be subject to negotiation and will not hit until 2020.
  
6. Other committees will almost surely recommend actions that involve hiring additional personnel. Adding additional personnel does not appear to be feasible.
  
7. The executive department is being reorganized. This should yield substantial savings, perhaps as much as \$500,000. This reorganization needs to focus on efficiency, position elimination, and cost-cutting, especially if there is any real notion of adding police, fire or other personnel.

A couple of additional points need to be made.

The following table, based on Little Rock's published budgets, shows that the city is spending a greater and greater percentage of its budget on personnel:

Year	General Revenue	Personnel Costs	% of gen. revenue used for personnel
2012	158,559,815	108,123,085	68%
2015	194,740,211	139,939,883	71%
2018	208,963,275	152,057,385	73%
2019	210,623,272	158,139,942	75%

This is a very troubling development, because it shows that the city is spending less and less on other things such as supplies, tools, maintenance, repair and other operating costs. This makes clear that we need a comprehensive staffing study.

In summary, it does not appear that Little Rock is in a position financially to add any personnel in one department unless there are major cuts in other areas. Even with the apparently optimistic 2019 revenue increases which are projected, the bulk of the anticipated increases in revenue for 2019 will be absorbed by pay increases that are already promised to existing personnel.

Based on the limited information which I have been able to review, it will not be possible to add any personnel this year without major cuts to other areas of the approved 2019 budget. Across the board cuts should be studied very carefully before implementation, because they impact effective and ineffective departments equally. Meaningful across the board cuts would need to be very large to have any impact. If police and fire departments are exempted from cuts, all of the other departments would have to make large cuts to free up any material revenue. For example, based on 2019 numbers, to raise \$10,000,000 for additional police and fire, the other operating departments would have to cut about 12.5% across the board.

The finance committee continues to explore ways to raise additional revenue. Thus far I am not aware of any ideas that will generate substantial new revenue, except the following:

1. Increase gross retail sales in Little Rock.
2. Increase the city sales tax.
3. Increase the property tax base in Little Rock. (operating millage is at the legal maximum)

Items 1 and 3 will occur if more persons who work in Little Rock also live here, own real estate here, and shop here. Those are the keys to success. Adding new jobs in Little Rock, by itself, does not guarantee that the new employees will either live or shop here.

Little Rock's sales tax is one-half of one percentage point less than North Little Rock's general sales tax. I would not be supportive of this regressive tax unless I was sure that all current revenues were being spent wisely.

I look forward to our meeting on Wednesday.