LAWRENCE BOARD OF REALTORS®
3838 W. SIXTH STREET / LAWRENCE, KANSAS 66049

August 17, 2012

Lawrence City Commission
P.O. Box 708
Lawrence, KS 66044

Subject: Comments on the Proposed Enterprise Fund Transfer Policy

Dear Mayor Schumm and Members of the City Commission,

In 2011, the City Manager's office released a proposed policy governing the transfer of funds from the city's enterprise funds to the city general fund. Over the last decade, the city has transferred an extremely large amount of funds from each of the enterprise funds into the city general fund each year in order to provide revenue for the city's basic operations and to "offset the costs" of providing services to those enterprise funds, even though no policy had been adopted to govern those transfers.

Prior to the issuance of the proposed policy, the Lawrence City Auditor had issued a report that was critical of the city due to the lack of a policy governing the transfers and the comparatively high amount of transfers in the City of Lawrence compared to 15 peer communities. Despite the warnings provided in the City Auditor's report, the City Commission has taken no action and no further discussion has taken place on the proposed policy since 2011.

Although the City Commission has still not taken any action to adopt a policy governing the transfer of enterprise funds to the city general fund, the City Commission approved a city budget for 2013 on first reading that contains a near-record amount of transfers from the enterprise funds to the city general fund. In our opinion, the continuance of enterprise fund transfers at a near-record level without the prior adoption of a policy governing the transfers is an example of extremely poor public policy and now is the time for the City Commission to finally adopt a policy governing the enterprise fund transfers.

At this time, the city is struggling to identify adequate funding for much-needed capital improvement projects to lay the groundwork for future population growth and economic development in our community. Accordingly, the Lawrence Board of REALTORS® strongly believes that the City Commission should carefully study this issue and adopt a policy governing the enterprise fund transfers to restore accountability and transparency to this process.

Background Information on the Enterprise Fund Transfers

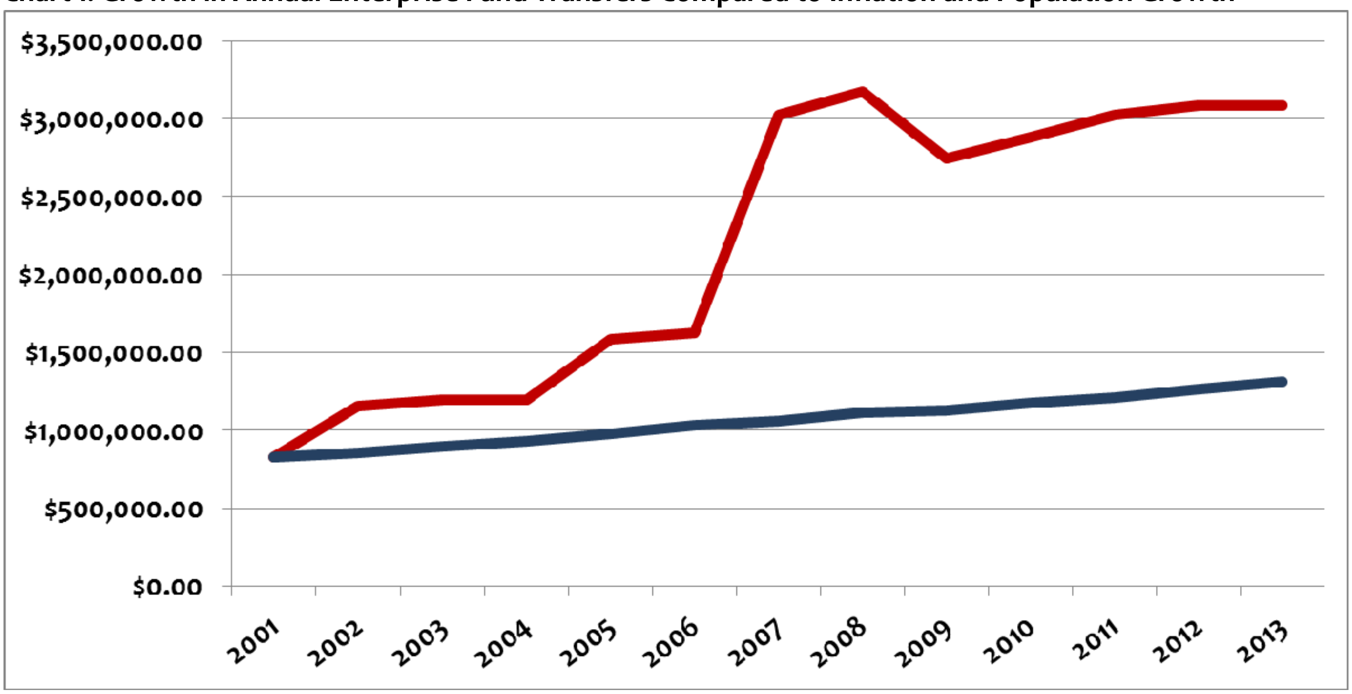
As you can see in Table 1 on the following page, the city has transferred a total of roughly $28.6 million (or an average of $2.2 million per year) from the enterprise funds to the city general fund from 2001 through 2013. The amount of this annual transfer has varied from a low of approximately $830,450 in 2001 to a high of roughly $3.1 million in recent years. This transfer has increased nearly every year with an average annual increase of 13.39%, median annual increase of 4.32% and a total increase of an astounding 271.5% from 2001 to 2013.

If the amount of the transfer from the enterprise funds had only increased each year by the amount of inflation plus population growth since 2001 (which is the standard measure for stable increases in local government funding sources), then the total amount of transfers over the same time period would have only increased 58.2% and totaled $13.8 million. This would have freed up approximately $14.82 million in these funds that could have been used for utility rate reductions or spending on capital improvement projects.

Table 1. Annual Transfers from Enterprise Funds from 2001 through 2013

Year	Amount of the Transfer	Annual Change in the Transfer	Amount Adjusted for Inflation and Population Growth	Difference
2001	$830,450.00	N/A	$830,450.00	N/A
2002	$1,156,150.00	39.22%	$858,353.12	$297,796.88
2003	$1,200,000.00	3.79%	$896,549.83	$303,450.17
2004	$1,195,000.00	-0.42%	$931,604.93	$263,395.07
2005	$1,588,525.00	32.93%	$981,632.12	$606,892.88
2006	$1,628,662.00	2.53%	$1,032,676.99	$595,985.01
2007	$3,025,600.00	85.77%	$1,063,657.30	$1,961,942.70
2008	$3,176,880.00	5.00%	$1,116,095.60	$2,060,784.40
2009	$2,744,858.00	-13.60%	$1,125,359.20	$1,619,498.80
2010	$2,882,103.00	5.00%	$1,174,987.54	$1,707,115.46
2011	$3,021,849.00	4.85%	$1,210,119.66	$1,811,729.34
2012	$3,084,896.00	2.09%	$1,264,454.04	$1,820,441.96
Budget 2013	$3,084,896.00	0.00%	$1,313,767.74	$1,771,128.26
Totals:	**$28,619,869.00**		**$13,799,708.06**	**$14,820,160.94**

Chart 1. Growth in Annual Enterprise Fund Transfers Compared to Inflation and Population Growth



Although the City Commission has recently slowed the exponential growth of the enterprise fund transfers by holding the annual transfers roughly even in 2012 and the proposed 2013 city budget, the Lawrence Board of REALTORS® continues to be concerned that there is no policy governing the transfer or use of the transferred funds in the city general fund. If the transferred funds are being used for purposes that do not directly relate to the development of additional water, waste water, solid waste and storm water capacity to meet future growth and economic development demands, then this artificially inflates the cost of these city services for Lawrence businesses and residents and neglects the community's infrastructure needs.

Analysis of the Proposed Enterprise Fund Transfer Policy

In 2011, the City Manager's office drafted a memorandum explaining the rationale for the proposed enterprise fund transfer policy, which is included on the agenda for the City Commission meeting. In attempting to create a rationale for the past and future enterprise fund transfers, the City Manager's office has essentially stated that the overriding purpose behind the transfers is two-fold: (1) to reimburse the city for the actual and reasonable costs associated with providing services to the public utilities; and (2) to provide an arbitrary and fixed amount of annual revenue from the enterprise funds through a percentage-based levy on the public utilities' gross receipts and fair market value of the public utilities' assets.

First, the City Manager's office has stated in the memorandum that the transfers are intended to reimburse the city for the reasonable cost of the actual services provided to the publicly-owned utilities by other city departments funded through the city general fund. According to the proposed policy, these overhead support services include accounts payable, budgeting, human resources, information systems, legal, payroll, purchasing, risk management and various additional services provided by other city departments to the utilities.

If these overhead support services were not provided to the utilities by other city departments, then ostensibly the utilities would be required to either hire additional employees to provide these services (in an arguably less cost-effective manner) or contract with third-party providers at an additional cost to obtain similar services. As a result, the Lawrence Board of REALTORS® absolutely and wholeheartedly agrees that that the enterprise funds should reimburse the city for the reasonable cost of the actual services provided to the publicly-owned utilities by other city departments funded through the city general fund.

In addition, LBOR absolutely believes that the city should be allowed to reimburse itself for the actual and reasonable cost of providing other direct services to the utilities funded by the enterprise funds. Among others that may be identified by the City Manager's office, this includes the reasonable cost for providing the following services:

(1) planning, platting and development and site plan review services for easements, rights-of-way and other utility-related issues by the Planning Department; and
(2) construction, reconstruction and repair of city sidewalks and streets prompted by the extension of utility service to new areas or disruption to existing city infrastructure prompted by the need for the utilities to construct, reconstruct or repair utility infrastructure by the Public Works Department.

Again, LBOR believes the city should be allowed to reimburse itself for the actual and reasonable cost of providing these direct services to the utilities funded by the enterprise funds. This is an example of good public policy and ensures that the utilities are paying the actual and reasonable cost of those direct services provided by city departments funded through city general fund.

Following a meeting with the City Manager's office on this issue in late 2011, LBOR is under the impression that the cost of these other direct services from the Planning Department and the Public Works Department were not incorporated into the calculation of "services provided" in the memorandum prepared by the City Manager's office explaining the proposed transfer policy. If the cost of these services had been included in this calculation, LBOR acknowledges that the costs of these other direct services may be significant.

However, we strongly believe that the City Manager's office should be asked to include this calculation in the policy rather than relying on the alternative justifications for the transfers discussed in more detail below, which are not examples of good public policy. Unfortunately, I am not aware of any attempts by the City Manager's office to actually calculate or supply the information related to the cost of these other services as requested during the meeting in late 2011.

If in the fact the amount of the annual transfer is based upon the actual cost of providing services to the public utilities funded through the enterprise funds from other city departments funded through the general fund, then we would question whether the costs of those services actually increased by 85.77% in 2007 when the annual enterprise fund transfer increased from roughly $1.63 million to $3.03 million. In our opinion, either the city had been drastically undercharging the enterprise funds for the costs associated with these services in previous years or the enterprise funds were found to be a valuable revenue source to fund increased expenditures in the city general fund without having to resort to an increase in property taxes.

Second, the City Manager's office has stated in the memorandum that the transfers are intended to be made in lieu of the property taxes and franchise fees (which are essentially a "tax" under the case law) that would normally be paid if the publicly-owned utilities were instead privately-owned utilities such as cable television, electric, natural gas or telephone utilities. However, LBOR does not support the notion that the publicly-owned utilities funded by the enterprise funds should be required to pay property taxes and franchise fees like privately-owned utilities, since this would be a nonsensical "tax" paid by one city department to another.

In LBOR's opinion, the city's publicly-owned utilities have been created and maintained to provide a valuable public service to the citizens, businesses and organizations located within the City of Lawrence. In contrast, privately-owned utilities are created and operated to generate a profit for private owners or shareholders. Every public service provided by a city department funded through the city general fund or a publicly-owned utility funded through an enterprise fund provides an important service that makes up the fabric and foundation of the community. Accordingly, each service is indistinguishable to the other and one public service should not be required by the city to pay a "tax" to the general fund to support other city services.

The rationale for the proposed PILOT payment is that privately-owned utilities pay property taxes based on the value of their capital assets and that publicly-owned utilities should make a similar payment since both entities benefit from the city's public safety, parks and recreation, economic development, planning and development services and other city functions. However, water, waste water, solid waste and storm water services provided by the publicly-owned utilities also provide an extremely valuable service back to the city's public safety, parks and recreation, economic development, planning and development services and other city functions.

For example, it would be extremely difficult to effectively carry out economic development efforts unless the city could assure potential developers and employers that the water, waste water and storm water services could be provided to the development or facility at a cost-effective price. In addition, it would be impossible for the Lawrence Fire Department to provide fire protection if the department did not have access to the water provided by the public utility. Again, every public service is indistinguishable and interdependent to each other.

Although the proposed policy is silent on the issue, the county and school district could also make an argument that they would be entitled to a PILOT payment under this proposal since they ostensibly also provide public benefits to customers served by the public utilities. This potential is not addressed in the policy or the attached memorandum and neither document provides an estimate on the potential cost of these PILOT payments to other local governmental entities, which could be extremely significant in a worst-case scenario.

In addition, the City Manager has proposed that each publicly-owned utility would be required to pay the city a franchise fee each year for the value of the city's right-of-way used by the utility to service its customers. The rationale for using this method is that privately-owned utilities pay an annual 5% fee of their gross receipts (which is legally considered a "tax" instead of a "fee") and that publicly-owned utilities should pay the same fee.

However, the city would like to levy a much higher 7% tax on the gross receipts of the public utilities discussed in this policy because they allege that their infrastructure is even more cost-intensive due to the fact that their lines run mostly under streets and sidewalks, which are much more difficult and expensive to maintain or replace in the event of problems with the underlying pipes. Essentially, the city will be taxing itself by requiring publicly-owned utilities to make the same (or higher) franchise tax payments to the city as privately-owned utilities.

Again, LBOR believes that the city's publicly-owned utilities have been created and maintained to provide a valuable public service to the citizens, businesses and organizations residing within the City of Lawrence. In contrast, they are not privately-owned utilities created and operated to generate a profit for private owners or shareholders. Accordingly, LBOR believes it is extremely poor public policy for the city to essentially tax itself by levying a tax on the operation of the city's publicly-owned utilities.

If the amount of the transferred funds under the proposed policy are intended to offset the cost of the city's public works department to "repair damage done to city streets by water and sewer repair" by the public utilities, then we question whether an annual flat fee amount based on a percentage of the gross receipts of the utilities is the appropriate measurement for the amount of the transfer. In the alternative, LBOR would assert that a more fair and reasonable method for calculating the amount of the annual enterprise fund transfer would be to base the amount of the transfer on the actual or anticipated costs of providing services from other city departments to the public utilities funded through the enterprise funds.

For example, the City of Lawrence has adopted a long-term capital improvement plan that establishes a regular schedule of capital improvement projects for the public utilities along with other city departments. In addition, the city should have an adequate amount of historical data on hand on water main failures and other repairs to our water and waste water infrastructure to estimate roughly how many repair projects will occur in a given year.

Using the long-term capital improvement plan and the historical data on repairs, LBOR strongly believes that city staff should be able to estimate on an annual basis the approximate costs associated with providing services to the public utilities funded through the enterprise funds from other city departments funded through the city general fund. This is a much for accountable, fair, reasonable and transparent method for establishing the amount of the annual enterprise fund transfers rather than an arbitrary and fixed payment based on a percentage of the gross receipts and fair market value of the assets of the public utilities.

At any rate, LBOR strongly believes that something must be done to change the status quo (which is essentially to do nothing and to continue to approve the transfers without the adoption of a formal policy) and restrict the future growth of the enterprise fund transfers through increased accountability and transparency. If nothing is done, then we believe that the amount of annual enterprise fund transfers will continue to grow at an exponential pace and the utilities will lose vitally important revenue that could be used to address the long-term growth needs of the community.

In conclusion, LBOR would urge the City Commission to adopt a policy governing enterprise fund transfers that would allow the city to transfer funds from the enterprise funds to the city general fund to reimburse the city for the actual and reasonable cost of providing overhead support and other direct services from other city departments funded through the city general fund to the publicly-owned utilities funded by the enterprise funds. In doing so, the Commission will promote accountability and transparency in both the establishment of utility rates and the use of the transferred funds within the general city budget.

Sincerely,

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