

A Whitepaper

# **Fayetteville – Past, Present and Options for the Future**

An Economic Development Conundrum



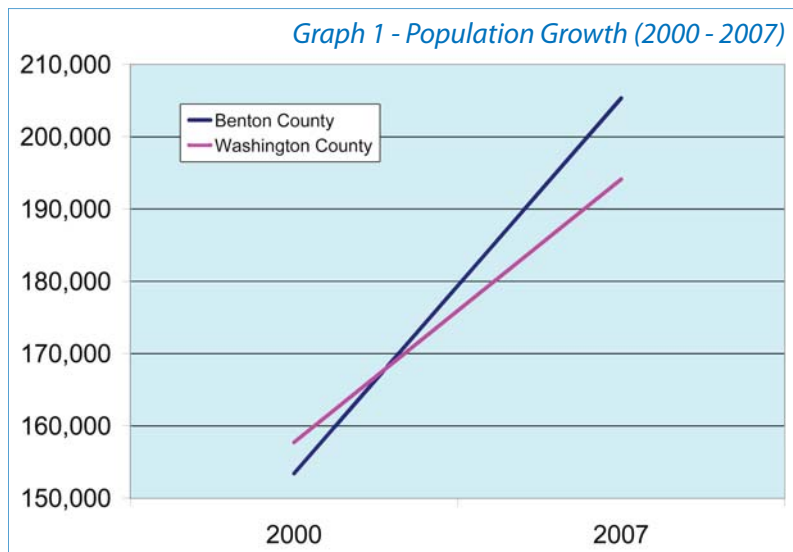
February 2008

### Summary

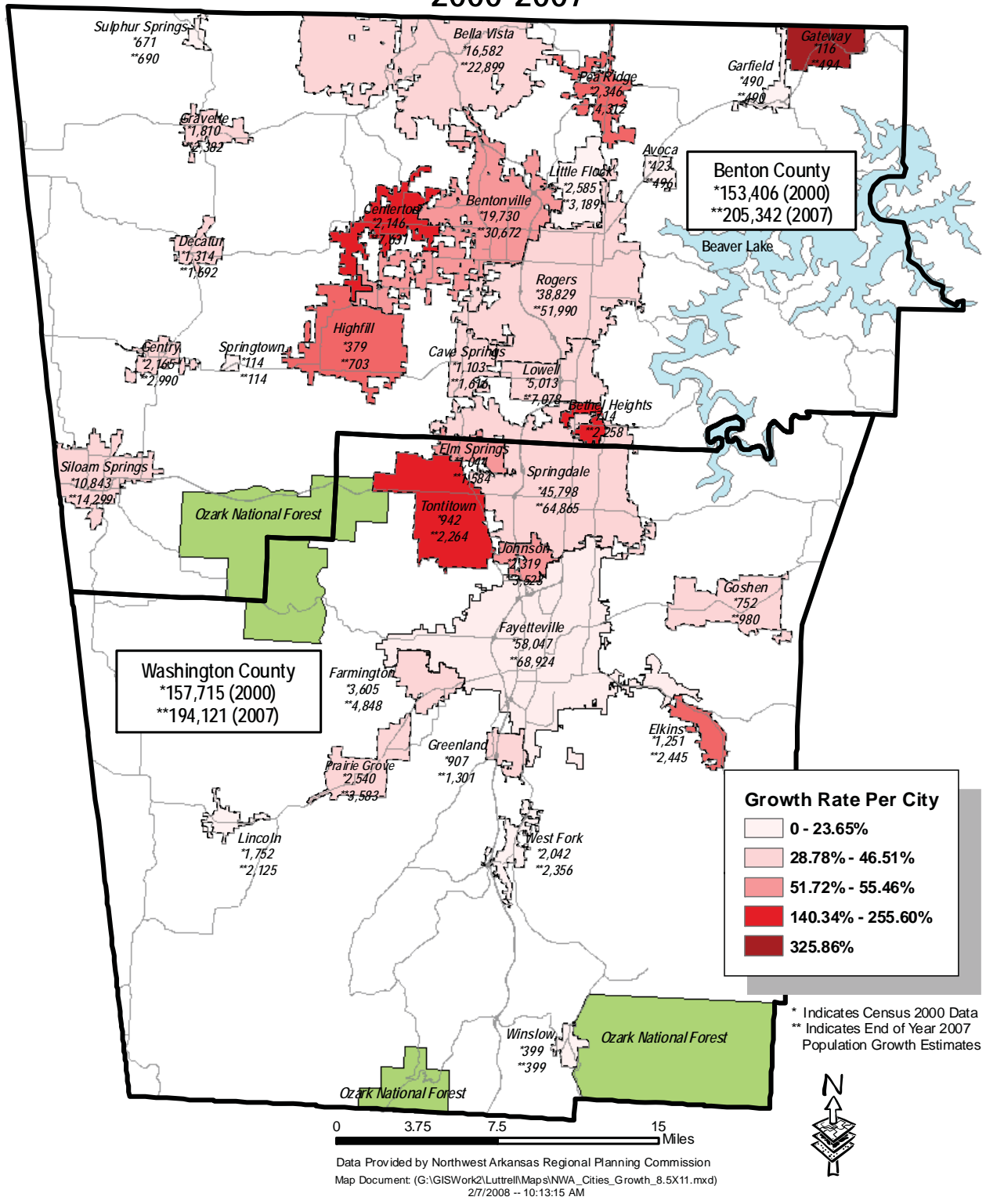
Fayetteville is the historic retail, cultural, and entertainment hub for Northwest Arkansas. Fayetteville, similar to most Arkansas cities, derives its primary revenue for municipal general fund operations from the local option sales tax. From the late 1990's through 2006, the City's sales tax revenue grew at an average rate of 6%. This revenue funded the increasing costs of government as well as new fire stations, new fire apparatus, new public safety personnel, effective street overlay, sidewalk and trail construction programs with related personnel, a veterinarian, an urban forester, as well as open and green space acquisition. Sustained growth in annual revenues funded all of the quality of life programs and activities that make and keep Fayetteville unique and separate it from its neighbors. In 2007, sales tax revenue decreased to approximately 2.3% below 2006 collections, and Fayetteville lost its dominance as the retail hub of the region. Without the creation and execution of a strategy for fiscal sustainability, funding may no longer be available for the expansion or even continuation of some of those quality of life programs and activities that make and keep Fayetteville unique and continue to separate it from its neighbors. The City is at a tipping point. Will Fayetteville guide change and chart its own fiscal future or will Fayetteville respond piecemeal confronting one fiscal crisis, only to be confronted by the next?

### Background

The University of Arkansas is developing into a premiere education and research institution, and as the chief economic engine in the community it remains the primary catalyst for growth of population, retail options, entertainment, and new business start-ups. Historically, other communities in the region did not have the population necessary to draw the investment of retail development to their communities. In the late 1990's that began to change as corporate investment in Benton County increased exponentially. This investment created significant job growth and population increases, which in turn brought retail investment and a challenge to the prior retail dominance of Fayetteville. From 2000 to 2007, the population of Benton County has grown from 153,406 to 205,232, a 34% increase. Washington County has grown from 157,715 to 194,121 during the same period for a 23% increase. The population growth in Benton County has generated the development of major regional retail options. Almost everyone has come to realize that the historic dominance of Fayetteville in the regional retail market has changed forever and that dominance will not return. The population of the region has expanded to a level that will support multiple major regional retail opportunities.



# Northwest Arkansas Growth 2000-2007



The City of Fayetteville, like all other Arkansas cities, derives its primary source of operating revenue for general government activities from sales tax. For Fayetteville, the primary source of general operating revenue comes from the one cent sales tax collected by the County and the one cent collected by the City. Fayetteville receives 36.8% of the County Sales Tax Collection. The Fayetteville penny has been split between capital and operations based upon the Council's direction. In 2007 that split was 50-50; for 2008 the split will be 60% for operations and 40% for capital projects.

During 2007, the Fayetteville portion of the Washington County sales tax generated approximately \$10,960,000. The City of Fayetteville penny sales tax generated approximately \$15,320,000 which was split between capital activities (\$7,660,000) and operations (\$7,660,000) of the general government. This sales tax collection is the result of approximately \$3 billion of taxable economic activity within Washington County with approximately \$1.5 billion of that activity occurring within Fayetteville.

Both City and County sales tax collections were down in budget year 2007 by a total of \$613,882 or 2.3% below the 2006 collections; unlike 1996 through 2006 when the City's sales tax collection grew by approximately 6% per year. Negative sales tax growth placed the City of Fayetteville in a significant budget predicament in 2007. There was a budget shortfall of approximately \$1.3 million for the 2007 fiscal year, which forced the use of cash reserves to fund expenses.

Of Fayetteville's \$35 million General Fund Operating Budget for 2008, \$21 million or 60% is derived from sales tax collections. This is by far the largest source of funds for the general operations of the City. For the 2008 budget, sales tax is not projected to rebound to the level of growth experienced in 2006 and earlier. An option was proposed for 2008 to fund this shortfall by diversifying the City's revenue stream by increasing the property tax millage. This option did not gain support and cost-cutting measures were implemented to accommodate the reduced revenue while striving to maintain essential services.

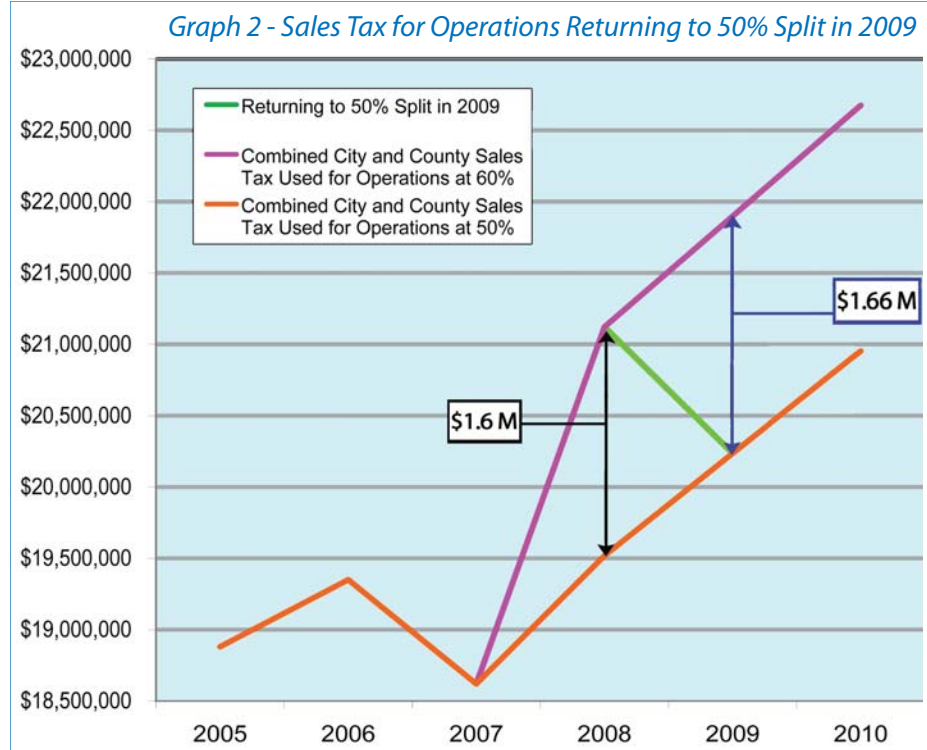
It was clear during this discussion that the adjustment made for 2008 will not be fiscally sustainable, and that for 2009 and beyond, other economic, financial, and service level decisions will be unavoidable.

### *Discussion*

The Fayetteville community has come to expect quality services: Police, Fire, Parks, Recreation, Trails, Animal Services, Tree Preservation, and Hillside Preservation to name a few. Some of the services currently provided are well beyond what other Arkansas cities are providing simply because of the cost of those services. The City of Fayetteville has been able to provide these services due to the historic growth of the sales tax revenue driven by population growth, shoppers from outside of our City, and the construction industry together with the ancillary purchases that accompany the buying of a new home. This historic level of sales tax growth will not continue under the current situation.

## FAYETTEVILLE - PAST, PRESENT AND OPTIONS FOR THE FUTURE

**Graph 2 – Sales Tax for Operations Returning to 50% Split in 2009** depicts forecasted sales tax changes through 2010. In 2006 sales tax receipts began to decrease during the last two months of the year. That slide continued throughout 2007. The 2007 sales tax receipts were below those of 2006. For 2008 sales tax collection is budgeted for 2% above the 2007 collection. This is slightly less than the 2006 collections.



Given the reduced Fayetteville retail market share, an annual growth rate for sales tax collections of less than the historic trend is projected to continue for the next several years. The Center for Business and Economic Research (CBER) prepared a statistical estimate (See Attached Report) of the most likely annual sales tax collections through 2017. The CBER estimate of 3.3% average annual growth is felt to be very optimistic in the near term, but even using this growth rate, income will not keep pace with the normal growth of expenses including:

- normal salary growth (no new hires and no COLA) of approximately 3%;
- normal inflation on all other expenses (except fuel and insurance) of 3.5%;
- fuel and insurance increases based upon discussions with suppliers and vendors.

Prior to 2008, the City's one cent sales tax was split evenly between capital projects and operational uses such as Public Safety. During the 2008 budget discussion, in order to increase operational funds, the utilization of the City one cent sales tax was modified from a 50-50 split to 60-40; meaning that 60% of the receipts generated from the penny were utilized for general government operations, primarily public safety. If the change in the split had not occurred, an additional budget shortfall of approximately \$1.6 million would have occurred. Additionally, to accommodate the reduced revenue, Public Safety positions were held open in 2008 within both Police and Fire Departments. This produced a saving of \$75,835. Also, the COLA of 3.5% or \$960,000 was not granted to employees. This, along with other budget cuts, resulted in a budget reduction of approximately \$1.9 million in the 2008 budget.

*Footnote:* The 2008 budget is built around 2% growth.

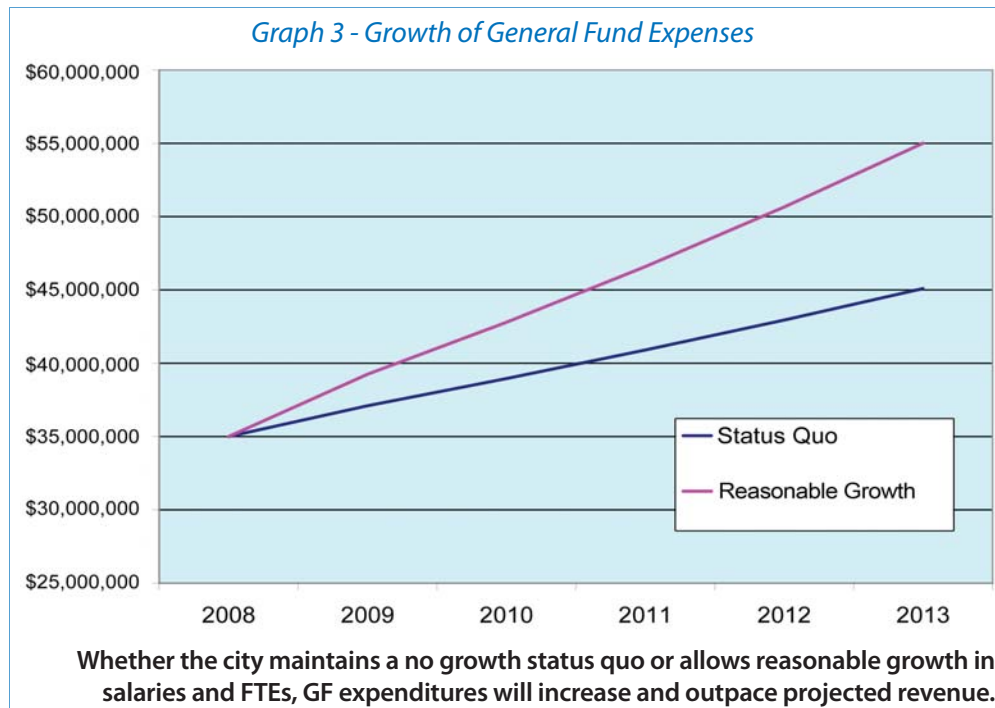
## FAYETTEVILLE - PAST, PRESENT AND OPTIONS FOR THE FUTURE

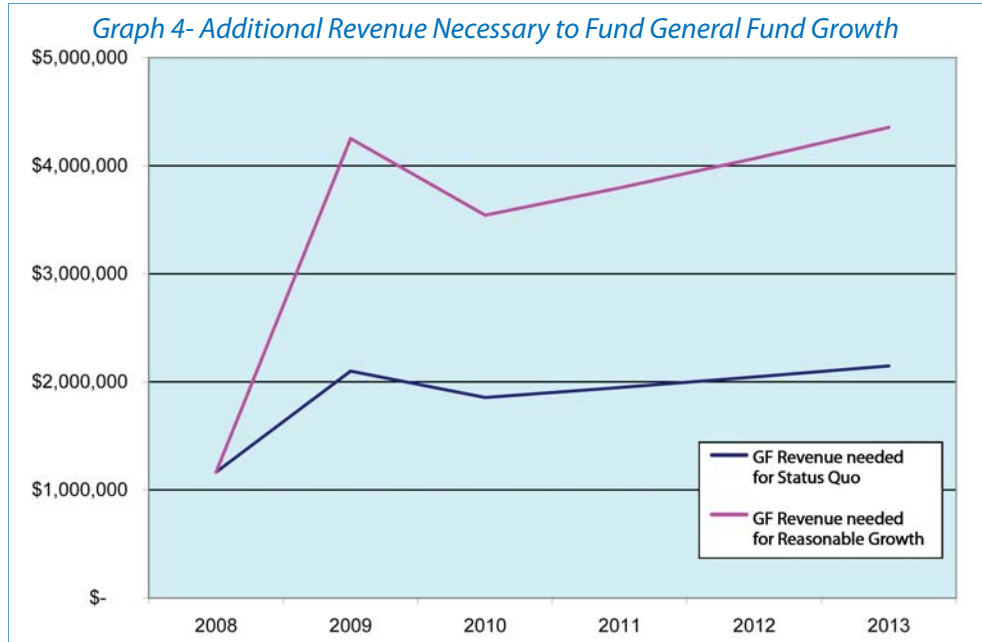
This 2008 reduction will need to be made up in subsequent years. The community is continuing to demand quality services. The Public Safety employee reductions will need to be reversed, and additional staff in Public Safety and other General Fund programs may be necessary in 2009. Additionally, the deferred COLA will need to be made up to keep the City's pay structure in line with the regional market, or employee turn-over and the associated costs will increase. Either the City will continue to provide the current number and level of services with annually increasing expenses, or the City will eliminate services and reduce the municipal workforce.

There has been discussion at the City Council level that the 50-50 split might be returned for the 2009 budget. If this occurs, the revenue available for the operations of the general government will be reduced by \$885,685, after factoring an increase of 3.7% in sales tax collections (from the CBER Study) and will worsen a deteriorating revenue situation for general government. As **Graph 3 - Growth of General Fund Expenses** indicates, with no changes other than normal salary progression, inflation, and fuel and insurance increases, the general fund expenses are projected to increase by 6% or approximately \$2,000,000 for 2009.

This budget projection labeled "Status Quo," does not account for returning the Public Safety positions held open in 2008 (\$75,835), nor the 2008 COLA (\$960,000), nor the 2009 COLA (\$1.05 million), nor does it account for any additional personnel in Public Safety, Planning, Engineering, or any other General Fund Program.

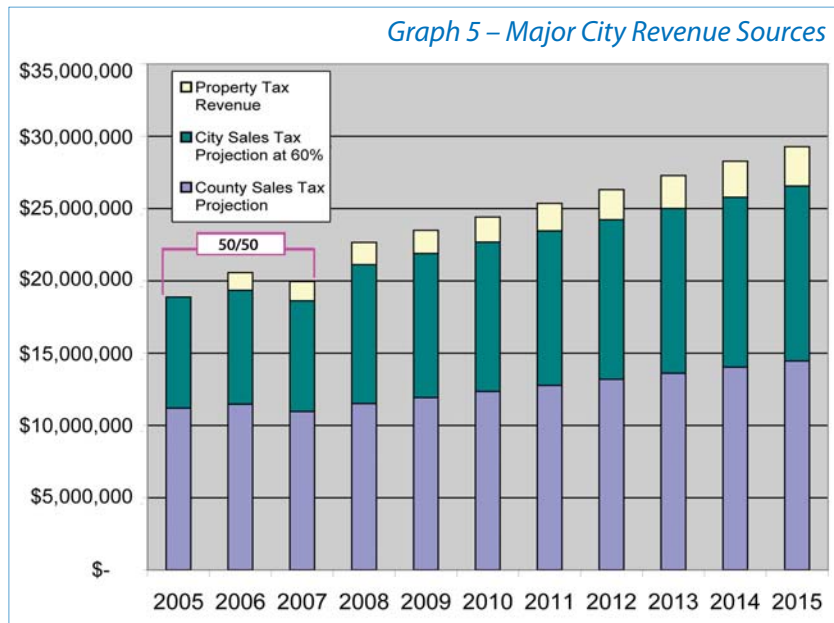
The "Reasonable Growth" line on Graph 3 indicates the impact on the General Fund of allowing a COLA in 2009, making up the 2008 COLA, and allowing a reasonable expansion of the number of FTE's within the General Fund. These costs are estimated to be approximately \$4.2 million. This FTE growth is virtually inevitable in 2009 because of the 2008 structured personnel reductions in Public Safety.





**Graph 4- Additional Revenue Necessary to Fund General Fund Growth** depicts two choices: Status Quo (normal salary growth, no new hires, no COLA, normal inflation, and fuel and insurance increases) or Reasonable Growth (Status Quo plus COLA for 08 and 09 and a reasonable expansion of FTEs). Regardless of the choice, substantial revenue growth is required.

**Graph 5 – Major City Revenue Sources** illustrates the breakdown of revenue sources and the major dependence upon sales taxes.



Sales tax for 2008 is budgeted to grow at 2% above 2007 collection. The CBER data used within this report shows growth of approximately 3.3%. Based upon recent history this seems to be very optimistic but has been used as the baseline. The CBER sales tax growth rate for the County and City during 2009

will generate approximately an additional \$836,000 in total revenue, utilizing the 60-40 split and the City’s fractional share of the County sales tax.

A 60-40 split provides an annual growth in total revenue of \$836,000. By maintaining the status quo (no additional personnel, no additional public safety, and normal growth of expenses) we will face a shortfall of approximately \$1,164,000 in 2009.

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Basic maintenance of the status quo is not realistic even if we maintain a 60-40 split.

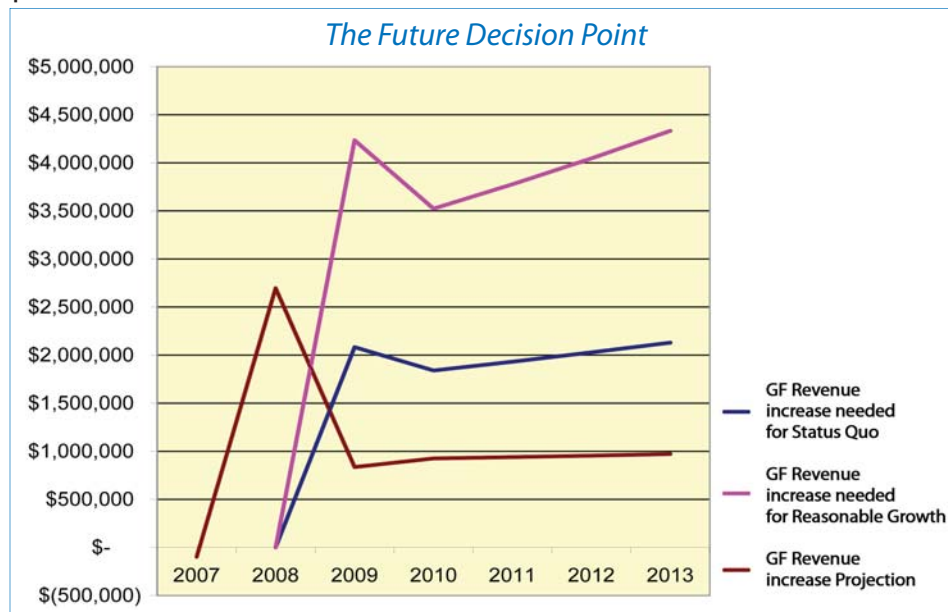
A millage increase of approximately 1.3 mils (raising operating millage to 2.6 mils) will be necessary to balance revenue and expenses and maintain the 2008 status quo through 2009, assuming we maintain the 60-40 split of sales tax collected.

If we do nothing and maintain status quo

- do not makeup the 2008 COLA,
- forego 2009 COLA,
- do not return Public Safety employees lost to structured personnel reductions in 2008 and
- do not allow any personnel growth to any other General Government program such as Planning or Engineering,

The additional 1.3 mils will be necessary to prevent service reductions and staff reductions. Additional service and personnel reductions will likely be necessary each following year or additional revenue will be required.

The status quo is not realistic.



2008 is a year in which the elected officials, the staff, and the public must come to realize that those basic services that everyone takes for granted are in jeopardy for the future. This City has an excellent Police Department, an effective and efficient Fire Department, an aggressive street and infrastructure maintenance program, a parks system that is the pride of the community, a community square and Dickson Street which are the icons of Fayetteville. If revenue can not maintain pace with expenses, a significant reduction in these and other services and personnel will be necessary.

2008 can be the year that Fayetteville begins a process that will allow the City to maintain its unique position in the State and region or it can be the year that Fayetteville becomes just another Arkansas city without the resources to provide the services and amenities that its citizens want and deserve.

## Where Do We Go?

In order to maintain the level of services currently being provided and to address the additional desires of the community, additional revenue streams must be developed.

In 2007, approximately \$3 billion of taxable spending occurred within Washington County with approximately \$1.532 billion of that activity occurring within Fayetteville.

With the population of Fayetteville estimated at 68,331, that means that the per capita purchase of taxable items was \$22,420. This per capita amount clearly indicates that Fayetteville enjoys the benefits of being a regional marketplace, but it also indicates that the building industry contributes a great deal to the Fayetteville economy. Some of the major construction/addition/alteration projects within Fayetteville during 2007 are below.

Underwood Plaza	\$13,000,000	Marshalltown	\$4,000,000
Washington Regional	\$11,000,000	Proctor & Gamble	\$3,000,000
Sam Club & Liquor	\$10,000,000	John Bradberry Bld	\$3,000,000
Staybridge Suites Hotel	\$9,000,000	WRMC Senior Center	\$3,000,000
WRMC Administrative	\$8,000,000	Ark 4 Retail Center	\$3,000,000
Commerce Park II	\$8,000,000	Nelson's Crossing	\$3,000,000
Malco Theatre	\$8,000,000	Shops at Steele Crossing	\$3,000,000
Biobased	\$7,000,000	Barber Retail Bldg	\$3,000,000
Mt. Comfort Church	\$6,000,000	Fayetteville Auto Sales	\$2,000,000
Metropolitan National Bank	\$6,000,000	Shogun Restaurant	\$2,000,000
Central United Methodist	\$5,000,000	Stadium Center	\$2,000,000
Proctor & Gamble	\$5,000,000	Clinton Retail Center	\$2,000,000
Washington Regional	\$5,000,000	Crossover Fire Station	\$1,000,000
Steele Plaza	\$5,000,000	Mason's	\$1,000,000
Candlewood Suites	\$5,000,000	Bassett Furniture	\$1,000,000
Value Place Hotel	\$5,000,000	Root Elementary School	\$1,000,000

Also, consider the various residential developments, both multi-family and single family, occurring within Fayetteville. Consider the home furnishing purchases, the labor and construction material, the sales tax and wages paid for the construction, and added property value. This development and growth in the community is an important, perhaps essential, contributor to the fiscal stability of the local government.

Building permit data for 2007 indicates that more than \$275 million in value has been added to the City through construction during the year. This will be assessed and added to the property tax roll and help grow the revenue from property taxes in subsequent years.

The property tax levy can be increased by the City Council to a total of 5 mils. This would diversify the City's revenue sources, but it could have a negative affect on many property owners. Additionally, even with the growth occurring within the corporate limits, this increase in property taxes will not sustain the community, as the \$275 million value added in 2007 will only bump up revenues by approximately \$71,500.

## A New Direction

It is clear that the long-term solution can not be completely resolved by increasing taxes. Fayetteville can not tax its way out of the current financial predicament. It also seems clear that the current level and type of services provided to the citizens should be maintained and even expanded as necessary. Fayetteville has a unique character and quality of life. The programs and services provided by the City are what help to preserve that uniqueness. If these programs and services are to be maintained, then the City's ability to generate revenue must be expanded.

What has propelled Fayetteville in its historic ability to fund unique programs and services has been growth. That growth has been within Fayetteville and within the region. The City has benefited greatly; recall how our sales tax is paying for the Wastewater System Improvement Project (WSIP) and Street Bond Program with the help of shoppers from outside of the City. Growth has helped to pay for not just these major infrastructure projects, but also for the on-going expense of the numerous quality of life services we provide.

As should be very clear from the discussion, without steady growth in revenue these programs which help create the unique Fayetteville and separate us from our neighbors would not have been affordable and will not be affordable in the future. Growth and development have funded the current Fayetteville.

We are in competition for economic growth and the tax dollars that it creates. The environment created by the Council, the Planning Commission, and others affects investment decisions. Gaining compliance with rules, regulations, ordinances, policies, and obtaining desired results is more than enforcement, it is attitude. Like the Police Officer enforcing the law, a well trained officer will leave most of his or her contacts feeling well treated (even when the contact is negative). An abusive officer can escalate a negative contact into an uncontrollable situation.

An exchange occurred recently during the Council Session concerning the East Square Development, the Renaissance Project. There were statements about partnerships and working together, and awareness and appreciation for the private investment that has occurred. These statements were positive and encouraging, while still communicating the City's desire for positive movement on the project. There have been other occasions when that positive re-enforcement did not occur, and some questioned the City's interest in the project. With the positive approach, the desire to create quality development was clear, and the tone set by Council was one that will encourage continued economic investment by the City.

Without economic growth and the resulting increase in sales tax and property tax, the unique programs and services provided by the City can not be continued into the future. Something must give; either expenses or revenue. Either we create an environment within our community which encourages investment or we run the risk of losing that which makes Fayetteville unique. As a community we need to begin to foster the relationship with those who wish to invest in Fayetteville. To date, Fayetteville's economic development has occurred with little direct support and no policy guidance from the City. That approach must change.

**Not all growth is good, but not all growth is bad either.** In order to know the difference however, a public discussion must occur which results in the creation of a public policy that defines how Fayetteville as a City wants to create and maintain fiscal sustainability.

During the past seven years the community has struggled with economic development and what it means for our city. The community had such a disjointed focus in 2002 that the Arkansas Department of Economic Development (ADED) told the City, Chamber of Commerce, and the University of Arkansas, that ADED did not know where to send potential contacts interested in growing their businesses within Fayetteville.

After the comments from ADED, the City Administration lead the discussion on how the private sector could create and fund the Fayetteville Economic Development Council (FEDC). The City is a full member of FEDC though not contributing financially to the organization. FEDC is now that single point of contact for those interested in investing in Fayetteville's future. What is problematic however is the lack of a clear policy direction set by the City Council for any organization trying to generate economic development in the city including city staff, FEDC, the Chamber of Commerce, and local businesses.

The City Administration, at the City Council's direction during the July 2007 Policy Planning Session, began a process to inform the Council and Public on economic development options and the impact of policy decisions on the fiscal well-being of the City. The result thus far has been three meetings, one with FEDC, one with the new Director of the Arkansas Economic Development Commission, and the most recent with the President of a local economic development agency from outside the region.

While there have been opportunities to begin a dialogue, serious discussion has yet to occur regarding the City's Economic Development Policy.

The purpose of these first forums was to provide an understanding of the level of commitment that is required of the elected body, the other community leaders, and the community in general to make and direct the change for the betterment of the community rather than allowing random change to guide the City.

Change will happen. Do we wish to guide it or will we react to it and be left to respond to fiscal crisis after fiscal crisis.

It is time to have that public policy discussion to create an Economic Development Strategic Plan so that we can guide the change and create a sustainable economic future for Fayetteville.

Some of the issues that will have to be addressed are:

- Legislative – Executive Relations,
- NIMBYism – No growth attitude,
- Funding for the City – Immediate and into the future,
- Maintaining the unique qualities and character of Fayetteville into the future

With a shared vision of the future, the community, the Chamber of Commerce, the Fayetteville Economic Development Council, the University, and the City Council can concentrate on the tasks at hand and move forward, focusing upon growing the economic base rather than increasing taxes.

Focusing on the past—what could have, should have, or might have been done —will not help the City move forward. It is time to look ahead.

### *How can we develop this Economic Strategic Plan and more importantly, how can we accomplish its objectives?*

Time is critical. Little can be accomplished this year which will have major impact upon 2008 or even perhaps 2009. If there is not a sense of urgency, nothing will occur, and the City will face not only a difficult 2009 but also a difficult 2010 and beyond.

The Administration has been developing a program through which the Council and the Public could define what actions we need to take immediately and how we can develop not just a plan for our future but also an action agenda which will help us achieve that future.

What is proposed is a short intense study period, perhaps 5 days, where we bring in experienced professionals in various fields, such as business development, planning, higher education, citizen advocacy, entrepreneurship, ecological economics, and elected officials, to lead discussions and listen to the public input. Based upon their combined experience, the public's input, and direction from Council, the group will suggest our next steps toward fiscal sustainability.

Some of the issues and topics that would likely be considered during the study are:

- Consider the current position of Fayetteville, its assets and opportunities, and its existing liabilities.
- Suggest a strategy for the city to leverage its intellectual assets and other available resources and encourage cluster development, prioritizing its short-term, midterm, and long-term planning and development efforts.
- Identify changes in current economic development programs and the process and approach to improve the quality and quantity of private investment.
- Analyze and assess public projects that might have the greatest potential in the near term.
- Identify effective structures to carry out the strategies identified.
- Suggest the panel's view of Fayetteville's market and role within the region.
- Comment on economic development options regarding the expansion of the existing industry clusters, health and financial services, education and tourism/arts. Identify measures to support those strategies.
- Comment upon potential improvements to our development review process.
- Comment upon changes to the City's organizational structure and hierarchy.
- Discuss how to balance economic development efforts between attracting new companies and retaining existing companies.

## FAYETTEVILLE - PAST, PRESENT AND OPTIONS FOR THE FUTURE

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The City of Fayetteville is at a tipping point with respect to its future, and everyone—public officials, business leaders, community organizations, and residents—must be involved in the choices. These choices must start with the commitment of community leaders to promote good government, engage its population, and achieve fiscal sustainability.

Some preconditions necessary for successful economic development to occur include the following:

- Effective local government support;
- A culture fostering local civic pride and corporate philanthropy;
- Sustained efforts to fight cynicism;
- Visionary developers;
- Regional cooperation;
- A strong focus on economic development; and
- Dedicated staff to initiate and sustain these efforts.

Community, business and civic leaders must come together to work out a common understanding of the role of City government in economic development planning and implementation. To thrive as a community and ensure that Fayetteville's efforts are enduring, the citizenry must insist that all community leaders step forward to identify, embrace, and opt into a plan to create a sustainable city.

Strong leadership is imperative to create long term, fiscal sustainability, and leadership must also support plans to create jobs, to encourage investment, and to promote high quality growth equitably across the whole city.

Government cannot be responsible for all things, however. Many more of its citizens must commit to stand up and help the City move forward.

Such improvement requires public/private partnerships that reflect the City's diversity. Going forward, business and neighborhood leaders must commit to engage positively toward the achievement of a well-defined plan for economic health.

Inclusivity is key to success.

Fayetteville has important decisions to make and now is the time to begin the discussion about Fayetteville's economic future.

**If there is City Council consensus to begin the policy discussion on creating an economic development strategy, the Administration will bring forward a plan in partnership with the University to implement that policy discussion immediately.**