

Agenda Report

TO: CITY COUNCIL

DATE: AUGUST 17, 2009

FROM: CITY MANAGER

SUBJECT: BUDGET UPDATE

RECOMMENDATION:

It is recommended that the City Council:

1. Direct staff to record impending state borrowing of property tax revenues, pursuant to Proposition 1A, as a receivable in the City's General Fund; and,
2. Provide feedback to staff regarding the budget strategy outlined in this report.

BACKGROUND:

On June 15, 2009 the City Council adopted the operating budget for fiscal year 2010. At that time, and consistent with the City Council's goal to Maintain Fiscal Responsibility and Stability, staff committed to return to the Council in September to present information regarding the fiscal year 2009 results, known state budget impacts and trends for fiscal year 2010.

Earlier this month, the state legislature passed, and the Governor approved, a budget that will have significant fiscal impacts on the City. Additionally, local revenues have continued to erode to a point that additional budget reductions will be necessary in order to balance the General Fund operating budget by 2014.

Given these challenges, staff believes it appropriate, at this time, to provide preliminary information to the Council and the community regarding these impacts, a report on General Fund revenues and expenses along with a preliminary plan to address the budgetary implications. Staff will return on October 5th with more definitive information and additional recommendations in order to maintain the City's efforts to address its budgetary challenges including the structural deficit.

State Budget

The adopted state budget will impact the City in three specific areas: 1) The “borrowing” of General Fund property tax revenues; 2) Takeaway of redevelopment funds in the current and subsequent fiscal year, and 3) a further reduction in funding for health-related programs and services, as summarized in the following table:

| | Fiscal Year 2010 | Fiscal Year 2011 |
|---|---------------------|--------------------|
| Property Tax Borrowing per Proposition 1A | 4,600,000 | |
| Takeaway of Redevelopment Funding | 10,700,000 | 2,250,000 |
| Reductions in Public Health funding | 1,000,000 | |
| Total State Action | \$16,300,000 | \$2,250,000 |

During budget deliberations the Legislature also considered shifting Highway Users Tax Account (HUTA) gas tax funds away from cities and counties, which would have meant a further loss to the City of \$2.4 million. While these funds appear safe for the moment, they remain at risk given that the state’s deficit for the current fiscal year is already estimated at \$15 billion.

The terms of Proposition 1A allows the state to borrow up to 8% of property tax revenues twice within any ten year period. The state is required to repay these funds within three years with interest. Any failure to repay borrowed funds eliminates the state’s ability to invoke future borrowing. Consequently, staff intends to properly account for this action as a loan on the City’s general ledger for which a corresponding receivable will be established. While this action will reduce the General Fund’s cash balance, fund balance will be unaffected since receivables are included as assets in determining fund balance. Pasadena is fortunate to have sufficient cash balances so that this action will not result in a cash flow problem. Other cities will not be as fortunate and will need to securitize their loans.

Previously the state sought to transfer to itself \$350 million from redevelopment agencies. Ultimately, that effort was ruled unconstitutional by the courts in the case of California Redevelopment Agency v. Genest. Nevertheless, an appeal is pending and the current state budget includes a similar, and much larger, transfer totaling \$1.7 billion in the current year and \$350 million next. Pasadena’s Community Development Commission’s share totals \$10.7 million and \$2.25 million respectively. As before, the California Redevelopment Association plans to initiate litigation to challenge this action. In the event this current effort fails, the impact on Pasadena would be significant given the need to utilize redevelopment funds to enhance/improve/repair existing infrastructure including parking structures in Old Pasadena and other facilities that promote economic development.

The Public Health Department has already experienced dramatic reductions in revenues as a result of state actions over the last few years. Since 2007 the Department has reduced its total full time equivalent staffing positions from 112 to 96.8 and overall appropriations have been reduced from \$13.1 million to \$11.7 excluding direct General Fund support. In fiscal year 2009 direct General Fund support totaling \$1.25 million was provided to the Department with an additional \$400,000 programmed in the current fiscal year. Staff is currently analyzing the potential impact of this latest round of reductions. Given the threat these reductions pose to the health of the community compounded by the already significant reductions the Department has faced over the last few years, it is anticipated that in October staff will be requesting additional General Fund support for the Health Department, which would necessitate reductions in other General Fund activities.

FY2009 General Fund Preliminary Budget Results

Throughout fiscal year 2009 General Fund revenues were closely monitored and projections revised accordingly, as presented in the City Council budget update reports. Unfortunately, while the plan to address the budgetary shortfall assumed an overall revenue reduction, revenues appear to have fallen further, roughly \$5.2 million below the revised budget figure.

| | FY07 Actual | FY08 Actual | FY09 Revised Budget | FY09 Preliminary Actual | FY10 Adopted Budget |
|-------------------------------|--------------------|--------------------|---------------------------|-------------------------------|---------------------------|
| Sales Tax | 33,380,079 | 35,444,025 | 35,110,457 | 31,806,272 | 33,465,092 |
| Transient Occupancy Tax (TOT) | 8,565,154 | 8,847,757 | 9,442,380 | 7,430,383 | 7,995,108 |
| Utility Users Tax (UUT) | 28,062,945 | 29,639,752 | 30,195,654 | 28,916,098 | 33,128,136 |
| Construction Tax | 3,827,836 | 3,984,216 | 4,500,000 | 2,338,719 | 2,000,000 |
| Property Tax | 34,342,668 | 35,284,428 | 35,581,233 | 38,547,392 | 39,946,208 |
| Other Tax | 13,860,616 | 14,491,438 | 15,021,628 | 15,010,043 | 14,677,110 |
| Other General Fund Revenue | 81,667,907 | 88,333,796 | 88,189,960 | 88,747,175 | 89,052,853 |
| TOTAL | 203,707,205 | 216,025,412 | 218,041,312 | 212,796,082 | 220,264,507 |

As indicated by the table, the most significant revenue impact has been in sales tax. Moreover, activity for the past two quarters indicates an accelerating decline in this key revenue source with collections for the third quarter of fiscal year 2009 (first quarter of the 2009 calendar year) 15.3% or approximately \$1.1 million, below the same quarter in the prior year. Construction tax suffered the greatest loss as a percentage as compared to the prior fiscal year, as building activities declined sharply. Property tax, which has been one of the City's strongest and

most stable revenue sources, posted gains over fiscal year 2008 generally consistent with budget projections; however, as discussed later in this report further growth in the near term is much less certain.

On the expense-side, the adopted fiscal year 2009 operating budget established General Fund appropriations (i.e., anticipated expenses) at \$230.8 million with \$200 million related to operations and \$30.8 million for debt service. Through aggressive cost-cutting measures including holding vacant staff positions open, deferring large purchases and most significantly reaching agreement with bargaining groups to forgo salary increases, General Fund operating expenditures were reduced to \$194.2 million. This result is not insignificant given that departments were required to absorb several previously approved personnel related costs including salary increases, retroactive pay and equity adjustments that were not included in the adopted fiscal year 2009 operating budget and exceeded \$1.1 million. Furthermore, while departments were directed to meet a managed savings goal of expending no more than 95% of appropriations, such efforts were not instituted until mid-November, nearly halfway through the fiscal year. Based on the preliminary data and factoring in the unbudgeted personnel expenses, departments achieved an overall 96.4% expenditure level. When combined with debt service expenses of \$30.6 million total General Fund expenditures total \$224.8 million.

| | FY07 Actual | FY08 Actual | FY09 Budget | FY09 Preliminary Actual |
|--------------|--------------------|--------------------|--------------------|-------------------------------|
| Operations | 183,176,174 | 183,551,196 | 200,011,303 | 194,230,833 |
| Debt Service | 33,940,058 | 33,490,743 | 30,823,198 | 30,633,774 |
| TOTAL | 217,116,232 | 217,041,939 | 230,834,501 | 224,864,607 |

The General Fund 5-year Financial Forecast, at the time of FY2010 budget adoption, reflected an estimated net operating loss of approximately \$9.55 million in fiscal year 2009. Based on preliminary data, the net operating loss may be closer to \$12.1 million as a result of a continued slump in revenues. Staff is currently exploring what options may be available to reduce this gap prior to closing the fiscal year 2009 accounting period. For example, cost-cutting measures in various internal service and/or non-general funds may provide an opportunity to credit back to the General Fund amounts paid for services delivered at lesser cost and amounts transferred for purchases that were ultimately deferred. It is expected that such actions, which will be presented on October 5th will reduce the budgetary gap to below \$10 million, thus remaining consistent with the five year plan to resolve the City's deficit.

Trends for Fiscal Year 2010

As discussed above sales tax revenues continue to lag. Additionally, the Los Angeles County Assessor recently reported a decrease in the City's assessed value of approximately 0.2%. Should the sales tax trend continue and the Assessor's estimate come to pass, projected General Fund revenues in fiscal year 2010 would be reduced by \$4 million or roughly 1.8%. Additionally, based on the preliminary fiscal year 2009 results discussed above, revenue projections for fiscal year 2010 will need to be revised downward.

Beyond the General Fund, a continued reduction in sales tax revenue will also negatively impact proposition A and C revenues that are used to support transportation activities including operation of the City's ARTS bus system.

Departments continue to manage expenses carefully. A total of 49 positions in the General Fund were eliminated with the adoption of the current operating budget. As other positions become vacate through retirements, of which 35 are expected by the end of the calendar year citywide, and normal attrition, all will be subject to close scrutiny and it is expected that many of these will be held vacant or under-filled at a lower classification. As of the first week of August, 104 positions were vacant citywide, 27 of which are in the General Fund.

Nevertheless, it is unlikely that these actions alone will be sufficient to offset further revenue reductions. Consequently, additional General Fund reductions will need to be implemented in order to fully balance the operating budget by 2014 notwithstanding the potential impact of additional state budget impacts. The strategy to achieve this will be consistent with that implemented last fiscal year which includes deferring large purchases, implementing efficiencies and cost-cutting measures, and where appropriate seeking modest revenue enhancements paid for by those benefiting from City services.

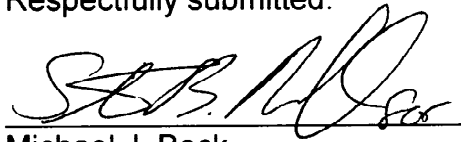
Given that personnel-related expenses represent the largest expense category in the General Fund, additional reductions in this area will be necessary. The City's various labor groups should be recognized and commended for their constructive efforts to address the budget shortfall and additional discussions will be pursued with these groups to identify additional means of reducing costs.

FISCAL IMPACT:

As a result of state actions, a total of \$16.3 million will be shifted from the City to the state of California this fiscal year. A portion of this, \$4.6 million is expected to be repaid within three years.

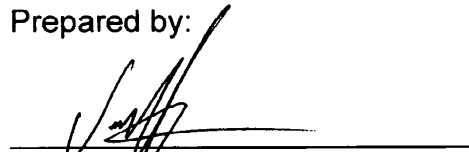
Based on preliminary data, fiscal year 2009 revenues were approximately \$5.2 million below the revised budget, or 2.4%. Expenses were 95.6% of budget. The resulting budgetary gap is \$12.1 million, or \$2.55 more than previously projected. Based on these results additional reductions in General Fund expenditures will be necessary.

Respectfully submitted:

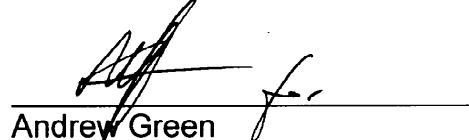


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