
Recession Options for Finance Directors of Public Agencies –

It's not business as usual for the building department

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Our economy is in a period of contraction, and local governments are looking at decreased revenues for the next several years. Governments have to look at every program – its value and its delivery – in this economy. While some governments are looking at across the board cuts in the hopes of riding out this storm, many economists and managers do not believe that strategy will take an organization through the end of this current downturn.

Rising fixed costs and a prolonged economic slump are forcing local administrators and elected officials to make important policy decisions as they prioritize funding. The decisions will impact the future of programs, staff positions, and service levels.

The purpose of this paper is to provide you with information and resources about the current economic climate and discuss why privatization of services is an increasingly attractive and viable alternative to maintain service levels while cutting fixed costs. Further, this paper will discuss the role of finance directors in the privatization of services.

Less Able to Meet Fiscal Needs

According to the 2008 City Fiscal Conditions Survey conducted by the National League of Cities, municipalities have been significantly impacted by the economic downturn. Nearly two-thirds of city finance officers reported that their cities were less able to meet fiscal needs in 2008 than they were in 2007. Seven in ten report that overall economic conditions are either a major or moderate problem for their city.

In recent research published by the International City/County Manager's Association and the Alliance for Innovations, "This fiscal crisis is the first in the postwar period in which local, state and federal governments have reported shortfalls in all major revenues—sales, income tax and capital property—at the same time."¹

Most communities throughout the country are looking at significant revenue shortfalls this year and beyond. "We do think this may be a year when we see a drop in collections," said Paula Martin, business systems manager for the Gwinnett County, Georgia tax commissioner's office. "In our estimates, it takes about two years for economic change to have impact on collections. We think it may catch up with us this year."² In Arizona, Fifty-seven cities and towns reported an average 10 percent drop in tax revenue in 2008 because of the poor economy, according to a survey by the League of Arizona Cities and Towns. Those same local governments expect to see another 10 percent drop in 2009.³

Many economists predict the situation will be worse for local government finances in 2010 and beyond. The National League of Cities report further stated that "With national economic indicators pointing to continued struggles, the impacts of those economic conditions on local revenue sources, and the lag between declining economic conditions and local revenue impacts, all indications point to worsening city fiscal conditions in 2009 and 2010."⁴

¹ Miller, Gerald & Svara, James (January, 2009), *Navigating the Fiscal Crisis: Tested Strategies for Local Leaders*, A White Paper prepared for ICMA by the Alliance for Innovation (www.transformgov.org)

² Bennett, D.L. (April 13, 2009) *Could be a tough year for collecting taxes*. *Atlanta Journal-Constitution*

³ Source, *Phoenix Business Journal*, April 8, 2009

⁴ Hoene, Christopher W. & Pagano, Michael A. (September, 2008), *City Fiscal Conditions in 2008. Research Brief on America's Cities, Issue 2008-2*. Retrieved 3-31-09, from www.nlc.org, Washington, D.C.

Revenues Down, Expenses Up

While revenue sources fall, fixed costs continue to rise. The NLC report noted that city finance officers report employee-related costs for health care coverage, pensions, and wages have significant negative impacts on their ability to meet city needs. "Health care and pension costs, in particular, are increasing at a faster rate than city revenues. This reality is unlikely to change in the near future, placing added fiscal strain on city budgets."⁵ Pension plans have been hit hard recently, experiencing a 15.6% decrease in the value of their assets from 2007 to 2008.⁶ The impact of this loss will be felt over time, depending on how the market fairs.

In addition to the deterioration of revenue streams among all levels of government, it has become harder for local governments to borrow money. Reuters reported on March 31, 2009 that the trend is for investors to stay away from bigger deals. Banks are less willing to put their capital at risk by underwriting new munis, which is one reason deal size is getting smaller, said Evan Rourke, a New York-based portfolio manager with Eaton Vance. "My guess is over time underwriting fees will widen out because there are less people willing to do it, it's simply supply and demand." The impact this will have on Tax Anticipation Notes is unclear at this time.

Borrowing from surplus or rainy day funds might be a short-term solution. In Seattle, Mayor Greg Nickels said he'll tap 45 million in the city's rainy day fund, eliminate 59 positions and will look for more cuts to make up for a looming \$43 million budget gap.⁷

Impact on Local Building Departments

According to the US Department of Labor February 2009 Employment Situation Summary, the construction industry lost 104,000 jobs in February 2009 alone. Employment in the industry has fallen by 1.1 million since peaking in January 2007.

Two-fifths of that decline occurred over the last 4 months. Employment fell sharply in both the residential and nonresidential components of the industry in February.

The U.S. Census Bureau of the Department of Commerce reported that construction spending during February 2009 was estimated at a seasonally adjusted annual rate of \$967.5 billion, 0.9 percent below the revised January estimate of \$967.2 billion. The February figure is 10 percent below the February 2008 estimate of \$1,075.3 billion.⁸

Construction activity has always been cyclical. Current economic conditions are adjusting to the credit and bank crisis, and this has been and will continue to be painful for local builders and building departments.

What are your permit numbers?

⁵ Hoene, Christopher W. & Pagano, Michael A. (September, 2008), *City Fiscal Conditions in 2008. Research Brief on America's Cities, Issue 2008-2*. Retrieved 3-31-09, from www.nlc.org, Washington, D.C.

⁶ Miller, Gerald & Svara, James (January, 2009), *Navigating the Fiscal Crisis: Tested Strategies for Local Leaders, A White Paper prepared for ICMA by the Alliance for Innovation* (www.transformgov.org)

⁷ *Seattle mayor makes budget cuts, will cut more jobs*, Puget Sound Business Journal, April 17, 2009.

⁸ U.S. Census Bureau News, U.S. Department of Commerce, April 1, 2009.

Certainly finance directors understand the indicators better than anyone. The outlook for the nation's cities in the next several years include a number of specific concerns related to building departments:

- Increasing employee-related costs, such as healthcare coverage, pensions and wages—all in a climate of decreasing revenues
- Declining property values, both for existing housing and new construction estimates.
- Lack of availability of credit for new construction activity
- Continue decline of revenue from building fees, use taxes and impact fees
- Fee schedules based on previous activity levels
- Use of reserves to support day-to-day operations
- Emotional and financial cost of layoffs due to a lack of activity

Is There Any Good News?

Strong organizations and their leaders are using this crisis as a stimulus to reinvent the status quo. For local governments, it's an opportunity to take proactive efforts aimed to create longer-term effectiveness, efficiency, and stability. It can be an opportunity for solutions that do more than just "weather the storm."

A Possible Solution—Public-Private Partnerships

Time and again, privatization has been shown to be a fiscally prudent choice for delivery of a myriad of public services. The current economic climate has only made the privatization consideration more urgent.

Public-private partnerships offer a way to avoid excessive fixed expenses. By freeing funds otherwise spent on fixed expenses, the organization can become more resilient and has the flexibility to adapt to existing conditions. This further allows for more innovations and focus on continuous improvement in other areas of the organization.

According to the National Council for Public-Private Partnerships (NCPP), government revenues during slow periods of growth are frequently not sufficient to meet spending demands, necessitating painful spending cuts or tax increases. "Partnerships can provide a continued or improved level of service, at reduced costs," said a statement by the NCPP. ". By developing partnerships with private-sector entities, governments can maintain quality services despite budget limitations."

In Colorado, a conservative estimate indicates that 35% of Colorado municipalities engage, in varying degrees, in a public-private partnership for building department services.

The Building Department and Outsourcing

The building department is a good place to outsource for several reasons:

- Staffing - Expenses in the building department are primarily staff related – so shifts in workloads and revenue can leave the department either underworked or stretched thin
- Reporting - Building codes are a highly regulated function based on strict standards (the International Code Council [ICC] and state code councils establish the standards). There are clearly defined performance measures associated with these standards (certifications, plan review turn around time, inspection response time) that are easily reported
- Fee-for-Service - There is a clearly defined revenue stream to pay for the service. Many local governments outsource solid waste for this same reason. It is a service that has a definable revenue stream, with private companies being able to gain efficiencies of scale by spreading resources.

In-house or contracted, building departments follow the same strict standards

The Building Department – 101 Staffing

Managing the revenue and expenses of a building department is a challenge because construction is cyclical. When activity is cyclical, so are the staffing needs. Depending on the type of construction, often a fully-staffed building department lacks specific certification or unique experience to handle all projects efficiently and effectively. Building Department costs are incurred long after the revenue is received—creating a potential negative cash flow situation. In other words, the building department is either too slow or too fast to maintain a continuous level of service with consistent revenue and corresponding expenses.

One option worth considering is staffing the building department for the base level of permit activity and outsourcing the remainder of the work, resulting in a department that is capable of ensuring high customer service levels through both slowing and ramping economic cycles. Turning over the entire building department to a private partner is also an option.

With either option, a strong public-private partnership will:

1. Decrease your fixed costs.
2. Provide a depth of professional experience and resources that you might not otherwise have in-house.
3. Cover the expenses of staff, benefits, vehicles and insurance.
4. Maintain customer service levels because staff support can be shifted as needed.
5. Reinforce public safety goals through community education and providing only certified staff.

Why is Managing the Building Department a Fiscal Challenge?

- Construction is cyclical
- Staffing level needs fluctuate
- Technical expertise needs fluctuates
- Costs are incurred long after the revenue is received
- Staff is mobile, incurring more associated vehicle and insurance costs

Reporting

Many municipalities include building department revenue and expenses in the general fund, which may make it difficult to determine the true cost of the building department. Employee benefits, such as health insurance, are often recorded in the HR fund, and capital outlays, such as vehicles, may be lumped in with other departments. Other commonly overlooked in-house costs include interest and pensions.

Outsourcing, on the other hand, provides a very clear method for determining the cost of the building department. The Finance Officer would not have to be concerned with expenses recorded in different funds, allowing him or her to provide council members with timely, accurate reports on the performance and cost of the building department.

The budgeting process becomes much easier and more accurate. No longer do employees have to be hired and released as the work ebbs and flows. No longer will costs need to be covered with or without an offsetting revenue stream.

Fee-for-Service

While there are a number of privatization methods that municipalities may consider, including load shedding, managed competition, management contracts, vouchers, long-term leases and others, revenue-driven outsourcing provides the financial certainty finance officers are seeking in these volatile economic times.

Revenue-driven contracts, which pay for services based on a percentage of fees collected, is a no-risk source of revenue.

% of fee billing, costs will never exceed revenues

The City of Milton, which outsources building

department services on a revenue-driven basis, is happy with its decision. "It's a really nice way to control resources and save money, especially right now," said Milton's Finance Director. "It's a no-lose proposition. Typically with a revenue-driven service, you can't go wrong."

The Finance Officer's Role in Privatization

The Government Financial Officers Association (GFOA) recommends that finance officers assume a lead role in seeking out and assessing privatization initiatives. Finance officers are also urged to assemble the team that establishes the privatization criteria, chooses the vendor-partner and monitors performance.⁹

"The finance officer should play a central, functional role in considering the feasibility of long-term privatization," said the report.

Moreover, the GFOA recommends that finance officers take the lead in assessing the financial strength and viability of all potential private partners and, once a service has been privatized, clearly communicate the financial results—positive or negative—to elected officials and community members.

"The City of Milton (Georgia) relies on a great deal of privatization," said Milton's Finance Manager. "All our city services are contracted out. For our citizens to be able to receive the quality services they receive and not have to pay government workers full-time when we don't need them full-time is very beneficial."

⁹ <http://www.gfoa.org/downloads/privatizationCEDCPDEBT.pdf>

Milton's Finance Director also noted that finance directors are increasingly concerned about costs and the possible financial benefits of privatization. "When you look at the full, actual costs of providing services in-house for any given department—including salaries, benefits, retirement as well as IT support, HR assistance, rent or building costs, etc., you quickly realize how extremely expensive it can be to operate that department."

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Before joining SAFEbuilt, Jon held positions as City Manager, Chief Administrative Officer and Budget Analyst in various cities and counties in Georgia. As Director of Regional Operations, he oversees SAFEbuilt's Southeast Region, including supervision of field offices, new office implementation and performance tracking.

"As a former city manager, I'm aware of the difficulty associated with creating, funding and maintaining a solid building department. I am also sensitive to every community's need for oversight and accountability with outsourced services. I am most proud of the fact that we at SAFEbuilt provide communities with reporting tools that allow decision-makers to quickly and easily determine the quality and effectiveness of our performance."

Privatization Considerations

According to the white paper entitled "Privatization of Municipal Services: A Guide for City Officials," published by the Georgia Municipal Association, municipalities considering privatizing a public service should consider the following:

1. What is the city's responsibility for providing municipal services?
2. Why should the city privatize a service?
3. Can the city reduce its present costs through privatization?
4. Can a private contractor deliver services at lower costs than the public sector and make a profit?
5. If the city privatizes a service, will the city lose control of its operation?
6. What privatization options are available?
7. What legal considerations should the city examine?
8. Will privatization cause labor problems?
9. Can the private provider guarantee performance and/or compliance?
10. What if the city is not happy with the agreement?

For more information about outsourced building department services, please visit www.safebuilt.com or call Scott Martin at 1-866-977-4111, ext 206, or email him at Scott.Martin@SAFEbuilt.com. SAFEbuilt is a leader in the building and safety services industry and has public-private partnership with nearly 100 public agencies nationally. The name SAFEbuilt describes the organization's purpose—to provide a safe-built environment for partner communities that simultaneously delivering economic benefits and reducing risk and liability. SAFEbuilt does this by providing full-service building department programs, building code plan reviews, complete project support and building code inspections.