MINUTES
FINANCE COMMITTEE MEETING
CITY OF DOUGLAS
COUNCIL CHAMBERS
425 TENTH STREET
DOUGLAS, AZ 85607

FRIDAY, DECEMBER 20TH, 2013

7:00 am

1. CALL TO ORDER/ROLL CALL

Meeting was called to order at 7:05 a.m.

Members Present:
Mitch Lindemann
Sandi Thomas
Mike Nava
Victor Varela

Members Not Present:
Ana Bernal (Excused)
Margaret Morales, Liaison (excused)

Also Present:
Carlos De La Torre, City Manager
Luis Pedroza, Finance Director / City Treasurer
Lorenza Rascon, Committee Secretary

2. PERSONS WISHING TO ADDRESS THE COMMITTEE IN WRITING OR VERBALLY ON ANY ITEM NOT ON THE AGENDA

None

3. APPROVAL OF MINUTES FOR OCTOBER 30, 2013

Mr. Mike Nava entertained a motion to approve minutes as presented. Ms. Sandi Thomas seconded the motion. Motion passed unanimously.

4. PRESENTATION/DISCUSSION ON COMPREHENSIVE ANNUAL FINANCIAL REPORT (AUDIT) FOR THE FISCAL YEAR ENDED JUNE 30, 2013

Mr. Luis Pedroza began by informing the Members that the FY 2013 audit was turned in on November 16. This is a yearly process and has been submitted for their review. He began by talking about the highlights of the audit. He believes the financials depicted at the end of the Fiscal Year are good. They were better than last year but it is important for them to remember that this is looking at a picture as to where the City is at a particular point in time. But at the same time the City in a better position than what was shown last year at the same point in time.

Mr. Mike Nava asked if the City is maintaining that same good position as of now.

Mr. Pedroza answered that the first quarter it was reported that the City was behind by $300,000. It’s a little early to tell where the numbers will end up because a lot of revenues need to be realize in the latter half of the year. It doesn’t look that great there.

Mr. Carlos De La Torre explained that the City had a very good July but August and September where not that good in terms of Sales Tax Revenue and as Members recall last year the City was almost in the same position. One of the things that has not been realized is the $300,000 coming in from the sale of a building. Looking at that it would offset and numbers will be in the black. This has not been executed and hopefully will be realized by the end of the fiscal year.

Mr. Pedroza referred the Members to the summary page given to them on some of the highlights of the audit. He explained that in the General Fund, revenues were at $14,107,252, expenses at $14,016,854 and Net Use of Financing Sources at $95,928. That is transfers in and out of General Fund and proceeds from a Capital Lease that was received. Overall Fund Balance is at $186,326. The other funds which are special revenue funds such as HURF, LTAF, Capital Projects, Grants and JCEF show revenue at $3,605,742, expenses at $4,515,294 and Net Use of Financing Sources at $786,085. There was one change in the way Special Revenue was accounted. In the past Public Housing Authority was not reported. This time accounting rules changed and it became part of the Special Revenue Funds accounting. In looking at the financials about $59,000 are used out of reserves. That is the reason why the total is in the red. He continued by explaining that Enterprise Funds had a good year. The total change on fund balance was of $1,193,162. Every year depreciation totals close to $1 million cumulative throughout that fund. That means that equipment, infrastructure depreciated in value so for the City to get a positive fund balance that definitely puts us in a position that we can cover that depreciation every year so that we don’t go out and finance for this equipment down the line. That is the ideal position that we would like for the General Fund but there is a lot of work to do there.

He continued to talk about the Balance Sheet which represents the health of the City compared to the previous year. Assets increased by close to $300,000 and liabilities increased by $58,845 that was largely attributed to self-funded insurance. When the City started with the self-funded insurance at the end of the fiscal year the City had to claim a liability that a certain amount of claims were owed. Overall, Fund Balance increased by $186,326, general cash position also increased by $488,754. The Special Revenue Funds, total Cumulative Assets increased by $22,984, Liabilities decreased by $336,051 and Fund Balance showed an increase of $298,845. We were in a better cash position attributed to us absorbing the Public Housing Accounting. They brought in close to $366,000 in cash into the books. The Paseo Grant reimbursement also helped in increasing this cash position. This is the grant that we had been waiting reimbursement for a while.

Mr. Nava asked what the project did.

Mr. De La Torre explained that the Paseo La Amistad grant funded the Linear Park from South of 3rd Street all the way to the Port of Entry. The American Recovery and Reinvestment Act gave us a grant but the City was on a reimbursement basis. One of the things that the City had to pay for was the project management and some change orders. There was a lot of discussion on the cost and eventually got that money back.

Mr. Nava commented that happens often when we are waiting for reimbursements.

Mr. De La Torre answered yes but this was a little bit more special because there were changes that needed to be made on the project. The City had to get it done, ADOT was administering the project, the City was paying the bills, but the Federal Government did not want to pay. There was a lot of discussion until the State got reimbursed and we were reimbursed by the State.

Mr. Mitch Lindemann commented that he read an email referencing how much money each city has lost on HURF funds. He asked if there was any plan on the State reimbursing the cities for that.

Mr. De La Torre explained that there are some Legislators that have been discussing ways of reimbursing the cities for that but every year they have that discussion but it never materialized because there is not enough money to go around. The League keeps a very close tab to that and ours was close to $800,000.

Mr. Pedroza answered it was close to $900,000. It was $2 million that the State swept overall in HURF.

Mr. Lindemann asked if it would help to have a Resolution from the Finance Committee to try to move that up.

Mr. De La Torre answered yes it would help and he thinks the League made a resolution last year to that effect. He thinks it's in everybody's mind.

Mr. Pedroza continued to explain that on the Balance Sheet on the Enterprise Funds the increase in Assets is of $902,803, also a reminder that Enterprise Funds get accounted differently than the General Government Funds. In the Enterprise Funds we see all the values of the Assets in the Balance Sheet, that includes all the pipes and wells and everything else that is why it shows $27,310,109. Liabilities pretty much decreased by $290,359 and Fund Balance increased by $1,193,162. Cash balance slightly decreased by $89,331 but that is very minor. He also depicted where we are at thru a chart. This shows a good picture of where we were over the past 10 years. The Cash Position which is the line at the bottom shows that during the great recession from 2008 the Cash Position bottomed down until 2009-2010. We had a lag where we really experienced that. In 2007 we were heading in an upward trend but as we hit the recession it bottomed out. We have been picking up very slowly but it has been trending upward. It's a good thing but it is attributed to the fiscal responsibility that we have been taking on to make sure we have made good investments and good expenditures. Fund Balance sort of mirrors that. It lay kind of flat during the recession and then when we are sort of getting out of it we seem to also be increasing in Fund Balance.

Mr. Lindemann asked if the City is realizing any payback from the Lehman Brothers that we lost.

Mr. Pedroza answered yes. Very slowly we are. We receive about 2 distributions a year which total anywhere between $8,000 and $10,000 but we lost close to $70,000.

Mr. Lindemann asked if they know how long the reimbursements will continue.

Mr. Pedroza answered that it will continue until we get reimbursed the full amount but there is really no set amount of how much we receive.

Mr. Victor Varela asked how much has been received.

Mr. Pedroza answered that we have received close to $20,000.

Mr. Nava asked if there is a guarantee that the City will get reimbursed the full amount.

Mr. Pedroza answered no that there is no guarantee.

He continued by explaining that the Enterprise Funds shows less of a drop. In 2009 Fund Balance picked up because of the Utility Fee increases. They saved those funds. Cash Position increased steadily almost every year. The City started investing in the Wastewater Treatment Plant. For Phase I close to $5million were put into the Asset line item. It goes from close to $14million all the way up to $21million. That is a huge investment within a period of 10 years.

Mr. Lindemann asked how close we are to paying off the WIFA loan.

Mr. Pedroza answered about 17 years. He explained it is a 20 year loan and we are on our 3rd year.

Mr. Lindemann asked if it makes any sense to repay that loan as soon as we can.

Mr. Pedroza explained the interest rate is at 2%.

Mr. Lindemann asked if it would be a savings.

Mr. De La Torre answered that it would not be too much of a savings. It would give the City the financial freedom to payoff that debt and keep Cash Balance for other Capital Improvements. It would help in case we need a new well then the money is already there and we wouldn't have to borrow it. That would be a benefit and as we accumulate more cash then we will reevaluate that situation and see if we can pay it off. From our perspective we want to have some solid years, 3, 4, 5 years, before we start to divest out there. We know that even if we have money in the bank the needs out there are significant and we would spend it in no time.

Mr. Lindemann commented that it is nice to have the ability to go in that direction if we want.

Mr. De La Torre asked Members to look at a chart on page 20 which shows Revenue vs Expenditures. He explained the bigger the difference the more Cash Balance we will have. This was the cause of scheduled rate changes over the last 5 years which is basically flattened out. It does not mean that there won't be any rate changes but we probably shouldn't wait too long before we begin to address those. Not that we want to build a Fund Balance but we want to make sure that we get used to having some sort of increase so that we continue to have those funds solid and we can meet all the requirements not only of the loans but also of reserve requirements and also the payments.

Mr. Pedroza commented that just the Sewer Fund itself is not really where we want it to be yet since it only has $633,000 in cash. Although in the past it carried a negative fund balance, thru the rate increase it had to erase the negative fund balance and start building up. We still have a few years to go before we can build an adequate reserve that can really cover requirements and in Capital Investment Projects that are needed right now. The Water Fund is the one carrying the most cash. It's close to $2.2million but if you look at it thru a prospective Capital Investment like Carlos said if we need a new well it's more than a $1 million for a new well.

Mr. Varela had a question on Sewer. He knows there have been considerable investments in the sewer system itself and asked if staff has analyzed the efficiency levels that would turn out to be more of a savings down the road. It's more advanced equipment, more advanced sewer plant, are we going to be able to manage that with less workforce that will lead to more savings down the road?

Mr. De La Torre answered that unfortunately most of the improvements for that investment was to take care of noncompliance issues. What was done was to address the problems that we had because of the lack of investments and improvements. The plant was built in 1947. The City made some minor improvements in 1980 and then when the prison came onboard they made some improvements in 1997-1998. We took over their system around 2000 and there were a lot of compliance issues that were found in 2001-2002. ADEQ told the City that we needed to make some improvements. All we did was catchup to what was needed to be done for a long time. The facilities that were installed there has a capacity to treat 3,000,000 gallons but the plant has a capacity of 2,000,000 gallons and today we are at capacity. If a new development comes in we don’t have the capacity to serve them. What we are doing is working with the Border Environmental Cooperative Commission to come up with a Grant because Bay Acres wants to be connected. In order for us to connect them we need to expand the facility. By expanding the facility we are not only expanding in terms of more flow but because there is no requirements it has to be upgraded. It is going to require an investment of close to $11million to increase the capacity to 3,000,000 gallons. What we did in terms of improvements, there are components up front of the plant, in the middle and at the end of the plant that are ready but there is something in the middle that still needs to be upgraded. We gains some efficiencies and where we used to staff the facility with 3 people we are only running it with 2 people.

Mr. Lindemann commented that in order to protect the aquifer some houses on 9th Street that are still connected to septic should be connected to the system also.

Mr. De La Torre agreed that we need to connect our own residents before we extend the services to Bay Acres. He explained that the only reason why we are doing that is the there is external financial help that is going to come into play not only from NADBank and EPA but also from rural development to offset the costs of making improvements to the plant. That is where our interest is, because we need to expand the plant but instead of doing it on our own we are using their resources as much as we can to offset the cost of those improvements. In looking at the cost, if $11 million are invested, $8 million will be absorbed thru the EPA grant, $1 to $2 million will be absorbed thru Rural Development, so the remaining which is $1 to $1.5 million will be absorbed by the City. When you expand the plant from 2,000,000 to 3,000,000 gallons at a cost of $1million to the City, that is very cheap. If we were to do it on our own we would have to do it at a cost of $11 million. That is the reason why we want to do it. That is the benefit. Down the road we have more connections and we address that community which is not getting better, it’s getting worst. If we have issues with septic and they are around us and they are around the wells then we address that issue. Another thing we are talking to the County about is if we address the sewer issue if they can address the flood control issue, the street issue, the lighting issue and they said yes. So that is something that we will be working on with them to be able to do that.

Mr. Lindemann asked if we will have enough capacity then to get all those hooked up.

Mr. De La Torre answered yes and the benefit is not only to connect those folks but if the development at the Golf Course were to expand then there will be enough capacity to connect those. Even if anything grows along 191 all the way to the prison we can continue to provide capacity there. We are doing the same thing with the water. We want to be able to take control of BDI so that we can basically assure the water supply for the city and we can absorb all those areas so that we have adequate supply not for tomorrow but for 10, 20, 30, 40, 50 years down the road so that we don’t have to worry about it. Today if we wanted to use the effluent water from the treatment plant we know that we need to set up a pump, pump the water upstream to send to the parks, the golf course but we couldn’t do that today. It’s a different type of effluent. Right now it’s classified as Class C and it would have to go to Class A. It would actually have direct human contact and we can’t do that today. The intent of doing those improvements it would basically put us in that light that we will be able to build some of the facilities so that we can pump the water upstream and we can reuse it. So instead of discharging that water to Agua Prieta we will be collecting it there and pumping it back into the system. Tucson and Phoenix have developed 2 systems and now are wishing they didn’t have to run 2 systems. So we are looking at that in terms of what would be the best solution for us to move forward.

Mr. Pedroza pointed out what he things are notable places in the CAFR to look at. Capital Assets are listed on Page 51, general government funds decrease it’s net assets by over 1million. What that shows is that the depreciation overtook the investments that were done for that particular year. That is the net asset position at that point. For the enterprise funds the net asset increased by 737,000. Another good page is debt which is listed on pages 57-60. There they will see the cities debt postion, all loans, capital leases. If they compare it to last year, the general government debt liability decreased by 367,000. Total debt liability is at 11.8 million. Enterprise debt also decreased by 200,000 and they are listed at 6million debt liability at this point. As mentioned last year, the public safety actuarial reports, retirement, is listed on page 68-70. This was discussed last year where it is underfunded and needing some reform as to how we fund those retirement plans. They seem to be in decline at this point. The last actuarial report shows police at 44% funded and fire at 38% funded. We are told that a good point or sound territory is at 80% funded. That is where we hopefully want to be but we need some state action in order for us to reform that pension plan.

Mr. Nava asked how much money the 44% and 38% is.

Mr. Pedroza answered the actuarial value of the assets for police was $7.4 million and fire $4.5 million. It’s at 44% which is almost half so it would have to be at $14million for police. Lastly on page 72 all funds are listed as revenue and expenditures and how they fared against what we had projected.

Mr. Lindemann asked as we start the next budget season we will be starting in the black instead of like in past years where we had to make up using reserves. He hopes that this time we start from square one without having to dip into the reserves.

Mr. Pedroza answered that as Carlos mentioned what we would like to move away from is depending on the one-time revenue sources that we have been depending on since 2008. We have been lucky. We have been able to sell some assets and bring some one-time revenues over. In years past it was the sanitation paying the general fund, this past year we sold land to the hospital and this year we are really depending on the sale of the government center building. Those types of asset sales are not to fund operation expenses and fund us for one year. It’s to really fund other capital investments. We would like to move away from that and start in the black without the one-time revenue sources. What is hindering us from moving in that direction is pension costs, rising costs in operations. For the last 2 years we started to see increases in revenues from the state whereas before we were seeing declines. We see those increases but they are being absorbed by increases in operation costs.

Mr. De La Torre explained that they are being erased by the return in cost in public safety. We had an increase of $250,000 and we are paying $300,000 in public safety. Whatever gain we have been able to see it has been erased by public safety retirement.

Mr. Lindemann asked if that is out of our control.

Mr. Pedroza answered yes.

Mr. De La Torre explained that unless we close the fire department and contract with rural metro and do away with the police department and contract that out with the sheriff’s department. Those are the bold moves. There are some options but those are very drastic moves on the city’s part.

Mr. Pedroza explained that even if there were to be some reforms on the pension plans itself it would take years for us to catch up on this expenses because we are so far out as far as where we need to be funded at.

Mr. Lindemann asked if that is the typical position of other cities as well.

Mr. De La Torre explained that the liability will stay for a long time.

Mr. Varela commented that the good thing is that we are not creating an additional cost but if we have additional revenues from the state that offset these particular expenses at least we are not digging ourselves into a bigger hole. We are still maintaining the public safety to where it needs to be. What we need to do is continue the path of efficiency levels and how we invest or spend our money to ensure that it continues to get better. Just hearing about how other cities have gone completely under he feels that we are in good shape by offsetting those expenses with the increases. Optimal would be to create that asset and continue to grow those assets but obviously those liabilities are very hard to control. In all aspects of things he things we are in good shape as long as the state continues to provide that extra revenue otherwise that is a different story. He asked if they project that the revenues from the state will continue to be there to offset some of these expenses.

Mr. De La Torre answered yes that the state was in bad shape a few years ago they made some shifts. The state is stable now unless we have a massive worldwide recession or in the US then it would hurt us but he thinks we are stable.

Mr. Pedroza feels a good indicator is the job market in Arizona. We see it increasing and unemployment rate keeps going down. That creates more income tax revenue, sales tax revenue. That is a good indicator.

Mr. Varela commented that we continue to see more influx of population from out of state.

Mr. Nava said that there were 3 references to the question of risk in relation to investments.

Mr. De La Torre explained that any time that we invest money we put it at risk and we try to play the numbers around. We have a fund that is sitting there of $200,000 that is for a specific and is only collection about $10 to $15 a month in interest. We can't reinvest it but how can we use that fund and put it at work for the benefit of almost the intended purpose of the program, a benefit to the community and get a better return on that investment. What we have established is a revolving fund so that if you are a landlord and you want to make improvements to your house, there is a loan that the city offers you for a 20 year period and very low interest and you make improvements to your rental home then you put it out in the market with the understanding that it has to be for low income families. A lot of times people don't want to get into that, they don't want to assume the risk, they don't want to deal with the stats for that loan. That money has been sitting there for at least 12 years. We can't continue to just have it sit there. We will be bringing this to council and ask if the city should buy some property, rehab them and flip them and put them up for sale and that way we have created a brand new house for somebody that can live there and put some favorable terms so somebody can get access to that house. The idea is how can we improve the community with that money. Or the city has some vacant property, let's build some low income homes and hopefully somebody can move from an apartment into a house. It would serve 2 purposes, put the money to work and help the community. This will be discussed in the future.

Mr. Nava explained that he took the reference as criticism of the city not having a policy in place dealing with risk but he thought we did.

Mr. Pedroza asked if it might be related to the self-funded insurance.

Mr. Varela commented that he did see that somewhere and it caught his attention because in the finance industry risk continues to be high focus with everything that happened. Risk is getting the finance industry to get ahead of the game. Revenue is not as large as it was before because of all the regulations. Revenue streams is not as good at it was 6 or 7 years ago; however, the risk portion is something that is being very closely looked at because if we can control the cost of risk then our net profits are going to be equally to that but there has to be a very tightly knit risk. To Mr. Nava's point do we have a policy procedure that mitigates risk to the point that maybe the revenue is not as large as it could be or should be but certainly reduce the risk that ultimately get us into a better position. Do we have something like that.

Mr. De La Torre thinks that the financial policies covers that but he can't recall the specifics are. They will look at that and if need be policies will be developed.

Mr. Varela feels that it's important because for the most part a business is a business whether it's an industry or anything else. In risk there has to be a tight routine and policy and procedures to protect the assets, protect from any loses, whether it be from employee issues to equipment to operating costs. Maybe something that can be looked at. Even if it has to be started from scratch we can put our thoughts together and see what we can protect.

Mr. Pedroza explained that policy states as far as investments is that everything gets $250,000 FDIC insured which is the reason why all CDs are invested at no greater than that amount. All bank accounts are collateralized so that if the bank goes under we are covered.

Mr. Varela commented that the city should have something to the investment side of it but he is talking about the operation side where we can technically make a huge impact to the net difference at the end of the year by really creating a risk culture that everybody is a business owner at every single department that takes care of the assets that is there versus than saying it's the city's equipment and I run it however I want.

5. ADJOURNMENT

Mr. Mike Nava entertained a motion to adjourn meeting at 7:54 a.m. Mr. Victor Varela seconded the motion. Motion passed unanimously.

Respectfully submitted by

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Lorenza M. Rascon
Committee Secretary