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Report to Mayor and City Council

Tuesday, March 21, 2017

Discussion

SUBJECT:

FISCAL YEAR 2017-18 BUDGET WORKSHOP #1

I. SUMMARY

This is the first of 3 budget workshops scheduled for City Council study of the draft FY17-18 budget. The other 2 workshops are currently scheduled for April 18th and May 16th. Budget adoption is scheduled for June 6th.

The FY17-18 budget process began in January, with departments preparing 1st drafts of their proposed expenditure budgets. The purpose of this workshop is to obtain City Council policy direction before recommendations are finalized. A draft budget will be presented to City Council on April 18th.

The Budget Subcommittee of the City Council (Mayor Pro-Tem Davis-Holmes and Councilman Hicks) met on March 16th to provide recommendations for this report.

II. RECOMMENDATION

RECEIVE the recommendations made by the Council Budget Sub-Committee from their March 16th meeting and PROVIDE direction on development of the draft FY17-18 budget.

The Economic Uncertainties Reserve will drop from 20% of the General Fund to 14.6%.

(\$15.5 to \$11.3 million)

III. ALTERNATIVES

TAKE another action deemed appropriate by City Council.

IV. BACKGROUND

Deficit Budget

The City Council adopted the FY16-17 budget with a \$1.8 million deficit. Amendments have been made which increase that deficit to \$3.2 million.

As reported on March 7, 2017, with the close of the FY15-16 books the General Fund balance decreased by \$8 million; primarily due to recording the liability for the Colony Cove mobile home park rent control judgment. The City is appealing the judgment, and the liability may be reversed; which would increase the General Fund balance by \$7.5 million.

The FY16-17 Midyear Financial Report is on this same agenda. If the City Council approves the staff recommendations, the revised estimate of the General Fund Balance is \$12.8 million, calculated as follows.

Beginning Fund Balance	\$18,710,435
Estimated Revenue	76,906,298
Recommended Revised Appropriations	(79,303,099)
Recommended Revised Net Transfers	(3,480,472)
Estimated Ending Fund Balance	<u>\$12,833,162</u>

The preliminary look at the budget indicates the FY17-18 General Fund deficit may increase if changes are not made to the budget structure.

Pros for FY17-18 budget:

- Sales tax is estimated to increase 2.26% or \$547,000.
- The FY16-17 property tax and utility users' tax revenues decreased due to price decreases of oil and natural gas. Those commodities prices are rebounding. It is too soon to calculate the expected impact on the FY17-18 budget, but the outlook is positive.

Cons for FY17-18 budget:

- The FY16-17 budget includes a one-time \$1.4 million NFL settlement that completed the full reimbursement of the City's expenses related to the NFL proposal.
- The Sheriff contract is expected to increase by 3.782%. The Liability Trust Fund

contribution is expected to be a 10% surcharge on services (FY16-17 is 9.5%). The resulting estimated dollar increase is \$765,250 (calculation included in Exhibit A).

- The City will incur ongoing legal costs to appeal the Colony Cove judgment noted above. From July 2015 through February 2017, legal fees for this case have totaled \$767,416. The preliminary estimate for FY17-18 for the Colony Cove appeal is \$500,000.
- The City’s contribution for employee retirement (pension + retiree health) is expected to increase by approximately \$920,000.

The existing operating budget deficit is \$3,232,595, calculated as the FY16-17 net deficit of \$5,877,273, less one-time restricted money transfers of \$3,257,975, one-time NFL settlement of \$1,400,000, and appropriations continued from FY15-16 of \$786,703. If we add the expected annual pension increases and 3% annual increases for the Sheriff, we can reasonably expect the General Fund will be exhausted in 2019 unless actions are taken to balance the budget.

	FY17-18	FY18-19	FY19-20
Estimated Beginning Fund Balance	\$12,833,162	\$8,957,688	\$3,226,433
Current budget deficit	(3,232,595)	(4,640,724)	(6,296,552)
PERS Increases	(642,879)	(1,090,531)	(1,198,183)
Sheriff increases	(765,250)	(565,296)	(548,337)
Estimated Ending Fund Balance	\$8,957,688	\$3,226,433	\$(4,268,301)

Reserve for Economic Uncertainties

On January 18, 2012, the City Council adopted Resolution No. 12-014, establishing a Reserve for Economic Uncertainties equal to 20% of annual budgeted expenditures. Previous City Council discussions identified a target Reserve level of \$20 million. The resolution did not outline what conditions could trigger use of the Reserve, or how the City would replenish the Reserve if it was used. Staff recommends the City Council consider the following revisions.

The City may consider use of the Reserve for Economic Uncertainties when:

1. A Fiscal Emergency is declared; or
2. When there is a physical emergency that requires immediate significant City response (e.g. earthquake, terrorist attack, etc.); or
3. When there is a significant loss of a major tax revenue source (e.g. more than \$1 million loss).

The City Council would make appropriate findings, documenting any decision to use the Reserve for Economic Uncertainties.

The Reserve for Economic Uncertainties would be replenished from:

1. Future increases of General Fund revenue, without corresponding increases to

General Fund expenditure appropriations, until the 20% Reserve is made whole; or

2. City Council consideration of any year-end favorable budget variances; or
3. City Council consideration of one-time revenue sources (e.g. settlements).

The Budget Subcommittee supported a change to the Policy, to be discussed by City Council. Staff will prepare a subsequent resolution for any City Council changes to the current policy outlined in Resolution No. 12-014.

Recommended Changes to General Fund Set-Asides

If the City Council approves the recommendations with the Midyear Report, the General Fund set-asides will be adjusted by removing restricted monies from the General Fund balance; and the estimated Unassigned General Fund balance will be \$6,691,134. The Budget Subcommittee of the City Council and staff recommend further adjustment of the set-asides as follows.

- Remove set-aside of \$1 million for Alameda Corridor wall.
- Remove set-aside of \$1 million for Capital Projects.
- Reduce set-aside for Self-Insurance by \$500,000.
- Show that the Reserve for Economic Uncertainty is reduced to \$11.3 million, which is \$3.2 million below the policy level of \$15.5 million.

	Revised with	
	Midyear	Further
	Recommendations	Recommendations
Estimated Ending General Fund Balance	\$ 12,833,162	\$ 12,833,162
Nonspendable Inventory	(301,819)	(301,819)
Nonspendable Prepaid Items	(40,613)	(40,613)
Restricted Alameda Corridor Projects	(1,000,000)	-
Committed Economic Uncertainty	(15,506,864)	(11,315,730)
Committed Reward Funds	(125,000)	(125,000)
Committed 50th Anniversary Events	(50,000)	(50,000)
Assigned Self Insurance	(1,500,000)	(1,000,000)
Assigned Capital Projects	(1,000,000)	-
Net Unassigned General Fund Balance	\$ (6,691,134)	\$ (0)

Employee Retirement

The City has 2 employee retirement costs: pension contributions and retiree health insurance.

The City contracts with the California Public Employees Retirement System (CalPERS) to provide a defined benefit pension for its employees. There are 2 components to the City's

funding contribution each year:

1. Normal Cost - a contribution based upon current additional service. This contribution is calculated as 10.627% of covered wages.
2. Unfunded Liability Payment - a contribution based on the amortization of the accrued liability, less the market value of assets in the plan. The unfunded liability is amortized over 30 years to determine the City's contribution. This contribution is \$5,048,701 for FY17-18. If the City pays the entire contribution by July 31st, the City will receive a 3.55% discount and pay only \$4,869,400 (a savings of \$179,301).

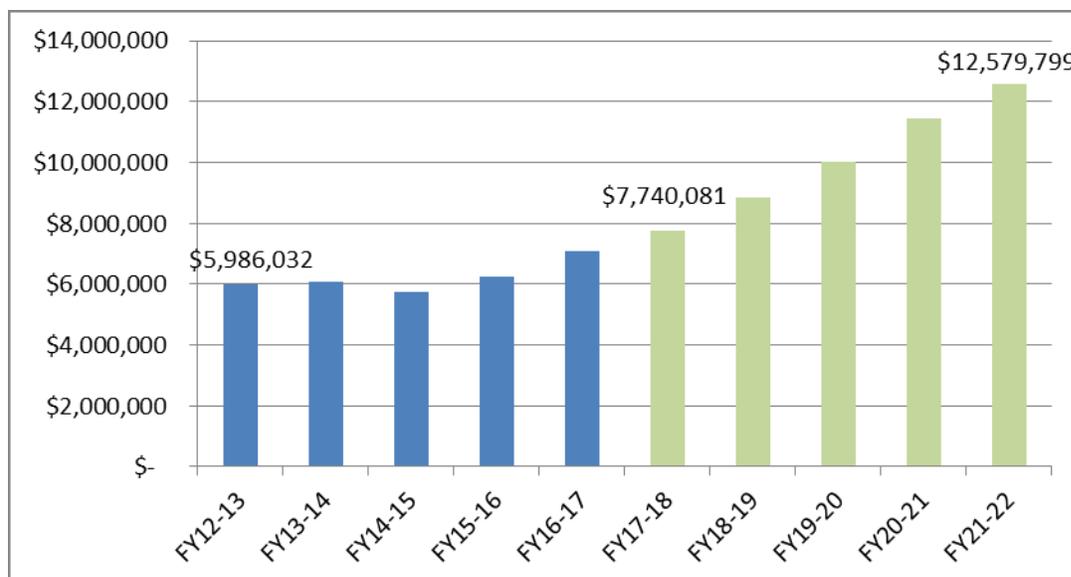
The Pension Unfunded Liability was \$81.3 million at June 30, 2015, and the plan had a funded ratio of only 67.6%.

The following is a statement made by Marcie Frost, the CalPERS CEO, on January 6, 2017.

"We are a maturing pension fund like many across our nation. More money is going out in pensions than coming in, we have a low funded status, a decline in the number of active workers supporting retirees, and a low-return investing environment. These issues are real, but we are on the right path to full funding - and the Board's action on the discount rate has strengthened our efforts."

On December 21, 2016, the CalPERS Board took action to lower the discount rate from 7.5% to 7.0% over three years. The following chart illustrates the expected increase to the City's pension contribution over the next 5 years, based upon no wage increases. The FY16-17 contribution is expected to be approximately \$7 million. The expected FY21-22 contribution is a \$5.5 million (77%) increase from FY16-17.

City's Actual and Expected CalPERS Contributions



The City's workforce has an average age of 49; meaning that retirements are expected to increase over the next several years, thereby increasing the City's cost of providing retiree

health insurance. The City’s retiree health plan is an Other Post-Employment Benefit (OPEB).

The OPEB Unfunded Liability was \$39.1 million at June 30, 2015 (liability of \$55.2 million, less Trust balance of \$16.1 million), and the plan had a funded ratio of only 29.2%.

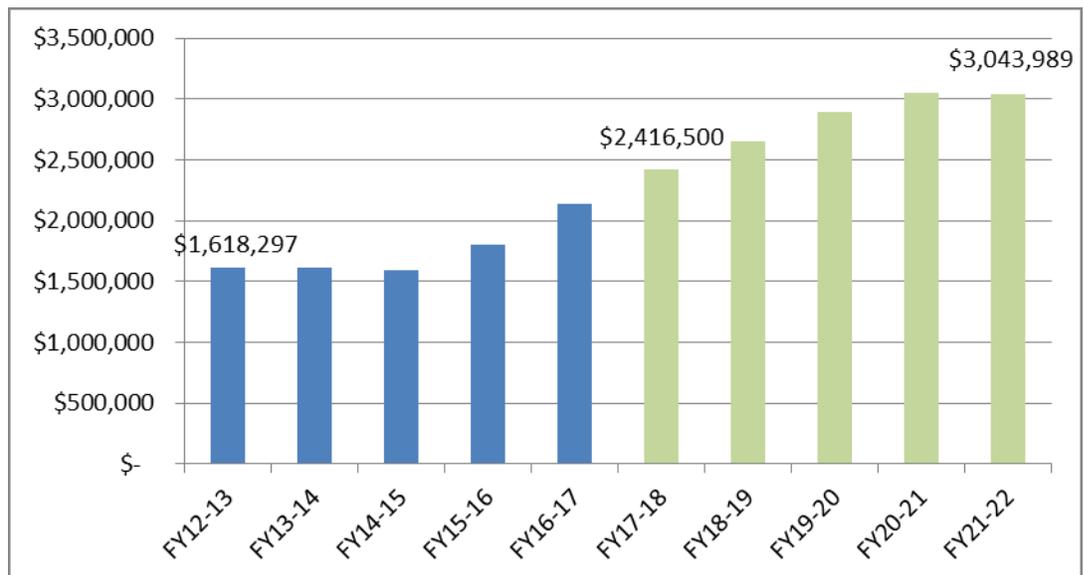
To help balance the FY16-17 budget, the City elected to use one year of interest earnings on plan assets (an IRS Section 115 Trust Fund) to subsidize the FY16-17 costs of retiree health insurance. The following table shows interest earned since inception of the Trust in FY11-12.

FY11-12	\$ 117,310
FY12-13	388,230
FY13-14	1,809,239
FY14-15	(62,797)
FY15-16	175,417
FY16-17, 1st half	441,784
	<u>\$2,869,184</u>

Staff expects to request a \$983,796 withdrawal from the Trust before June 30, 2017, which will increase the unfunded liability and reduce the funded ratio of the plan. The \$983,796 represents 34% of the interest earned to date. A delegation of authority to make the withdrawal is requested with a separate staff report on this same agenda. Staff does not recommend another withdrawal from the Trust during FY17-18.

The City’s independent actuary has calculated the following estimates of retiree health insurance costs over the next 5 years. The FY16-17 contribution is expected to be approximately \$2 million. The expected FY21-22 contribution is a \$0.9 million (42%) increase from FY16-17.

City’s Actual and Expected Retiree Health Costs



Retiree Health Funding Policy

On February 5, 2013, the City Council adopted Resolution No. 13-012, establishing an OPEB funding policy as follows:

1. Contribute to the 1% of wages to the Section 115 Trust beginning in FY13-14, increasing the contribution by 1% each year thereafter.
2. Effective FY11-12, 25% of the year-end General Fund balance in excess of a reserve goal of \$20 million will be designated as a contribution to the Trust.
3. Any one-time money (e.g. lawsuit settlement) will be considered for contribution to the Trust.

If the City adheres to the policy outlined in Resolution No. 13-012, the FY17-18 contribution to the Trust would be equivalent to 5% of employee wages, approximately \$1.5 million.

The loss of General Fund revenue over the last several years has contributed to the General Fund budget deficit and made the OPEB funding policy unrealistic. Therefore, staff recommends a change to the policy. One potential option is negotiated cost-sharing with employees. Another option is to contribute an amount equal to 25% of the prior year favorable variance for employee compensation, if any. A sample calculation follows.

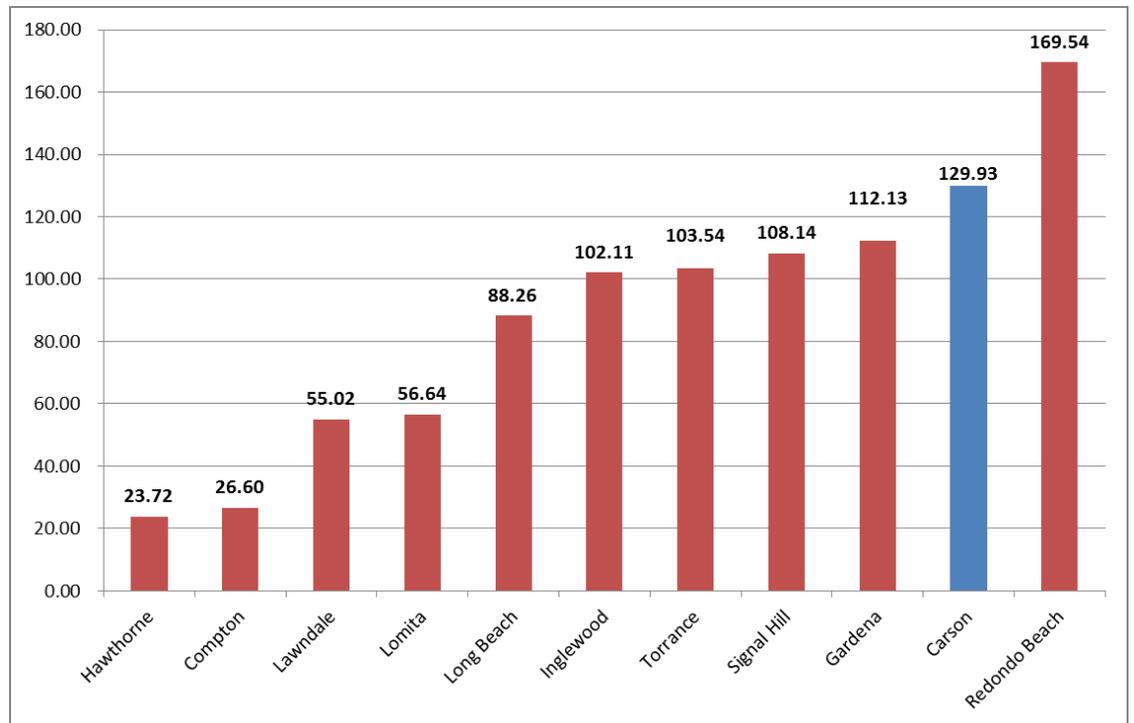
Budgeted Employee Compensation	\$42,348,221
Actual Employee Compensation	41,348,221
Favorable Variance	1,000,000
Contribute 25%	\$ 250,000

The Budget Subcommittee supported a change to the policy that gives City Council more flexibility to consider at each fiscal year-end whether to make a pre-funding contribution.

Community Services Program Review

Many expenditures of the City are required by law (e.g. record keeping) or public safety (e.g. Sheriff). There is a minor portion of the budget that is discretionary or subject to cost recovery. During the 2016 budget process, the City reviewed Community Development fees and made changes to improve cost recovery. For the 2017 budget process, staff proposes a review the Community Services programs and related fees.

Approximately 18% or \$13.2 million of the General Fund budget is appropriated for Community Services. The following chart summarizes annual spending per capita in surrounding cities for Recreation & Human Services.



It is a normal function of city government to subsidize recreation services to the community. It is a policy decision of the City Council to determine the level of that subsidy. Although in staff's experience, it's fairly unusual for city government to provide the depth of human services programs provided by the City of Carson. Typically county offices and non-profit agencies provide most human services to the community.

The City Manager and Director of Finance selected 6 areas of the Community Services budget to review with the Budget Subcommittee. Criteria for selection included annual expenditures over \$150,000, heavily subsidized by the General Fund, with specific-benefit services (rendered to a specific group of citizens, as opposed to the general benefit of the community). A snapshot of the annual General Fund subsidy follows for these 6 programs follows. Program revenue, expenditures and other information are presented in Exhibit B to this staff report.

	FY13-14 Subsidy	FY14-15 Subsidy	FY15-16 Subsidy	FY16-17 Subsidy
Community Center	\$(1,488,932)	\$(1,697,443)	\$(1,360,118)	\$(1,577,548)
Middle School Enrichment	(116,904)	(114,098)	(127,285)	(145,277)
O'Neal Stroke Center	(114,912)	(152,367)	(186,230)	(193,866)
Early Childhood	(350,989)	(323,953)	(305,857)	(337,449)
Adult & Youth Sports	(236,460)	(251,013)	(242,567)	(229,002)
Veterans Sports Complex	(367,348)	(442,914)	(384,971)	(335,590)
Subtotal of Subsidies	\$(2,675,545)	\$(2,981,788)	\$(2,607,028)	\$(2,818,732)

The Budget Subcommittee of the City Council requested that staff return with a holistic review of these programs; including cost recovery levels, fee rates, staffing levels, and

contracting options. Sufficient direction was provided at the Subcommittee level to begin the analysis necessary for this budget process. Staff expects to provide more specific recommendations to the Budget Subcommittee and the City Council at a later budget workshop.

Employee Educational Reimbursement

For FY16-17, the City did not fund the employee educational reimbursement program. This is one of the few employee benefits not subject to negotiation with the bargaining groups. Actual educational reimbursement costs associated with the FY15-16 program totaled \$45,099. The Budget Subcommittee recommends continued suspension of the program for FY17-18.

Credit Card Receipts

The City accepts credit cards for payment, and pays a merchant credit card processing fee for each transaction. The fees are expensive, but a necessary cost of doing business. The FY17-18 estimate for merchant credit card fees is \$80,000. It is becoming more common for hotels to pay their transient occupancy tax payments via credit card, and for developers to make large permit payments via credit card. The average fee is about 2.75% of the transaction. Therefore, if a developer pays a \$40,000 permit fee with a credit card, the City will pay a processing fee of approximately \$1,100 for that transaction.

The City has 2 options to reduce its costs: 1) impose a credit card convenience fee up to the amount of the City's cost, as allowed by California Government Code Section 6159(g); or 2) establish a per-transaction dollar cap for credit card use.

The Budget Subcommittee of the City Council recommends full cost recovery by charging a convenience fee on credit card payments. Customers would be made aware of the charge and could then make a decision to pay by check or cash. Staff was requested to examine the fiscal impacts of exempting smaller transactions from the convenience fee.

Cultural Arts Grant Funding

The FY16-17 amended budget includes \$164,688 of funding for Cultural Arts grants as follows.

- Alexey Steele \$13,660
- Department of Theatre & Dance, CSUDH \$17,936
- Montecarlo Cultural & Community Medicine Foundation \$21,284
- Sophisticated Dance \$35,569
- Rockin Blues Entertainment \$32,370
- Mariachi Academy of Carson \$33,856
- International Printing Museum \$10,000

During the FY16-17 budget process, the City Council only funded half of the program (\$82,344), anticipating the Carson Community Foundation may be able to fund the second half of the program. On January 24th, the City Council funded the second half of the FY16-17 program from the General Fund. The Budget Subcommittee recommends suspending the funding program for FY17-18.

City Event Funding

If the City Council approves recommendations in the Midyear Financial Report, the FY16-17 budget will include a total revised appropriation of \$323,785 to fund City Events. The estimated associated revenue is \$49,882, resulting in a net General Fund contribution of \$273,903 (see attached Exhibit C).

The Carson Community Foundation has been established, and has received total donations of \$48,500. The Foundation granted \$5,000 to the City for the “Why I Like Carson” essay contest. The City Council has discussed the Foundation’s potential to fund City Events in the future, relieving the General Fund. It will take some time for the Foundation to accumulate donations, and begin a routine fundraising program. Recently, the Foundation Board prioritized City events for funding consideration, and the results follow.

Priority “A” Events Identified by Foundation, with FY16-17 City Costs included for informational purposes only

Event	Month	Est. Revenue	Est. Cost	Net City Contrib
Jazz Festival	Oct	11,050	25,685	14,635
Women's Health Conference	Oct	11,300	31,500	20,200
City Anniversary Events/Miss Carson	Oct	-	30,000	30,000
“Why I Like Carson” Awards Ceremony - Public Relations Commission	Nov	5,000	5,000	-
Veterans Day Celebration	Nov	-	10,075	10,075
Dr. Martin Luther King, Jr. Tribute	Jan	-	5,000	5,000
Youth Conference	Mar	-	18,738	18,738
Cinco de Mayo	May	-	10,000	10,000
Filipino Independence Day	Jun	-	10,000	10,000
Juneteenth Celebration	Jun	5,000	15,000	10,000
Total "A" List		\$ 32,350	\$160,998	\$ 128,648

Staff recommends the City Council specifically identify which projects should be funded with a City contribution for FY17-18, as well as the contribution amount. Expected staffing costs will be estimated and calculated for each event identified, limited to only overtime specific to the event, additional part-time staff specific to the event that are not already serving another function at the event site, and full-time staff that are called in specifically to serve the event (e.g. tradesman for set-up). Staff will distribute a sheet that lists the events, where Council Members can designate events for the review at the next budget workshop.

Next Steps in the Budget Process

Based upon City Council direction with this agenda item, staff may prepare proposed resolutions to amend the City Council policies for General Fund reserves and Retiree Health funding.

The Utility Users Tax Citizens Budget Oversight Committee is scheduled to consider FY17-18 budget recommendations on April 11th.

The next City Council budget workshops are scheduled for April 18th and May 16th. The City Council may also wish to schedule a special budget workshop outside of a regularly scheduled City Council meeting.

V. FISCAL IMPACT

There is no immediate fiscal impact related to direction provided by the City Council. Staff will use the direction to continue preparation of the draft FY17-18 budget, currently scheduled for public hearing and adoption on June 6th.

VI. EXHIBITS

A - Estimated FY17-18 Sheriff cost (page 12)

B - Selected Community Services Program Summaries (pages 13-18)

C - Master List of City Events (pages 19-20)

Prepared by: Kathryn Downs, Director of Finance