M E M O R A N D U M

TO: Zero Waste Advisory Commission Members

FROM: Ed Van Eenoo, Deputy Chief Financial Officer

DATE: April 8, 2016

SUBJECT: Austin Resource Recovery Budget and Financial Management

---

I am writing this memorandum in the hope of providing clarity on a number of issues pertaining to the budgetary and financial management of Austin Resource Recovery (ARR). It is my understanding that the Commission has requested in-depth financial and budgetary data from ARR and has expressed concerns about its financial management over the past several years and looking forward into the future. Below, I will outline the history of financial management measures taken in recent years with respect to ARR.

First, however, I would like to highlight the opportunities for the Commission to contribute to the City's budget process with respect to ARR. As you may know, City staff are currently engaged in preparing the annual five-year financial forecast for presentation to Council on April 27th. This forecast is meant to provide a broad first-look at the upcoming fiscal year, and sketch likely expenditure and revenue trends over the medium-term on both a City-wide and departmental level. As with all budget deliverables, ARR financial staff have submitted financial forecast data to my staff at the Budget Office, where it is thoroughly analyzed, vetted, and refined before it is presented to Council or other stakeholders. The same process applies during the development of the City Manager's Proposed Budget, where all ARR budgetary requests are evaluated by my staff before being considered for approval by City management. The Budget Office also provides robust financial oversight throughout the fiscal year, with an analyst assigned to tracking ARR's expenditure and revenue trends, reviewing performance trends, and maintaining regular communication with the department.

The Commission also has an opportunity to contribute its own oversight, expertise, and analysis to the development of ARR's budget. Because financial forecast data will not be finalized until only a few days before the April 27th presentation, it would be inappropriate for staff to release any such data to Boards and Commissions before it is received by the City Council. However, throughout May and June, financial staff from the corporate Budget Office and individual departments will be presenting information from the financial forecast to our Boards and Commissions and actively encouraging and soliciting their feedback. This feedback is then amalgamated by Budget staff and shared with City management to inform their decisions in crafting the final Budget proposal that will be presented to the City Council on July 27th.

It is my understanding that one particular item of concern for the Commission is the reduction of the ending balance of the ARR Fund from a peak of $24.3 million—representing 33.4% of annual expenditures—as of the end of fiscal year 2010-11, to its fiscal year 2015-16 budgeted level of $5.5 million, which represents 6.1% of budgeted expenditures. This reduction has been the consequence of a deliberate plan of action on the part of City financial staff, City management, and the City Council to balance three goals: first, to continue steps towards achieving our City's zero-waste goal by 2040; second, to pursue this goal while limiting the impact to ARR's ratepayers; and three, to comply with State law concerning fees charged by City departments that requires that these fees not exceed the City's cost of providing the services in question.

The Commission is undoubtedly familiar with the many steps taken by ARR in recent years to aggressively pursue the achievement of zero waste. The expansion of the recycling program, introduction of the 24-gallon trash cart, and implementation of an organics pilot program are some of the most prominent examples. Of course, all of these important measures do come at a cost. For instance, the 24-gallon cart has a lower fee than the others. The City thus incentivizes garbage reduction and increased recycling, but ARR experiences an incremental decrease in revenue whenever a customer downsizes. City Council has also provided consistent and unambiguous direction to City staff, particularly in recent years, that the affordability of City services for our tax- and ratepayers needs to be a paramount concern. Moreover, each year the City faces increases in our base cost drivers, particularly due to health insurance and Council-approved wage increases. The combination of the expansion of services and incentives necessary to achieve zero waste and the upward pressure on expenditures as a result of base cost drivers is necessarily in tension with the City's desire to ensure the affordability of its services.

To help ameliorate this tension, financial staff, with Council's guidance and assent, made the decision to gradually reduce the ARR Fund's ending balance in order to offset what would otherwise have been far larger rate increases for ARR's customers. More specifically, from fiscal year 2010-11, when the ARR Fund's ending balance peaked, through fiscal year 2013-14, year in which the ending balance reached its lowest point, the City raised ARR's base rates only one time, by $0.75, introduced the lower-cost 24-gallon cart, and increased other cart fees only slightly. A customer who began this period using a 32-gallon cart and switched to a 24-gallon saw their monthly payment decline by $0.15. The 'typical' ARR customer using a 64-gallon cart saw an increase over this period of only $1 per month, representing an annual compound growth rate of only 1.7%. Limiting growth in fees to such a moderate rate would not have been possible without the drawdown in the ARR Fund's reserves. Beginning in fiscal year 2014-15, as a result of the drawdown of the ending balance, the continuing expansion of services, and the impact of cost drivers, the City was forced to increase ARR's rates more aggressively to achieve structural balance. For instance, whereas the fiscal year 2013-14 budget anticipated ARR's expenditures to exceed its revenue by $8.3 million, in fiscal year 2014-15 this budgeted imbalance was reduced to $1.5 million, and in the current fiscal year it was further reduced to a budgeted $1.2 million.

The second-most salient factor contributing to the status of ARR's revenue and its Fund balance is a comprehensive and ongoing City-wide effort to ensure compliance with State law requiring that the fee charged for a service not exceed a municipality's cost of providing that service. As part of this comprehensive effort, in 2012 City budget staff worked in concert with ARR financial staff to conduct a thorough review of ARR's services and fees and to develop a model for accurately tying these fees to the

Department's cost to provide specific services. The most significant result of this review was the need to reduce the commercial base rate from its fiscal year 2011-12 level of $20 to $9.50 in fiscal year 2012-13. On the other hand, it was also found that the commercial rate for ARR's portion of the Clean Community Fee should be increased from $4.50 to $6.80 in order to fully recover the cost of services specifically provided to the business community. Corporate Budget staff work each year with ARR financial staff to reevaluate this cost-of-service model, ensuring that it reflects any realignment of ARR service delivery and is updated with current budgetary data. Once properly vetted and updated, staff use the model to generate the rates that would achieve full cost recovery for the Department. As noted above, City policy over the past several years was to limit increases in these rates to a level below full cost recovery, relying on a drawdown in Fund balance in order to mitigate the impact to ratepayers as the department expanded services and incentivized behavior aimed at achieving zero waste.

In addition to the periodic maintenance and review of ARR's cost-of-service model, and the ongoing oversight and monitoring provided ARR by our corporate Financial Services department, the City management is intensifying its commitment to improving the efficiency of ARR's service delivery through the use of the newly created Office of Performance Management (OPM). Launched this winter, this Office will oversee the City's performance measurement process, and just as importantly, it will conduct targeted, in-depth reviews of a limited number of City departments each year. The Office of Performance Management has already been scheduled to conduct its comprehensive review of ARR's operations, performance, budget, and financial management in advance of the fiscal year 2017-18 budget process. Data compilation for this effort will begin in October 2016. Conducting such reviews is an extremely resource-intensive effort, on the part of both OPM staff and the staff of the department being reviewed. Despite not being fully staffed, OPM is nonetheless currently engaged in the review of three City departments (Public Works, Fleet Services, and Austin Code) and it simply is not feasible given existing resources for them to launch a review of a fourth department in conjunction with the FY 2017 budget process. I share the Commission's belief that ARR would benefit from a comprehensive analysis of its goals and performance targets, its efficiency in terms of achieving these goals and targets, and its financial stewardship. This is the exact purpose for which the City Manager created this new, independent unit and is why the ARR has been scheduled to be reviewed as part of OPM's next review cycle.

cc: Marc Ott, City Manager
Deputy City Manager
Assistant City Managers
Chief Financial Officer