

Fiscal Sustainability

Introduction

For the City of Scottsdale to be fiscally sustainable, its yearly income must meet or exceed all its financial needs which must include contributions to reserve funds for those years when the income may be less than predicted. To be truly sustainable, there also needs to be contributions to a Capital Improvements Projects (CIP) fund to be used to add and/or replace depreciating capital investments.

In the good years, that is exactly what the city did. In the more recent past, funds have been taken out of the reserve funds to balance the budget, and no money has been put into building these other funds. For this reason, the past city treasurer told the city council that their budget was not sustainable, which was the truth. This paper looks at the whole issue of fiscal sustainability for the City of Scottsdale.

Key Points

- The city relies heavily on sales tax income, and visitors and tourists are heavy contributors to the sales tax income. Therefore tourism is an important source of income that needs to be protected.
- To be fiscally sustainable, the yearly expenses have to include contributions to reserve funds for emergency use, to maintain and/or replace infrastructure, and for other capital projects.
- Both income and expenses go up with growth, however in general the increase in expenses exceeds the increase in income, so the city has to recognize the impact of each type of growth on the city's finances and be careful about the kinds of growth allowed.
- The city commissioned a sustainability study and analysis from Applied Economics, however it only looked at the city as a whole and did not break down the various factors that contribute to sustainability in order to be able predict what will happen if the current land use changes. A proper analysis, using the same numbers, will show that in general, with our current tax structure and rates, growth does not pay for itself and does not make the city sustainable.

Sustainability Analysis

The city's sustainability will be analyzed by looking at the factors that contribute to the city's financial sustainability, and by doing an alternate analysis using the numbers provided in the city's sustainability report in addition to published numbers that show the impact of tourism on the city's economy. The figures presented below are from published budgets from the city, from the tourism report published by the city, and from the Applied Economics Sustainability report

done from the city, so this is not based on opinion but on facts available to any citizen of Scottsdale.

Sustainability Factors

To determine what makes the city financially sustainable, it is necessary to determine what factors cause changes in income and/or expense and make appropriate decisions that insure that either we do not increase our expenses or if we do, that any increases in expenses are matched by equivalent increased income. Table 1 below summarizes the major sources of income and Table 2 does the same for major expenses for the fiscal year of 2011 to 2012, from the city’s published budget numbers for that fiscal year.

Table 1 Income Summary

Major Item	Actuals 2011/12	%	Notes
Sales tax	92,864,088	43.0%	Variable each year
All State shared taxes	42,310,835	19.6%	Variable each year
Fees & Fines	32,882,884	15.2%	Variable each year
Property tax	24,803,074	11.5%	Fixed dollar amount
All Other	14,562,797	6.7%	Variable each year
Permits & Building fees	8,420,935	3.9%	Variable each year
Total	215,844,613	100.0%	

Table 2 Expense Summary

Major Item	Actuals 2011/12	%	Notes
Police & Fire	111,248,510	51.5%	Large increases
Other employees	54,474,285	25.2%	Small increases
Administration	34,813,688	16.1%	Relatively fixed
Public Works	15,942,772	7.4%	Moderate increases
Total	216,479,255	100.3%	

As seen, sales tax is by far the dominant source of income, but it will vary as a function of how much is bought in the city of Scottsdale each year. In general, for most years, the sales tax income is 50% or more of the total income, looking at the city’s actual data from the past 10 years. The only fixed income is property tax but that is only 11.5% of the total income. Property tax will increase as a result of new development, but only by the amount of assessed value increase due to a new development, and the city council can increase it up to 2% a year, but they have not done that. All the other sources are variable which creates a big problem when trying to create a stable budget. However because of that variability in income, it is even more important to be conservative when estimating income, and to insure that contributions are consistently made to the Reserve Fund.

On the expense side the dominant expense is Police and Fire which are generally expenses that will grow as the city grows because more police and fire are necessary to support that growth. Administration and other employees are relatively fixed or will experience small inflationary increases, as a function of both time and growth. Public works would normally see increases too and is another expense that will probably increase with growth in the city.

While the current expenses roughly equal the income for this particular year, there is no expense shown for money put aside for reserve funds, infrastructure maintenance funds, or Capital Improvement Projects funds, so in reality the expenses required for a sustainable budget will be much higher than what is shown. For this reason alone, the budget for this year is not sustainable and will only get worse with inflation and as our infrastructure ages and needs to be repaired or replaced.

The other point to make is that the city's income is highly variable each year, mainly relying on sales tax income, while the city's expenses are likely to grow, especially as the city increases population or grows in other ways. In general, the sales tax income will increase with the population, but the question is does it increase enough to compensate for the increase in expenses that will be attributed to that population growth? To properly answer that question, it would be necessary to come up with a margin figure (the ratio of income to expense) for each contributing factor. Margin is the ratio of income to expense for each factor individually. If this ratio is greater than one (income exceeds expense), that factor has a positive impact on the city financially, and if less than one (income less than expense) a negative impact. The factors that would need to be isolated to predict how the sustainability of the city is impacted by increases or decreases are shown in Table 3 below.

Table 3 Sustainability Factors

Sustainable Factor	Income	Expense	Margin
Tourism	Sales tax Bed tax	A percentage of police, fire, and operations. Tourism related facilities	1.39
Single family residential	Sales tax Property tax	A percentage of police, fire, and operations.	Unknown
Multi-family residential	Sales tax Rental tax	A percentage of police, fire, and operations.	Unknown
Commercial	Property tax Sales tax for some	A percentage of police, fire, and operations.	Unknown
Industrial	Property tax Equipment taxes	A percentage of police, fire, and operations.	Unknown

The city has determined a margin ratio for tourism, and it is 1.39 for this past year, which means for every dollar the city spends on supporting tourism, it gets \$1.39 back or a profit of almost 40% on investment (from the City's tourism report). This factor includes any expense that could possibly be attributable to tourism, including percentages of police, fire, and public works. The tourism report shows a detailed breakdown of both income and expense that went into this margin ratio.

The other factors have not been determined, however it will be shown, in the analysis of the City's Sustainability report below, that all of the other 4 factors, together, have a margin less than 1, indicating that if the city increases population and brings in more businesses, the city will incur more increases in expenses than it gains in increased income. This is a key point because it indicates that all growth is not good for the city financially.

City Sustainability Report

In 2010, the city commissioned a "sustainability" study from Applied Economics as part of the 2011 General Plan update. While this study was supposed to be a sustainability study, it did not separate out the various contributors to sustainability, such as shown in Table 3 above, nor did it consider the City's need to accumulate reserve funds that are required to offset the variability in income, to be able to replace aging infrastructure, and to make necessary capital improvements. When questioned on this, the authors admitted that the city did not ask them for the type of analysis that could be used to determine what the impact of increasing population and getting more businesses to locate here would have on the city's finances and therefore sustainability. They indicated that that type of analysis could be done, but wasn't asked for.

Using the numbers from the Sustainability Report, but also using the City's published numbers for the impact of tourism from the 2013 Visitor Statistics study, I performed an analysis to determine if the city is financially sustainable without the income from tourism. Only the income from tourism minus all expenses attributed to tourism, as detailed in the Visitor Statistics report, was subtracted from the total income. I also redistributed the sales tax to the three areas of the city, identified in the Sustainability Report, based on housing units rather than point of sale (where the store is located). I also had the past city treasurer review this analysis and he agreed with the approach and results. The results of this analysis showed the following, most of which is also shown by the graph in Figure 1.

1. Sales tax is the major source of income for the city. The report failed to separate out sales tax resulting from tourism, thereby missing THE key point about what makes the city sustainable, our tourism industry.
2. Tourism is the key to the city being sustainable as it is the only thing that has a positive balance between cost and revenue (margin). Therefore every effort should be made to insure that our tourism industry remains strong. We must insure that development and growth do not degrade our tourism industry, even in a small way.
3. In general, residential development does not pay for itself, so adding more residents does not make the city more sustainable, but rather pushes it toward increasing losses.
4. The loss to the city for residential development appears to be proportional to the density of residential development, the higher the density the larger the loss to the city. Proper allocation of sales tax to residential unit rather than point of sale (where the store is located) showed that the more rural northern area had a positive margin (income exceeded expenses) while the other two areas had a margin less than 1 (expenses exceeded income) where the amount expenses exceeded income seemed to track

residential density (higher density equated to higher loss).

The graph below shows the margin (amount income exceeds expenses) for each of the 3 areas and the city as a whole. There are separate colored bars for the report’s original output (blue), the change in the result if sales tax is allocated to housing units rather than point of sale (dark red), and the change if the income from tourism is removed first, and then the remaining sales tax is allocated to housing units rather than point of sale (green).

As can be seen, just reallocating the sales tax in a more reasonable fashion, shows that the North comes out with a very positive margin, the South slightly negative, and the Central highly negative. These results track the population density as the North has the lowest density, followed by the South, with the Central at the highest density.

The results for city as a whole didn’t change until the excess income from tourism was subtracted at which point the city goes from a positive margin to a negative margin. This shows that tourism sustains the city currently because of its very positive ratio of income vs. expense and without the income from tourism the City is in the red.

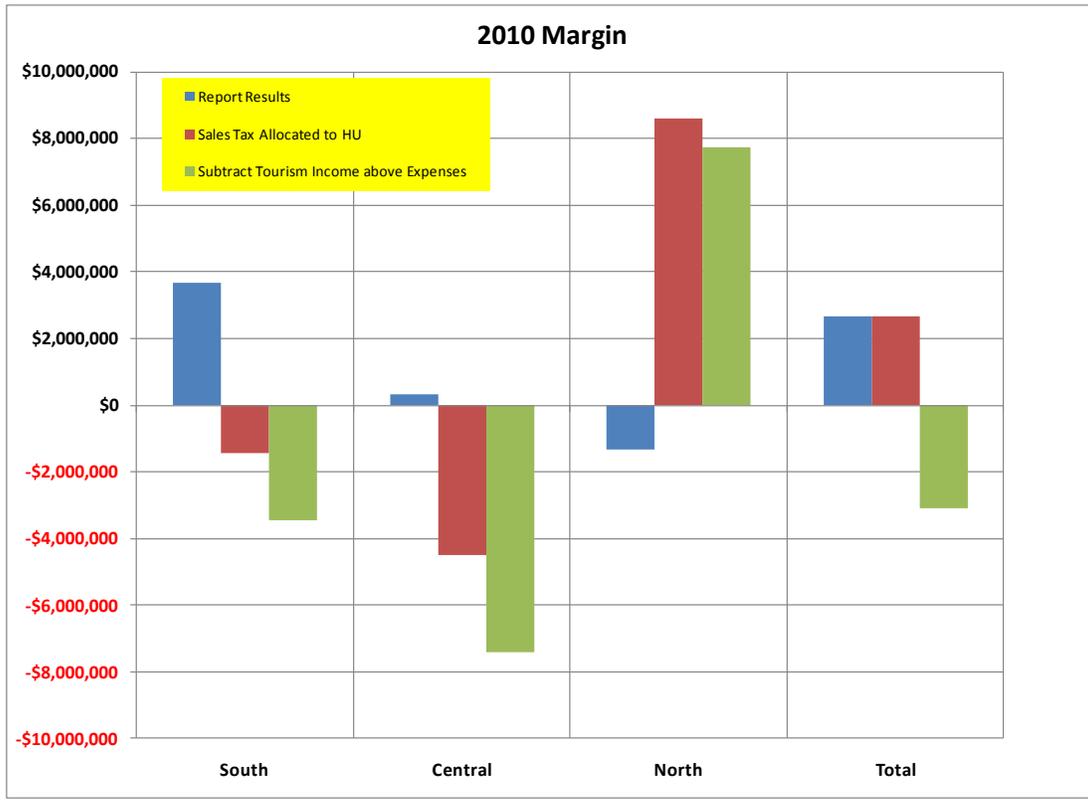


Figure 1 Margin by Area 2010

The entire analysis is available to anyone who wants to see the details and numbers that led to what is shown here.

Fiscal Sustainability Report Review

Summary

This study was supposed to provide an analysis that would guide the city toward sustainability, but in truth, due to the way the numbers were used, it does just the opposite. It comes to conclusions and recommendations that are totally wrong if the city is to remain sustainable. This review will show the following, most of which are shown by the graph in Figure 1.

1. Sales tax is the major source of income for the city. The report improperly allocated sales tax to each area and thereby reached conclusions that were incorrect. Furthermore it failed to separate out sales tax resulting from tourism, thereby missing THE key point about what makes the city sustainable.
2. Tourism is the key to the city being sustainable as it is the only thing that has a positive balance between cost and revenue. Therefore every effort should be made to insure that our tourism industry remains strong. We must insure that development and growth do not degrade our tourism industry, even in a small way.
3. When the sales tax income is properly allocated, the north area actually contributes more than it costs, by a large margin, while the other two areas have a negative balance of income vs. expense. This is mainly due to city expenditures per dwelling unit being far lower in the North than in other areas of the city.
4. Residential development does not pay for itself, so adding more residents does not make the city more sustainable, but rather pushes it toward increasing losses. Furthermore, the loss to the city is proportional to the density of residential development, the higher the density the larger the loss to the city. This is true without considering any of the necessary capital projects to increase and maintain infrastructure growth requires.

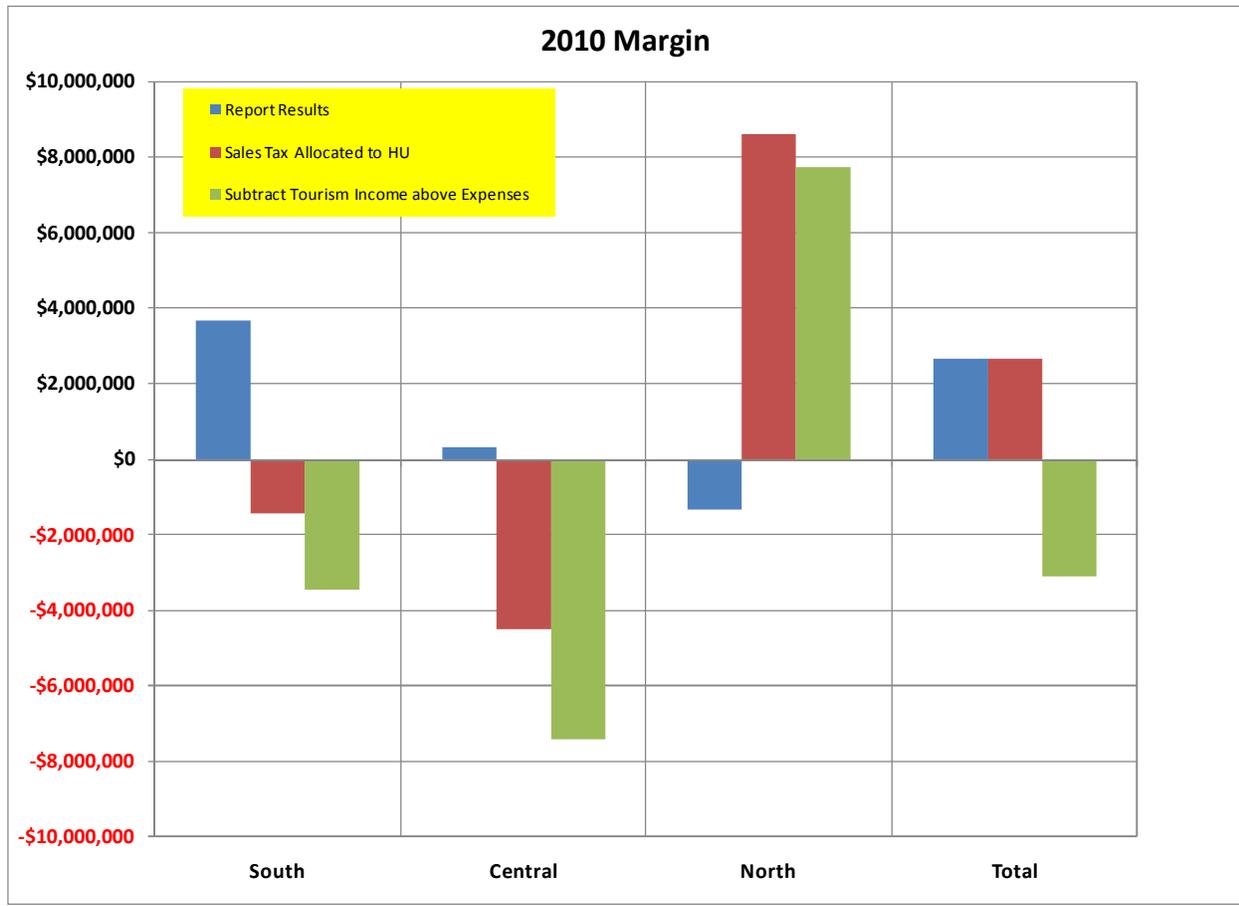


Figure 1 Margin by Area 2010

Detailed Analysis

The original report splits the city up into three areas, and then makes some conclusions based on that division, that are totally inaccurate and misleading. It would seem that the boundaries were drawn, and the ground rules of the study specified, specifically to justify changing development patterns in the Southern area and even more so in the Northern area.

First, dividing the city in this way ignores the intention of the previous visioning process and planning efforts that led to a development and character plan for the city that intentionally resulted in the divisions mentioned in this report. Based on this process, the city was intentionally developed to put old town, the arts district, and many of the resorts in the Southern area of the city, most of the industrial uses and big box stores in and around the airpark which is located in what is defined as the “Central” area, and the low density residential uses, ranches, and horse use areas in the “North” area. This is by design, not chance and the very good reasons why the city was planned in this way should be respected and followed.

Second, since sales tax is the major contributor of income for the city, allocating its income to the point of sale totally distorts the picture this report is trying to draw in that the actual sales tax

income, provided by each of the three areas, is in truth based on where the buyers LIVE, not where they SHOP, i.e. people in the North and South areas do spend a significant amount of money in the Central area, thereby inflating the Central area's income and deflating the other two. How sales tax is allocated between tourists, residents, and other valley residents who shop in Scottsdale is also critical to this entire analysis. Therefore, how the residents portion of the sales tax income is allocated to each area is the critical component that led to the deficit in the North area and the conclusion that it isn't contributing its "fair share". By simply dividing up the total sales tax income based on the number of housing units in each area, the results are way different as shown in Table 1 below. The conclusion that would now be drawn is that the North area is the only one contributing its fair share. Note that this simple analysis does not consider the average income in each area, which would presumably generate more purchases and therefore more sales tax which would further bias the results favoring the north. Next best would be the southern area, because it has a lower population density than the Central area, which has the highest. Even in the original report, the Central area was barely positive even when it got full credit for every purchase made in that area.

Table 1 Proper Allocation of Sales Tax Income

Total Sales Tax	\$115,445,968		
Item	South	Central	North
Housing Units	42,218	60,408	17,934
Allocation in Analysis	\$45,522,196	\$62,669,279	\$7,254,492
Allocation By Percent Population	\$40,427,156	\$57,845,554	\$17,173,258
Difference	-\$5,095,040	-\$4,823,725	\$9,918,766
Study Net Impact	\$3,665,380	\$312,075	-\$1,313,003
New Net Impact	-\$1,429,660	-\$4,511,650	\$8,605,763

This simple analysis also does not consider income from tourists and other sources other than residents. If that is factored in, the results are even more dramatic. Table 2 below assumes 20% of the total sales tax income comes from tourists or other sources, which is more conservative than the number generally thought of as the percentage tourism contributes to our local economy. With this adjustment, the following results and conclusions can be seen.

The city as a whole is over \$20M dollars in the red.

Conclusion #1: Without tourism the city would have a huge negative balance.

Conclusion #2: Residential development doesn't pay for itself.

Conclusion #3: The higher the residential density the higher the loss to the city. This is based on the residential densities in each of the three areas, with the Central having the highest density followed by the South and with the north last.

Only the northern area comes out with a positive balance and the other two are highly negative.

Table 2 Sales Tax from Tourism Included for 2010

Year	2010			
Total Sales Tax from study	Total =	\$115,445,968		
Adjustments for other sources	% of Total Tourists & Other	20.0%		\$23,089,194
Adjusted Sales Tax by region	Adj. Total =	\$92,356,774		
Item	South	Central	North	Total
Housing Units	42,218	60,408	17,934	120,560
Allocation in Analysis	\$45,522,196	\$62,669,279	\$7,254,492	\$115,445,967
Allocation By Percent Population (w/Adj)	\$32,341,724	\$46,276,443	\$13,738,606	\$92,356,774
Difference	(\$13,180,472)	(\$16,392,836)	\$6,484,114	(\$23,089,193)
Study Net Impact	\$3,665,380	\$312,075	(\$1,313,003)	\$2,664,452
Adjusted Net Impact	(\$9,515,092)	(\$16,080,761)	\$5,171,111	(\$20,424,741)

This trend continues in the analysis of 2030 as shown in Table 3 and even the loss is about the same. Note that the loss is greater than in 2010 for each area as a function of the percent of population increase. However all this assumes that the tourism industry continues to contribute 20% of the sales tax income, which clearly may not happen if the city develops in a way that tourists do not find attractive. If tourism declines, so will the total sales tax income, pushing the city further in the red.

Table 3 Sales Tax from Tourism Included for 2030

Year	2030			
Total Sales Tax from study	Total =	\$152,720,367		
Adjustments for other sources	% of Total Tourists & Other	20.0%		\$30,544,073
Adjusted Sales Tax by region	Adj. Total =	\$122,176,294		
Item	South	Central	North	Total
Housing Units	44,620	69,824	22,385	136,829
Allocation in Analysis	\$50,151,479	\$89,280,592	\$13,288,295	\$152,720,366
Allocation By Percent Population (w/Adj)	\$39,841,746	\$62,346,707	\$19,987,841	\$122,176,294
Difference	(\$10,309,733)	(\$26,933,885)	\$6,699,546	(\$30,544,072)
Study Net Impact	\$4,234,924	\$7,439,230	(\$1,761,610)	\$9,912,544
Adjusted Net Impact	(\$6,074,809)	(\$19,494,655)	\$4,937,936	(\$20,631,528)

If we make the sales tax income due to tourism smaller to account for the Maximum cost that can be attributed to tourism, the overall loss the city sees is smaller, but still well negative. Table 4 shows those results where only 5% of the sales tax income is assumed to come from tourism putting the remaining 15% back into the total sales tax income that is supposed to balance the cost of residential and industrial development. This is approximately the assumed cost of tourism, though one could easily make the argument all the city services, attributable to tourism,

would be there anyway to support our residents. The 5% taken here represents only the sales tax income from tourism that exceeds the cost of tourism.

Table 4 Analysis with Cost of Tourism Included

Proper Sales Tax Allocation				
Year	2010			
Total Sales Tax from study	Total =	\$115,445,968		
Adjustments for other sources	% of Total Tourists & Other	5.0%		\$5,772,298
Adjusted Sales Tax by region	Adj. Total =	\$109,673,670		
Item	South	Central	North	Total
Housing Units	42,218	60,408	17,934	120,560
Allocation in Analysis	\$45,522,196	\$62,669,279	\$7,254,492	\$115,445,967
Allocation By Percent Population (w/Adj)	\$38,405,798	\$54,953,277	\$16,314,595	\$109,673,670
Difference	-\$7,116,398	-\$7,716,002	\$9,060,103	-\$5,772,297
Study Net Impact	\$3,665,380	\$312,075	-\$1,313,003	\$2,664,452
Adjusted Net Impact	-\$3,451,018	-\$7,403,927	\$7,747,100	-\$3,107,845

These simple examples show something that has been known for a long time, but not recognized in the planning process. Residential development by itself is a loser for the city, when it comes to income vs. expense, and this is because of the dependence on sales tax as the major source of funds for the city, vs. a mixture of sales and property tax that most other areas in the country work on. The city went through another study years ago to justify residential development and it was clear that residential uses loose the city money unless virtually all of the sales tax income was attributed to residents in the city. The results from this new study are virtually identical.

When the area boundaries were defined to segregate low density residential uses in the North, which don't have much commercial because population density is not high enough to support more commercial, the natural and expected outcome is that this area loses the city more money. That is because most of the stores, the northern residents shop at, are located in the Central area. Again, this is per plan because the rural areas in the North don't have the population density to support large stores whereas the Central area does. However what is interesting is that this study would seem to back up the assertion that residential uses cost the city more than they bring in. The analysis above backs this up, but further the higher the density of the residential development, the bigger the loss to the city. It also shows clearly that tourism is what makes the city sustainable, not residential or industrial development.

Following this thought a little further, the worst thing the city could do is to jam a lot more residents into any part of the city, including down town. The thought that additional residents bring in additional sales tax may be true, but the question is do they bring in enough to offset the cost of providing infrastructure, services, recreational areas, or even general maintenance? If you were to do a real study you would find the answer is definitely NO. The city is currently sustainable because we have significant sales tax income from visitors, tourists, people who work in Scottsdale, and other valley residents who shop in Scottsdale. Therefore, the correct

strategy is to maintain UNIQUE shopping experiences that will generate this very necessary additional income, not to continue to add residents, especially in dense urban environments. Correct use of the data in this report will clearly show that.

All of this also supports the argument that the residents of the city are better off if the city buys all the land in the Preserve boundary rather than allowing some of it to be developed. This is even more true if the cost of adding the required infrastructure were included. Purchasing the land is a onetime expense, while allowing it to be developed produces a high ongoing expense to the city and its residents. Buying all of the preserve also supports our tourism industry, which is what really sustains the city.

Fiscal Sustainability Report Detailed Issues

Executive Summary

North Sub Area. “This subarea includes a significant amount of vacant land for new development,

assuming that parts of the large state land parcels in the north will be developed in the next 20 years. Projected growth includes about 4,500 new housing units, mainly low density, and 3.5 million square feet of new retail and office space.”

Since when did we assume that some of the preserve land was going to be developed?

General Approach

“It does not specifically include construction costs for new or replacement infrastructure,” this is one of the major costs of development that is hidden but costs the taxpayers.

2.1 Development Characteristics

“The North subarea, which has currently over 16,800 acres of vacant land, is the only part of the city that is projected to still have any significant vacant land in 2030, estimated at 11,100 acres. However, this is contingent on the sale of state lands in the North subarea. The projected timing of state land sales and subsequent absorption are fairly subjective.”

Again, this is making an assumption that a good portion of the state land, slated for preservation, will be developed. This goes against all previous planning which assumed NONE of the land in the RSB would be developed. All infrastructure was based on this previous assumption, so if this land is developed, where is the cost to the city buried?

2.2 Fiscal Assumptions

“The model does not include any construction costs for new infrastructure, which is largely in place except for in the North subarea, but it does include relevant maintenance costs to the city for streets and parks.”

First, new or upgraded infrastructure would be required if the population is increased by a significant amount ANYWHERE, not just in the northern area. Second, excluding this cost buries the fact that residential development costs the city more than it brings in.

3.3 Impact Analysis for the North Sub Area

“The North subarea is the only subarea with negative annual net impacts. In 2010, the North subarea shows an annual net impact of (\$1.3 million) in the general fund and transportation fund combined. By 2030, the North subarea would have an estimated annual net impact on the City of (\$1.8 million), based on the assumptions used in this analysis.”

This analysis totally ignores the impact residents in the North have on the sales tax income in the

Central and Southern areas. Is anyone dumb enough to assume that residents in the north don't spend any money in the rest of the city when all the major stores and service industries are in the Central area and all the specialty stores are in the Southern area? A very simple analysis, allocation the total sales tax income across the areas by the population of each area shows the North area to have a big positive impact and the other two lower or negative. The assumption that sales tax be allocated based on point of sale is not only wrong, it totally biases this analysis and all of its conclusions.