

## Executive Summary

In early 2004, Shelby County Mayor AC Wharton, Jr. and the Shelby County Board of Commissioners elected to undertake the first ever Five-Year Strategic Plan and Efficiency Study for Shelby County Government. In so doing, Mayor Wharton and the Commission agreed to take a hard look at the financial realities within the County and to project forward in a way that would ensure lean government, progressive policy, and overall stability. The result is a roadmap of sorts that identifies opportunities to streamline government, diversify revenue sources, and implement progressive policy that will restore and maintain fiscal health.

### Background

Shelby County has many strengths, including a diverse population and economy, recreational and cultural amenities that support a high quality of life, excellent transportation, large amounts of attractive developable land, a tradition of prudent management that yields excellent credit ratings, including a AA+ from Standard & Poor's – a rating higher than Standard & Poor's AA rating for the State of Tennessee.

Despite its strengths, the County is wrestling with serious financial pressures. It is not alone. Local and state governments in Tennessee and throughout the country are struggling from years of sluggish economic growth and accelerating spending. According to a 2003 survey by the University of Georgia for the National Association of Counties, to which 715 counties responded, including 263 in the South, 72 percent of counties were facing budget shortfalls. The most recent National League of Cities survey of municipal finance officers indicated that 83 percent of officials expected that their cities would be less able to meet financial needs in 2004 than in the prior year. The National Governor's Association described FY2004 as the worst financial crisis since the Second World War; the National Conference of State Legislatures, the National Association of State Budget Officers, the Center on Budget & Policy Priorities, and the Kaiser Commission on Medicaid and the Uninsured are among many expressing concern about the financial condition of state and local governments in FY2005.

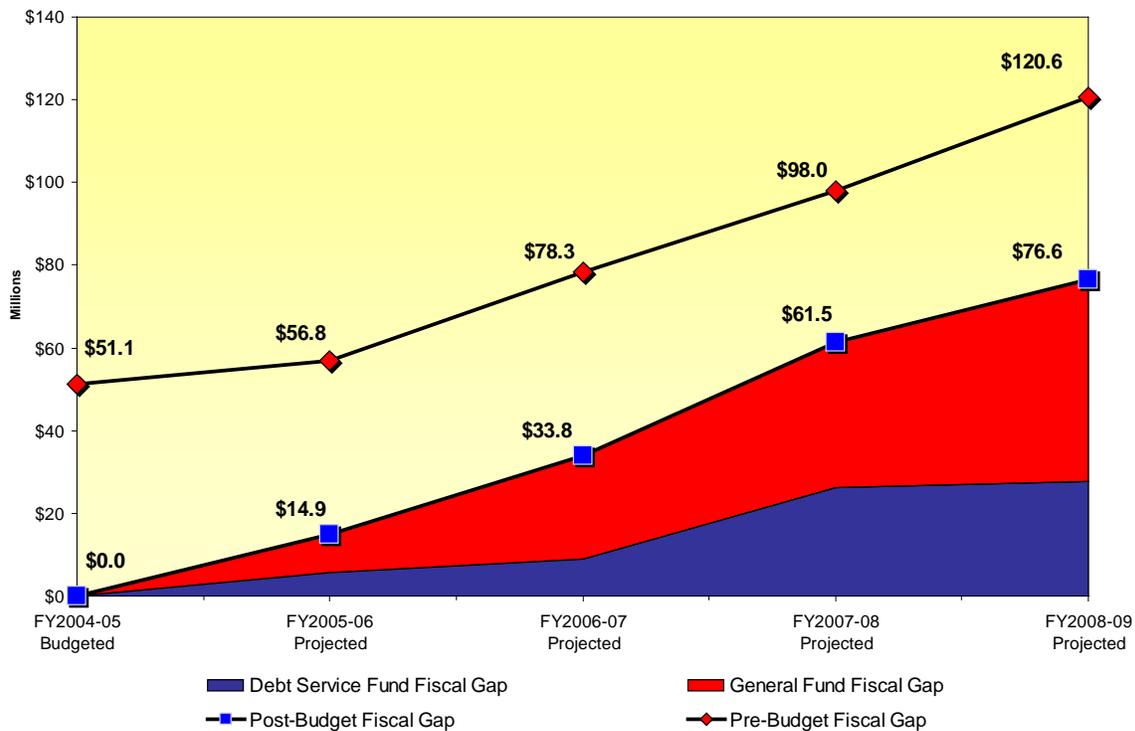
In late 2003, the Wharton Administration, in consultation with the County Commission, started for the first time a *Program Based Budget* approach to developing the County's FY2004-05 Budget. Instead of accepting the structure and services of County divisions and departments as they were before, and making adjustments based upon percentage increases or decreases, the County identified program components of its operating division's services, accompanied by associated costs. This information helped the County's elected officials weigh the resources that should be directed to each program, or if a given program should be continued at all.

Using these initial Program Based Budget submissions as a baseline, the County engaged professional counsel to begin formal development of the *Five-Year Strategic Financial & Management Plan* ("Five-Year Strategic Plan" or "Five-Year Plan"),

supported by the Debt Reduction Resolution adopted in the Summer of 2004 by the County Commission.<sup>1</sup>

During the first phase of the Five-Year Strategic Plan, the Administration identified the gap each year from FY2004-05 through FY2008-09 between the County's recurring revenues for existing programs and its recurring expenses. The assumption in this initial gap analysis was based upon existing tax rates and fee levels in the General Fund and the Debt Service Fund, and the continuation of current trends without corrective action. Assuming these trends<sup>2</sup> – this fiscal gap would have climbed from \$51.1 million in FY2004-05, to \$120.6 million in FY2008-09, totaling \$405.1 million over five years.

### Projected Fiscal Gap: Before & After FY2004-05 Budget



Resolved to overcome this gap, County Government identified savings and revenue initiatives to balance the FY2004-05 Budget, fund \$129.7 million in General Obligation debt as part of its FY2004-05 capital program for schools and other improvements, and augment employee wages by 2.0 percent. In so doing, the County eliminated the fiscal

<sup>1</sup> The production of the Five-Year Plan has been overseen by a Steering Committee chaired by the Mayor and including representatives of the Sheriff, Board of Commissioners, Juvenile Court, and senior executive staff. Scores of interviews with County managers and staff have supported financial and operations analyses and initiative development. Briefings have been provided to representatives of the County's community of businesses and foundations.

<sup>2</sup> Trends referenced include the County's maintenance of moderate wage increases for its employees (3 percent a year), reasonable capital investment in schools and other infrastructure (\$129.7 million in FY2004-05, declining to \$77.4 million in FY2008-09), and fund balance reserves appropriate for a county with such high-quality credit ratings.

gap for FY2004-05 without raising the property tax rate by focusing instead on savings. The County eliminated about 100 vacant full-time positions. It eliminated programs, parks maintenance, Showplace Arena, and the Rifle Range. It reduced funding to libraries, The Med, and Election Commission funding. Additional positions were eliminated in Archives, Human Resources, Soil Conservation, and the Divorce Referee. As discussed below, the County eliminated or reduced funding, positions, and facilities associated with services that could be more appropriately provided by municipal governments or non-profit or for-profit organizations. County employees were asked to contribute an additional \$1.5 million in premiums to offset a portion of increased health insurance costs.

These reductions, \$6.7 million in new cost recovery initiatives, and other adjustments amounted to savings of over \$50.0 million in FY2004-05, accumulating to \$214.3 million over five years, or 52.9% of the cumulative gap originally projected.

Looking to the future, it is expected that revenues will grow at an average of about 1.0 percent. General Fund expenditures are projected to climb at an average rate of 4.5 percent, while Debt Service growth is expected to grow at 5.8 percent a year. These rates of spending increases are hardly out of control, particularly in light of national trends in health benefit costs, employee retirement costs, and the County's school funding responsibilities. But expected growth in spending without additional corrective action is well above inflation, and higher than expected revenue growth. Clearly, revenues need to be boosted, and expenditure increases need to be contained.

### **Addressing the County's Challenges**

Although the County's initial steps are moving in the right direction, much more work is required to restore County Government to stable financial health. Eliminating the remaining fiscal gap in the final years of the Five-Year Strategic Plan requires squarely addressing the embedded structural challenges still facing the County, recasting the scope of its services, its revenue base, and elements of its organization, while continuing to find greater efficiencies.

- **One challenge has been the broad scope of the Shelby County Government's services.** Trying to be many things to many people, the County over the course of many years has layered on service responsibilities that are either more appropriate to a municipal government, or that non-profit or for-profit organizations could provide. Program by program, the County is considering how to refocus its resources to be a "wholesale" provider of core County services (e.g., Jail, Courts, Schools, Health, Roads, Bridges). For "retail-municipal" services typically provided by municipalities, the County is either getting out of the business altogether (e.g., Showplace Arena, parks maintenance, the Rifle Range, Oakville Nursing Facility) or sharply reducing funding (e.g., Shelby Farms, Libraries), devolving these responsibilities to municipalities, non-profit or for-profit organizations. For other types of "retail-municipal" service that the County Government will continue to provide to specific areas instead of the County as a whole – such as Patrol Services

by the Sheriff or ambulance services in unincorporated areas – the County will consider new approaches to fully recovering these costs in those areas that benefit from them.

- **A second challenge is the fragmented nature of the County Government.** Shelby County Government has seven separately elected officials in its Executive Branch, including the Mayor, Sheriff, Register of Deeds, County Clerk, Assessor, Trustee, and District Attorney General. There are five elected clerks and 40 elected judges. While the 13 members of the County Board of Commissioners approve respective budgets, thereby exercising central oversight, fragmented administration among the Executive, Clerk, and Judiciary does not lend itself to efficiency. Fragmentation leads to duplication. Fragmentation is particularly evident in human resources, procurement, fleet management, grants management, information technology, use of telecommunications equipment, facility management, and other functions that support divisions that provide service directly to the public. Multiple standards, information technology platforms and collection and other administrative methodologies place a drag on efficiency.

The Five-Year Plan reflects the County's commitment to honor the Constitutional provisions for separately-elected offices, while working to consolidate and otherwise make more efficient the administrative operations that serve each elected official. The County is already making certain inroads on improving coordination among its Courts, Clerks, and Executive Branch through the Criminal Justice Coordinating Council. The Circuit Court and the Chancery Court have put in place a shared Court Management Computer System that provides the functionality for Court employees to process and track filing, comments, decisions, sentencing and billing of a case. The Five-Year Plan calls for building on this progress, considering either the establishment of a single Justice System Administrator appointed by the County's elected justices and clerks to take responsibility for justice system administration on a consolidated basis, or outright integration of support services with those administered by the County's General Government.

As administrative "silos" are removed, however, they must be replaced by integrated systems and support services that themselves are improved sufficiently in their effectiveness and responsiveness to be trusted by each official. The Five-Year Plan calls for joint committees of elected officials to develop in concert revised human resources, information technology, and procurement policies, performance standards, and functions. The County also will seek opportunities to consolidate information technology (IT) and telecommunications, Archives and the Office of the Register, as well as complementary functions associated with Public Works Plan Review, Inspections, and planning and economic development functions.

Supported by consolidation, technology, more flexible job classification, and related productivity initiatives, the County will aim to reduce via attrition the number of civilian full-time employees in the General Fund by 1.5 percent a year in FY2005-06, and 2.0 percent a year during the remaining three years of the Plan. After five

years, the total General Fund full-time employee positions should decline from the present level of 4,299 to 4,165. The estimated \$8.2 million in accumulated savings generated by these reductions will contribute to the County's ability to afford to provide competitive wages and benefits to its remaining employees, without resorting to across-the-board layoffs.

For certain support functions that should stay within the County Government's purview, the County will consider applying managed competition to maintain or improve service delivery at reduced cost. Examples of such services include facility maintenance, printing, mail services, and material control.

Initiatives to refine the scope of County Government and overcome the effects of fragmentation identified through the FY2004-05 Budget and Five-Year Plan's development should produce at least \$48.6 million in savings and cost containment over the next five years, with more anticipated once other fragmentation-reducing initiatives are close enough to implementation to quantify.

- **Another challenge is efficiency. There are important indications that the County Government provides services cost-effectively, but there are opportunities to do even better.** Shelby County's excellent credit ratings and level of tax burden per capita do not suggest bloated, wasteful government. When combined County and City property tax burden per person for non-school government services is considered, for example, Shelby County residents supported a levy in FY2003 of \$599 per capita, lower than the \$680 shouldered in Nashville-Davidson, \$721 in Knox County, and \$784 in Hamilton County – an indication of a relatively efficient government. When school spending is added to account for the fact that nearly one in five Shelby County residents are enrolled in public schools (far higher than the other counties), combined County-City property tax payments per person in Shelby County (\$1,099) are still in line with that of Nashville-Davidson (\$1,030) and Hamilton (\$1,068), while well above only Knox County (\$941).

It is true that property tax rates in Shelby County are higher than the three other counties, when Shelby County's higher school funding burden is factored in. But Shelby County's lower per capita assessed property values largely offset the higher rates. Subtract the school spending burden, which is driven by demographic factors discussed below, and the County Government's demand for taxation on each resident compares favorably to Tennessee's other large counties.

Property Tax Rates and Revenues				
	Shelby	Davidson	Knox	Hamilton
<b>Tax rates (1)</b>	<b>\$7.02</b>	<b>\$4.58</b>	<b>\$5.66</b>	<b>\$5.58</b>
<b>Total levy per capita</b>				
County	\$620	\$893	\$485	\$538
City	\$479	\$137	\$456	\$530
<b>Total</b>	<b>\$1,099</b>	<b>\$1,030</b>	<b>\$941</b>	<b>\$1,068</b>
<b>Levy per capita excluding schools</b>				
County	\$248	\$543	\$265	\$255
City	\$351	\$137	\$456	\$530
<b>Total</b>	<b>\$599</b>	<b>\$680</b>	<b>\$721</b>	<b>\$784</b>

This noted, the County can still squeeze out greater efficiencies. While the County either eliminated or reduced funding for certain services as its shifts from being a retail service provider to a wholesale one, much of the \$50 million in gap closing initiatives generated through the FY2004-05 Budget stemmed from reducing full-time positions, using temporary employees instead of full-time staff where appropriate, and taking other measures noted above to provide the same level of service more efficiently. The County will do more.

Moderate salary increases to keep pace with inflation will be accompanied by reduction in payouts of accumulated sick leave. Civilianization will be applied to security staffing at the Corrections Facility. Certain functions that benefit certain individuals or firms seeking County service, such as background check and permit processing tasks will be shed, or costs will be more fully recouped. Appropriate application of electronic monitoring as an alternative to incarceration, as has been done successfully in a number of other counties, will recover more costs and, in time, reduce Jail population and demand for Jail staffing.

For social services, the County will consider how case screening mechanisms already in place can be strengthened to make maximum use of external funding for eligible recipients, while Title I funding to offset local expenses for HIV/AIDS services will be pursued. The County will seek Federal approval to classify the health clinics it supports as Federally Qualified Health Clinics, thereby expanding Federal reimbursement for County costs associated with clinic services.

In addition to the savings generated through the FY2004-05 Budget, the Five-Year Plan process has identified initiatives that should yield at least \$18.6 million in savings and cost containment through FY2008-09. Millions more may be expected from other savings initiatives once they take sufficient shape to quantify.

- **A fourth challenge: the County can better recover costs** through fees for service that better reflect the level of resources required to pay for the service provided to particular entities or individuals, and rates charged for similar service in other

jurisdictions. Given the County's relatively limited number of revenue sources, cost recovery should be managed in a coordinated, systematic, and aggressive manner. The FY2004-05 Budget took an important step in this direction by expanding cost recovery for the cost of General Sessions Court litigation, misdemeanor fees, and Sheriff's ticket fees.

One initiative in this area undertaken as part of the Five-Year Plan's development, under the direction of Administration & Finance and a Compliance Officer working on behalf of the County Attorney, was the creation of a comprehensive schedule of County fees, fines, permits (herein referred to as "fees") for each of its operating Divisions. Rates and fiscal impacts for each fee were reviewed to the extent that information was available to determine if adjustments could be made to reflect inflation in costs since the rates were last established. A large, but – due to the fragmentation of the County's Government – by no means complete schedule of fees has been assembled. The County has found that adjustments to many fees can be made under its authority, while others require State approval before they can be increased. Combined, over \$10.6 million in costs over the course of the Plan could be recovered if the fee rates could be simply adjusted to match the Consumer Price Index since they were last adopted.

In light of precedents in fire services and school improvements, and to address issues related to services for incorporated areas, the County will consider the creation of a "Rural Services District" (RSD). Fulton County, GA (the home of Atlanta), which provides a range of typically urban services in unincorporated county areas (fire, police, economic development, parks and recreation) uses a concept similar to an RSD. These services are funded by fees and charges and by a separate property tax allocation for the special services district.

An RSD would serve several purposes. The costs of providing services unique to unincorporated areas would become more transparent. The County would be able to separately identify the costs and available revenue sources for the services. In turn, the County would be able to better match costs and revenues and determine service alternatives and relative efficiencies of providing the services.

The Five-Year Plan process has identified initiatives that should recover at least \$39.3 million of the County's costs in FY2005-06 through FY2008-09.

- **Another challenge is the County Government's revenue structure, which does not sufficiently capture the breadth of economic activity in the County,** requiring property tax payers to bear the lion's share of the load if new revenues are needed. Of the \$664.6 million in locally generated taxes in FY2005, \$583.8 million (87.8 percent) is to come from current and delinquent property taxes. The second largest source of local tax revenues, the Wheel Tax, generates only \$30.0 million, 4.5 percent.

The Five-Year Plan does not seek handouts from the State Treasury. But the Plan does call for the State Government to provide the County with the authority to put its own house in order through the establishment of a more diverse, stable revenue base that better captures the breadth of the County's economic activity. The County will consider seeking approval for the establishment of alternative revenue sources that might include an Occupational Privilege Tax, County Real Estate Transfer Fee, and an adequate Facilities Tax/Impact Fee. It is also considering taxes on beer, wine and spirits – a share of the burden of which can be exported to non-residents who enjoy the City's entertainment, cultural, and dining amenities.

- The final challenge stems from socioeconomic conditions that drive higher demand on County-supported services**, particularly when compared to Tennessee's three other most populous counties: Davidson, Knox, and Hamilton. Shelby County has a higher share of its total population living below the poverty level (16.0 percent) than the three other counties. Health indicators show higher live birth rates (16.1 per 1,000 population), infant mortality rates (13.5 per 1,000), and numbers of deaths due to heart disease (2.5 per 1,000) – all of which suggest greater need for public health services. Shelby County has higher overall crime rates (7,416 per 100,000 residents), as well as levels of more serious crimes than the three other counties. Nearly 20.0 percent of Shelby County residents are enrolled in public school, compared to 14.5 percent in Knox County, 14.3 percent in Hamilton County, and 13.4 percent in Nashville-Davidson County.<sup>3</sup>

Summary Statistics	County			
	Shelby	Nashville-Davidson	Knox	Hamilton
<b>Primary City</b>	Memphis	Metro govt.	Knoxville	Chattanooga
<b>Population characteristics</b>				
Population	906,178	569,842	392,995	309,510
Public school net enrollment	175,463	76,374	56,935	44,217
Public school net enrollment as a % of total population	19.4%	13.4%	14.5%	14.3%
<b>Wealth and income indicators</b>				
Percent of population below poverty level	16.0%	13.0%	12.6%	12.1%
<b>Crime statistics (per 100,000 in MSA)</b>				
Total offenses	7,416.4	5,984.3	4,249.0	6,372.9
<b>Health and healthcare indicators</b>				
Live birth rates (per 1000 population)	16.1	15.5	12.5	13.1
Infant mortality rate (per 1000 live births)	13.5	9.8	5.3	10.6
Deaths - heart disease (per 1000 population)	2.5	2.1	1.9	2.0

Note: Data sources are provided in the Revenue section of the Five-Year Plan.

In FY2004-05, Shelby County is budgeted to direct \$332.6 million of Property Tax, Wheel Tax, Sales Tax, and Payments In Lieu of Taxes to support School operations, as well as \$66.4 million in debt service for public education capital improvements. The

<sup>3</sup> The Plan's Revenue Chapter presents supporting data in greater detail. Crime statistics are per 100,000 in the Metropolitan Service Area.

larger proportion of the County's population requiring education services translates into greater spending pressures.

On the revenue side, Shelby County shows a consistently and significantly lower level of assessed property tax values than its closest comparable in Tennessee, Nashville-Davidson, both on a density basis (per square mile) and a per capita basis. Shelby County's commercial/industrial property value per capita is less than 60.0 percent of the ratio for Nashville-Davidson, for example, while residential value per capita is less than 85.0 percent found in Nashville-Davidson.

Given service pressures stemming from Shelby's socioeconomics, as well as underlying softness in assessed property values, it is remarkable that total County-City tax burden per capita is only slightly higher than in Nashville-Davidson.<sup>4</sup>

While a boost in property value and economic prosperity for impoverished residents will not happen in a day, work to achieve this cannot wait until tomorrow. Through its new City/County Office of Economic Development the County will play an expanded role in coordinating economic development efforts and bringing accountability to the process. The County and the City of Memphis are analyzing past approaches to Payments In Lieu Of Taxes ("PILOTs"), in light of their affect on tax generation, administration, and true impact on attracting and retaining business.

As part of the Smart Growth Initiative, the Office of Planning and Development is being reorganized, to ensure the maximum efficiency of the County's economic development programs. It will revise zoning codes and policies, appropriately staff and support the Industrial Development Board, promote air and water quality. The County is formulating a comprehensive Brownfields Program to encourage redevelopment of unused or underused properties. Partnership with the County's business community will be important. Economic development priorities will be reflected in the County's capital planning process, including investment in education.

Key to success will be focusing economic development priorities and tools in an integrated manner, overcoming tendencies toward fragmentation that have diffused effectiveness in other aspects of public sector management.

### **Closing the Fiscal Gap**

The fiscal gap is caused by two factors:

- Debt service requirements will continue to increase through 2015. By increasing revenue in FY2005-06 and again in FY2009-10 we can eliminate the debt service fiscal gap.
- General Fund expenditures increase 3.0 to 5.0 percent annually, due in part to inflationary type cost increases, while revenues increase by only about 1.0 percent.

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<sup>4</sup> In terms of return on investment, it is noteworthy that the City-County aggregate graduation rate in Shelby County is 68 percent, compared to that of Nashville-Davidson at 61 percent.

Significant growth of existing revenues requires economic development, which will take several years, or major tax reforms, which are unlikely. In the near term, the only solution is a combination of shrinking county government and establishing new revenue sources.

The initiatives with fiscal impacts identified in this plan, if fully implemented, can get us through the next two years. In FY2007-08 and thereafter, other initiatives, including those herein with fiscal impacts yet to be determined, will be necessary each year to close the fiscal gap.

The initiatives identified to close the fiscal gap through the FY2004-05 Budget and Five-Year Plan process may be summarized as described below and shown in the following table:

- 12.6 percent will be derived from initiatives associated with reducing the scope of County Government and County Government fragmentation;
- 34.9 percent stem from savings initiatives associated with other forms of efficiencies;
- Revenue-raising cost recovery initiatives account for 18.4 percent; and
- Revenue initiatives to expand and diversify the County's tax base could yield 25.4 percent of gap closure; and
- 8.7 percent stem from the effects of other adjustments made during the FY2004-05 Budget process.

Type	FY2004-05	FY2005-06	FY2006-07	FY2007-08	FY2008-09	Total Five-Year Impact	% of Total Impact
Scope of Government/ Overcoming Fragmentation	\$7,862,161	\$8,905,458	\$10,043,639	\$10,641,283	\$11,191,995	<b>\$48,644,536</b>	12.6%
Savings	20,515,971	27,302,739	31,441,563	23,761,651	31,600,391	<b>134,622,316</b>	34.9%
Cost Recovery	6,648,000	13,881,709	15,496,865	17,106,473	17,715,537	<b>70,848,584</b>	18.4%
Tax/ State Approved Revenue Options	0	19,000,000	26,250,000	26,250,000	26,250,000	<b>97,750,000</b>	25.4%
Other Adjustments	17,170,897	4,017,617	4,088,821	4,215,795	4,224,975	<b>33,718,105</b>	8.7%
<b>FY2005-06 TO FY2008-09 INITIATIVES - TOTAL IMPACT</b>	<b>\$52,197,029</b>	<b>\$73,107,523</b>	<b>\$87,320,888</b>	<b>\$81,975,201</b>	<b>\$90,982,899</b>	<b>\$385,583,541</b>	

Note: Figures include budgeted Initiatives as well as those outlined in the plan.

To close the gap in the out-years, the County must meet the continuing challenge to implement initiatives that have not yet been fully defined while accessing other state approved revenues.

The FY2004-05 Budget and Five-Year Plan initiatives reflect the County Government's commitment to putting its own fiscal house in order. Doing so will depend on the cooperation of the County's elected officials; it will also depend on additional authority from the State to diversify its own tax base. Virtually everyone with a stake in County Government will have to bear some measure of burden; but this burden will be much less than the long-term costs of lost economic competitiveness, quality of life, and credibility if the County relied on a steady diet of property tax rate increases, sweeping layoffs, service reductions, or one-time gimmicks to paper over its challenges.

It should be made clear that the County *will* balance its budget each year. Initiatives with fiscal impacts that are currently to be determined will continue to be developed and will be implemented. If these and other initiatives are not implemented, and alternative approaches do not materialize to replace them – if the County cannot achieve internal consensus and State support – the County will make the necessary adjustments to services, staffing, or other measures to achieve structural balance, however undesirable. With the proper level of cooperation and focus on results, the Five-Year Plan process will be a better way.

The Five-Year Plan is as much a process as a document. Projections will change. Some initiatives may work more effectively than expected, others less so. As such, the County will update the Plan in years ahead and establish systems to report on its implementation. In the final analysis, the Five-Year Plan will only be as strong as the will to make it happen.