701 East Carson Street

Legislation Text

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Report to Mayor and City Council

Tuesday, April 18, 2017

Discussion

SUBJECT:

FISCAL YEAR 2017-18 BUDGET WORKSHOP #2 (CITY COUNCIL)

I. SUMMARY

This is the second of three scheduled budget workshops. The Council provided direction during the March 21st budget workshop on reserve policies and reserve levels, employee educational reimbursements, and reductions in the Cultural Arts Programs. Staff has prepared revenue estimates and compiled the draft expenditure budget; however the department directors have not met to review potential budget reductions and new revenues to recommend to the City Council.

The City Council Budget Subcommittee continues to review the budget as well, including examining the costs and revenues of Community Services programs. The General Fund budget deficit of $2.6 million in FY16-17 could grow to $7.0 million in FY17-18 if no significant changes are made to the draft budget by June 30th. Staff will continue to work with the City Council Budget Subcommittee to identify cost savings and new revenue in preparation for the third budget workshop scheduled for May 16th.

The City Council Budget Subcommittee has completed a review of the draft FY17-18 Capital Improvement Program, with an estimated funding shortfall of $6.8 million. During the oral presentation for this report, staff will walk through the capital project recommendations.

This report discusses a series of budget uncertainties and changes based on federal, state and county actions; which will also be highlighted during the staff presentation.

The draft 2017 Five-Year Model is attached to this report, and includes the draft budget for all funds of the City (see Exhibit A).

II. RECOMMENDATION

PROVIDE additional direction to Staff regarding the draft budget.

III. ALTERNATIVES

TAKE another action deemed appropriate by City Council.

IV. BACKGROUND

Recap of the March 21, 2017 Budget Workshop #1

The City Council made the following decisions with regard to the draft FY17-18 budget, which have been incorporated herein.

1. Amend the General Fund set-asides as follows:

    a. Eliminate the $1 million set-aside for the Alameda Corridor sound wall;

    b. Eliminate the $1 million set-aside for Capital Projects;

    c. Eliminate the $125,000 set-aside for reward funds, indicating that if the City Council grants a reward, the distribution can be appropriated at that time; and

    d. Reduce the $1.5 million set-aside for Self-Insurance to $1 million.

2. Suspend the employee educational reimbursement program for FY17-18.

3. Reduce Cultural Arts grant funding to $80,000 for FY17-18.

The City Council also directed staff to propose merchant credit card processing fees to be charged to the City's customers using credit/debit cards. Processing fees vary by card and account. To ensure the City does not charge more than its cost, as required by state law, staff requires additional time to develop a thoroughly vetted recommendation; and expects to return to City Council with a recommendation during the 3rd budget workshop scheduled for May 16th.

General Fund Revenue Estimate

For FY17-18, staff expects a $1.3 million decrease in General Fund revenue compared to FY16-17. A summary of the expected net decrease follows.

FY16-17 Estimated General Fund Revenue	$76,906,298
FY16-17 reimbursement related to NFL proposal	(1,400,000)
FY16-17 budgeted reimbursement for debt service	(982,075)
FY17-18 expected return to normal building permit activity	(700,000)
FY17-18 expected increase in property tax	730,000
FY17-18 expected increase in sales tax	640,000
FY17-18 other immaterial revenue changes	394,398
FY17-18 Estimated General Fund Revenue	**$75,588,621**

The FY16-17 budget includes a one-time $1.4 million reimbursement of all City costs related to the former NFL proposal; a one-time budgeted $982,075 reimbursement of the debt service payment for the 2009 Lease Revenue Bonds; as well as an unusual increase of about $700,000 in building permit revenue related to the Union South Bay project and other improvements along Carson Street. Staff expects building permit activity will return to a normal level for FY17-18.

Assessed values, the basis for property tax, increase by the lesser of CPI or 2% each year. Staff received information from the state that the expected CPI increase for 2017 assessed values is 1.02% (approximately $150,000). The City also receives an increase in property tax when properties are sold and reassessed at a higher value. Staff performed an analysis of property sales through March 3, 2017 and estimates the new assessed values will increase the City's property tax revenue by another 1.16% (approximately $170,000). Staff previously reported a FY16-17 property tax decrease due to the price of oil. Each January, oil stored by the refineries is reassessed based on the current price of oil. The price of oil in January 2017 rebounded to nearly the same level as January 2015; and staff expects the City's property tax revenue will recover most all of the estimated $414,000 decrease suffered in FY16-17. Therefore, the total increase to property tax revenue is expected to be $730,000 or 4.89%.

Information provided by the City's sales tax analysis consultant, HdL, indicates that FY17-18 sales tax may increase by approximately $640,000 or 2.65% to reach $24.8 million. Combined with the expected 1.4% decrease from FY15-16 to FY16-17, the result is a net increase of only 1.02% over a two-year period.

Actual FY15-16	Expected FY16-17	Expected FY17-18
$24,504,724	$24,162,070	$24,801,607
$ change >>	$ (342,654)	$ 639,537
% change >>	-1.40%	2.65%

Approximately 30% of the City's sales tax is derived from autos and transportation. Another 19% comes from business and industry. Only about 15% of the City's sales tax is derived from general consumer goods.

<u>Draft General Fund Budget</u>

The draft FY17-18 expenditure budget includes an overall $3.0 million increase compared to FY16-17. A summary of the net increase follows.

FY16-17 Budgeted General Fund Expenditures	**$79,303,099**
FY16-17 budgeted debt payment (offset with reimb)	(982,075)
FY16-17 budget includes amounts carried from FY15-16	(786,703)
FY16-17 budget includes cost of Nov 2016 election	(250,000)
FY16-17 includes staff vacancy savings	917,246
FY16-17 includes use of Trust for retiree health	983,796
FY17-18 increase in pension liability payment	692,382
FY17-18 increase in retiree health costs	300,000
FY17-18 expected Sheriff cost increase	765,250
FY17-18 request for General Plan update (offset with revenue)	300,000
FY17-18 request for Petroleum Administrator (offset with revenue)	100,000
FY17-18 includes estimate for Colony Cove litigation	500,000
FY17-18 other immaterial revenue changes (less than 1%)	481,230
FY17-18 Draft General Fund Expenditures	**$82,324,225**

The FY16-17 budget includes some non-recurring amounts such as a debt payment (offset with reimbursement revenue, as noted above), amounts carried forward from the FY15-16 budget, the cost of the November 2016 election, staff vacancy savings, and a use of the Section 115 Trust for retiree health insurance.

Employee compensation accounts for more than half of the City's General Fund budget. No salary increases have been included in the draft FY17-18 budget.

As reported previously to the City Council, the City's payment for the employee pension unfunded liability is increasing by $692,382 for FY17-18. Due to recent action of the California Public Employees Retirement System (CalPERS) Board to reduce the assumed rate of return on investments, the City's payment for the unfunded liability will increase by more than $1 million in FY18-19.

	FY16-17	**FY17-18**	**FY18-19**	**FY19-20**	**FY20-21**	**FY21-22**
Unfunded Liability Payment	4,356,319	5,048,701	6,132,648	7,317,408	8,692,956	9,841,566
Increase		692,382	1,083,947	1,184,760	1,375,548	1,148,610

For FY17-18, the City can save $179,301 or 3.55% by paying the unfunded liability payment by July 31, 2017 (vs. paying equal installments from July 2017 through June 2018). Considering the current rate of return on the City's investments, staff recommends an early payment.

Also, as previously reported, the City's cost of retiree health is expected to increase by approximately $300,000 for FY17-18; due to the increased number of retirements.

As reported on March 21st, the Sheriff expects the per-unit cost of services will increase by 3.782%; and the surcharge for the Liability Trust Fund contribution is expected to increase from 9.5% to 10.0%. This results in an overall additional cost of $765,250 or 4.2%. The Sheriff contract is roughly one-quarter of the General Fund budget, expected to total $18.8 million in FY17-18.

The Planning Division has requested additional funding during FY17-18 to begin a General Plan update. During FY16-17, the City adopted a new fee to pay for General Plan updates (a surcharge of 8.8% on planning fees); which is expected to generate approximately $300,000 of revenue during FY17-18. The $300,000 request is offset by that revenue. The Planning Division also requests $100,000 for a consulting Petroleum Administrator; which will be offset with a proposed new fee.

Finally, as reported previously to the City Council, staff has included $500,000 in the draft budget as an estimate for appeal of the Colony Cove fair return judgment.

Summary of General Fund Budget

A summary of the draft General Fund budget follows.

General Fund	FY16-17 Budget	FY17-18 Draft
Revenue	$ 76,906,298	$ 75,588,621
Expenditures	(79,303,099)	(82,324,225)
Transfer to City Events	(237,853)	
Transfer to Capital Asset Replacement		(250,000)
Other Net Transfers*	(3,242,619)	20,301
Net Activity	**$ (5,877,273)**	**$ (6,965,303)**

**FY16-17 Net Transfers includes moving restricted money out of the General Fund into Special Revenue funds, as required by Governmental Accounting Standards Board pronouncements. The net operating activity for FY16-17 is a deficit of approximately $2.6 million.*

Estimated Balance June 30, 2017	$ 12,833,162
Net FY17-18 Activity - DRAFT	(6,965,303)
Estimated Balance June 30, 2018	**$ 5,867,859**

The calculated policy reserve level would be $16.5 million (20% of expenditures). Therefore, the estimated balance at June 30, 2018 would be $10.6 million less than the policy level.

Staff included a recommended $250,000 funding transfer to the Capital Asset Replacement fund during FY17-18, for necessary purchases of vehicles and other equipment.

The draft budget does not yet include any funding for City events, pending City Council direction during consideration of this agenda item.

Staff recommends the following preliminary steps to balance the budget.

1. Direct Executive Management to identify all proposed expenditures which are

not required by federal, state or local law, legally binding agreements or other mandates; or are not necessary for public safety and risk mitigation. The City Council can adopt a FY17-18 budget on time, yet continue to study expenditures for future service-level adjustments.

2. Direct staff to estimate staff vacancy savings and reduce the draft employee compensation budget (e.g. perhaps a position cannot be filled until October).

3. Implement a hiring freeze for all positions for which the City has not yet extended a conditional offer.

4. Direct staff to make the FY17-18 employee pension unfunded liability payment by July 31, 2017, resulting in a savings of $179,301.

5. Do not fund City Events with General Fund contributions.

<u>Gas Tax Revenue</u>

The state passed the Road Repair and Accountability Act of 2017 (SB1 and AB1); which increases gas taxes effective November 1, 2017, vehicle registration fees effective January 1, 2018, and zero-emission vehicle fees effective July 1, 2020. Michael Coleman, Fiscal Policy Advisor to the League of California Cities has estimated the increase to the City's gas tax allocation. FY17-18 is an implementation year with only partial fiscal impact. A summary of revenue history and future expected revenue follows.

FY13-14	$	3,044,349
FY14-15	$	2,690,593
FY15-16	$	2,068,802
FY16-17	$	1,824,520
FY17-18	$	2,620,225
FY18-19	$	3,730,450

The expected gas tax revenue for FY16-17 was recently revised, and is approximately $81,000 less than what was reported with the FY16-17 Midyear budget report on March 21st.

Staff recommends the additional FY17-18 gas tax revenue be used for pavement slurry seal and overlay, as discussed below.

<u>Draft Five-Year Model</u>

The Five-Year Model includes 2 years of actuals, the current year estimate, the draft budget, and four additional years into the future. The Model takes the current budget structure, incorporates assumptions, and includes known future events (e.g. election costs for election years). The Model is prepared for all budgeted funds of the City; and is a working draft based upon the most current budget information. As the draft budget changes throughout the next 2 months, the Model will change as well.

For the most part, staff has assumed that expenditures will continue to grow by CPI, as forecasted by the California Department of Finance.

FY17-18	FY18-19	FY19-20	FY20-21	FY21-22
2.3%	2.6%	2.5%	2.5%	2.5%

A notable exception is the Sheriff contract, about one-quarter of the General Fund budget. Staff has assumed the cost of the Sheriff will continue to grow at the rate of 4% per year, based upon the FY16-17 growth of 4.3% and the expected FY17-18 growth of 4.2%.

Another notable exception is the cost of employee retirement. The employee pension unfunded liability payment of approximately $5 million (or 6% of the draft General Fund budget) grows by an average of 17.7% annually over the next five years.

Nothing has been included in the Model for future revenues from anticipated development projects. In some cases, the future revenue is immaterial for purposes of mid-term financial planning. For example, the Union South Bay is a 357-unit residential project with a small amount of retail. If the developer spends $60 million on improvements, the additional annual property tax revenue for the City may be about $40,000. For that same development, each retail establishment may produce $5,000-$15,000 of annual sales tax for the City. On the other hand, development of the 157-acre site is likely to produce millions of dollars in new tax revenue to the City; but the timing of that new revenue likely falls outside of the scope of the 2017 Five-Year Model.

The results of the current draft Model indicate the General Fund will run out of money by the end of 2018 (20 months from now). If changes are made to the draft General Fund budget, the expected result will change. A snapshot of the draft results follows.

General Fund	FY16-17	FY17-18	FY18-19	FY19-20	FY20-21	FY21-22
Beginning Balance	$18,710,435	$12,833,162	$ 5,867,859	$ (2,697,910)	$(12,923,407)	$(25,342,50
Revenue	76,906,298	75,588,621	77,334,675	79,004,003	80,803,235	82,499,46
Expenditures	(79,303,099)	(82,324,225)	(85,620,745)	(88,749,801)	(92,642,629)	(95,855,63
Net Transfers	(3,480,472)	(229,699)	(279,699)	(479,699)	(579,699)	(679,69
Net Activity	$(5,877,273)	$(6,965,303)	$(8,565,769)	$(10,225,497)	$(12,419,093)	$(14,035,87
Ending Balance	**$12,833,162**	**$ 5,867,859**	**$(2,697,910)**	**$(12,923,407)**	**$(25,342,500)**	**$(39,378,37**

<u>Federal, State & County Funding Impacts</u>

There are several special revenue funds with noteworthy future events and uncertainties.

- The Family Support Grant expires at the end of 2019. This is a revenue source of about $55,000 per year, which primarily funds a part-time Recreation Coordinator.
- As noted above, new state law increases the City's gas tax allocation. The first full year of revenue is expected to be FY18-19, generating about $1.6 million of additional revenue that can be used for right-of-way maintenance, including

pavement.

- The Community Development Block Grant (CDBG) is at risk. The U.S. Department of Housing and Urban Development (HUD) will not be able to provide firm funding numbers to the City prior to the budget being adopted in June. The CDBG program funds about $0.7 million of annual expenditures; including 2.5 FTEs, neighborhood pride projects, and improvements to comply with the Americans with Disabilities Act (ADA).

- The federally funded Workforce Investment Act (WIA) program is also at risk; and firm funding numbers are not available from the South Bay Workforce Investment Board (WIB) at this time. The WIA program funds about $0.6 million of annual expenditures, including 3.7 FTEs and vocational training for program participants.

- The City expects to receive Measure A money from the County for park improvements and maintenance, which has not been included in the draft budget or the Model. The preliminary estimate is about $350,000 per year for improvements, and $80,000 per year for maintenance of facilities that were originally funded with Measure A capital money. Once staff is able to secure better information, it will be included in the draft budget.

- The Neighborhood Stabilization program was funded with one-time federal money. At the current rate of spending (approximately $46,000 per year), the balance of the funding will be expended by the end of 2021. This program pays for a part-time employee; as well as warranty, escrow, title and appraisal expenses.

- The City expects to begin receiving Measure M money from the County in FY17-18 for public transportation costs. Estimated revenue is $1.1 million annually. The expenditure guidelines have not yet been finalized; but the ballot language stated the funds would be used to improve freeway traffic flow/safety, repair potholes/sidewalks, repave local streets, earthquake-retrofit bridges, synchronize signals, keep senior/disabled/student fares affordable, expand rail/subway/bus systems, and improve job/school/airport connections. At this time, staff is proposing the new revenue be used for green-streets projects, and pavement slurry seal and overlay expenditures.

<u>Other Notable Impacts</u>

During preparation of the draft budget and the draft Model, staff noted the following impacts to other funds of the City.

- As part of redevelopment dissolution, the Successor Agency transferred $38.3 million of unspent redevelopment bond proceeds to the City. Funds have primarily been used for the Carson Street Master Plan project and the Wilmington/I-405 interchange. On this same agenda, an additional $5 million is requested for the interchange project; and another $60,000 is requested for curb ramp improvements on Avalon Blvd. If the requested amendments are approved, the estimated ending balance of this fund will be $6.1 million at June 30, 2018.

- Carson Circuit revenue has decreased significantly. As a result, more Proposition A money must be used for transit operations, leaving less available for upgrading street signs and administrative employee compensation. A summary of the decreasing revenue follows.

Actual FY14-15	Actual FY15-16	Expected FY16-17
$ 191,341	$ 151,200	$ 105,000

- Administrative Tow Fees have also decreased significantly. Unless these fees recover during the next year, either the FY18-19 budget for Sheriff special operations will need to be reduced or another funding source will need to be secured. A summary of the decreasing revenue follows.

Actual FY14-15	Actual FY15-16	Expected FY16-17
$ 185,675	$ 182,525	$ 122,415

<u>Capital Project Recommendations</u>

Based upon the highest priorities identified by Public Works and Community Services staff, a list of recommended capital projects for FY17-18 was developed and shared with the City Council Budget Subcommittee on April 17th (Mayor Pro-Tem Davis-Homes and Council Member Hicks). Criteria for priority included public safety and funding availability. Any Subcommittee recommendations will be shared with the City Council during the April 18th consideration of this agenda item.

The list of recommended FY17-18 projects is attached to this report as Exhibit B. Proposed projects have a total estimated cost of $14,194,388; however only $7,383,509 of funding was identified; resulting in a funding shortfall of $6,810,879 million, primarily related to facility rehabilitation projects.

The 2016 Pavement Management Program update indicates the City will need to spend $8 million annually for pavement slurry seal and overlay to *maintain* the City's current pavement rating of 67 on the Pavement Condition Index (PCI); which is a "fair" rating (70 is threshold for "good"). The draft budget, which is subject to change, includes the following allocations for pavement slurry seal and overlay.

	Slurry Seal	Overlay	Totals
Measure M	370,000	370,000	740,000
Proposition C	250,000	250,000	500,000
Gas Tax	470,000	130,000	600,000
Totals	**$ 1,090,000**	**$ 750,000**	**$ 1,840,000**

Staff proposes using the City's FY17-18 Measure R allocation of $1.1 million to partially fund the Sepulveda Blvd widening project. Therefore, the City's FY17-18 budget may include only one-quarter of the recommended expenditure to maintain the City's pavement at a PCI rating of 67.

Community Services Recommendations

The Community Services Department has been working through recommendations for Recreation and Human Services program, based upon direction provided by the City Council Budget Subcommittee on March 16th. Staff expects to discuss draft recommendations with the City Council Budget Subcommittee on April 17th. After further direction and refinement, staff hopes to bring recommendations to the entire City Council on May 16th.

City Event Recommendations

Staff received initial feedback from 4 City Council Members regarding FY17-18 funding for City Events. A summary has been compiled and attached to this report as Exhibit C. Staff seeks City Council direction for the amount of the General Fund subsidy to be placed in the draft FY17-18 budget.

Vacant Employee Positions

On March 21st, the City Council directed staff to return with a list of vacant employee positions. The list, along with recruiting status, is attached to this report as Exhibit D. The annual cost of these 26 positions is estimated to be $2,173,584.

Next Steps

The 3rd Budget Workshop is currently scheduled for May 16th. At that time, staff expects to present the following:

- Recommendations for credit card processing fees;
- Recommendations for Community Services fees and expenditures;
- Recommendations for the City's vehicle fleet; and
- Updated draft budget and five-year model.

V. **FISCAL IMPACT**

There is no immediate fiscal impact resulting from the recommendations contained herein. The expected impact to the proposed FY17-18 budget resulting from City Council direction tonight will be presented during the next budget workshop.

VI. **EXHIBITS**

A - Draft 2017 Five-Year Model (pages 12-46)

B - FY17-18 Recommended Capital Improvement Projects (pages 47)

C - City Event Feedback from City Council (pages 48-49)

D - Vacant Full-Time Employee Positions (page 50)

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