OFFICE OF THE CITY MANAGER

TO: CITY COUNCIL **DATE:** March 16, 2009

THROUGH: FINANCE COMMITTEE

FROM: CITY MANAGER

SUBJECT: FIVE -YEAR GENERAL FUND FINANCIAL PLAN UPDATE

Over the past several months, staff has presented to the City Council financial information that demonstrated the worsening structural deficit as a result of the negative impact the economy has had on City's budget. It has been acknowledged that without dramatic reduction in our current spending trends, the annual General Fund budget deficit of approximately $14 million would result in a deficit fund balance of $42.9 million by FY2013. Recent estimates indicate that by the end of the current fiscal year this gap would have increased to nearly $16.6 million as a result of lower revenues. If such an increase in the deficit were to occur, the City would exhaust not only its available undesignated fund balance, but its designated fund balance by the end of fiscal year 2011.

Given this information, staff began the process of preparing the City Manager's recommend FY2010 operating budget with very different economic parameters than were used in the past. Based on past budgets, there was an expectation that the robust economy would ultimately resolve the structural deficit. The original goal for the FY2010 budget was to present to the City Council a balanced budget by FY2011. However, the economic environment combined with increasing expenditure pressures has made it impossible to achieve that timeframe without sever impacts to programs and services. The revised goal is to balance the budget by 2014, which is manageable in spite of the fact there reductions to services and programs will still be required.

General Fund - Revised Financial Plan

	FY2009 Adopted	FY 2009 Revised	FY 2013 Projected	FY 2013 Revised
Beginning Amount Available for Appropriations	28,349,377	28,349,377	(28,734,241)	4,363,445
Total Revenues	200,443,616	198,159,310	223,599,974	222,758,880
Total Expenditures	(185,170,404)	(180,932,486)	(198,433,502)	(206,519,009)
Net Operating Transfer (In / (Out)	(30,641,231)	(26,777,147)	(39,298,168)	(18,310,140)
Off Budget Reserve Activity	1,350,188	1,350,188	0	0
Net Income/(Loss)	(14,017,831)	(8,200,135)	(14,131,696)	(2,070,269)
Ending Amount Available for Appropriations	14,331,547	20,149,242	(42,865,937)	2,293,176

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Five-Year Financial Plan Structure

The General Fund five-year financial plan is the mechanism by which the future health of the City's largest and most important fund is analyzed. By tracking and trending current and anticipated revenues and expenses provides a planning tool for the City's policy makers. Traditionally these projections tend to be conservative and in recent years revenues have generally exceeded budget estimates and actual expenditures have been less than originally anticipated.

The format of the attached five-year financial report has changed from previous reports. Staff has attempted to simplify the report and tie it to Pasadena's Comprehensive Annual Financial Report (CAFR). The model supporting the plan summary was also made interactive so staff and the City Council can actively modify assumptions during the meeting to see how they impact the five-year plan.

In previous reports, changes in reserves were reported in the Transfers IN/(OUT) section. Staff believes that it is more accurate to reflect these changes in the expenditure or revenue category in the plan. This ensures that all items impacting the budget are reflected in the budget totals. The attached five-year financial report reflects the actuals for fiscal year 2008, the adopted budget for the fiscal year 2009, the revised estimate for the fiscal year 2009, and the estimated financial activity for each of the fiscal years beginning with fiscal year 2010 through fiscal year 2014.

Revenues Assumptions

The assumptions used for General Fund revenues are based on revenue estimates developed as of January 2009. General Fund revenues for fiscal year 2009, excluding transfers in, are anticipated to be approximately $2.3 million or 1.1% below the appropriated budgeted. Although the appropriated budget projected 5.4% growth in revenue, at this point we are anticipating only a 0.3% growth rate over what was actually collected in the prior year. The primary reasons for the reduction are consist of shortfalls in sales tax, transient occupancy tax (TOT), construction tax, charges for services, and investment earnings. There are, however, some positives as of January that has helped to offset even larger declines in revenues. Property taxes and utility user taxes have had surprisingly good growth through January 2009. Trends indicate a $1.2 million or 2.6% increase in the combined secured and unsecured property taxes when compared to budget. Additionally, utility user's tax revenues are trending to be approximately $2 million or 6.6% ahead of budget. The assumptions include an additional transfer of .5% from the Power fund to make the total transfer 8% for fiscal year 2009, which will require City Council approval. Absent these increases, General Fund revenues would be approximately $2.6 million short of budget.

Revenues	FY 2009 Adopted	FY 2009 Projected	Change	% Change
Property Taxes	44,358,847	45,533,847	1,175,000	2.6%
Sales Tax	26,332,843	25,057,843	(1,275,000)	-4.8%
Utility User Tax	30,195,654	32,195,654	2,000,000	6.6%
Transient Occupancy Tax	9,442,380	8,242,380	(1,200,000)	-12.7%
Franchise Taxes	2,437,729	1,937,729	(500,000)	-20.5%
Other Taxes	17,083,899	15,483,899	(1,600,000)	-9.4%
Total Taxes	$129,851,352	$128,451,352	($1,400,000)	-1.1%
Licenses & Permits	2,762,032	1,962,032	(800,001)	-29.0%
Intergovernmental Revenues	12,177,923	12,843,723	665,800	5.5%
Charges for Services	22,419,585	21,319,587	(1,099,998)	-4.9%
Fines & Forfeitures	7,855,091	8,355,091	500,000	6.4%
Investment/Interest Earnings	21,028,884	20,941,854	(87,030)	-0.4%
Rental Income	1,186,623	1,117,179	(69,444)	-5.9%
Miscellaneous	3,162,126	3,168,492	6,366	0.2%
Total Other Income	$70,592,264	$69,707,958	($884,306)	-1.3%
TOTAL REVENUES	$200,443,616	$198,159,310	($2,284,306)	-1.1%

Economists predict, that the downward slide in the economy could continue for another 9 to 15 months. As a result, staff has assumed in the five-year plan that revenue growth, excluding transfers in, on average, will range from a low of 0.5% in fiscal year 2010 to a high of 4.3% in fiscal year 2014 in the five-year financial plan. This equates to estimated General Fund revenues, excluding transfers in, ranging from $199.2 million in fiscal year 2010 to $226.7 million in fiscal year 2014.

Expenditure Assumptions

General Fund expenditure assumptions are based on activity through January 2009. In November 2008, all departments were directed to limit spending to 95% of their original FY2009 budget allocation. The majority of departments, however, have been unable to achieve the requested 5% expenditure reduction thus far since the decision to cut back did not come until late in the second quarter of the fiscal year and the reality that departments were required to absorb over millions in labor cost increases that were not included in the adopted budget. The five-year financial plan, assumes departments will continue to spend at their current trend for FY2009 for an annual savings of $4.2. It is estimated that departments will be able to reduce expenditures by about $9 million during FY2010. The plan also assumes that wage increases previously negotiated will not be paid in fiscal year 2010, resulting in a cost avoidance of over $5 million.

Included in the years beginning with fiscal year 2010 is a substantial increase in the actuarial estimate for the supplemental contribution to the Fire and Police Retirement System (FPRS). The amount increases from approximately $4.7 million in fiscal year 2010 to approximately $10.2 million in 2014. Although most of these increases will be offset with revenue from loan repayment proceeds from PCDC and bond reserve proceeds, legislative restrictions of SB481 and the continuing poor performance of the FPRS portfolio will combine to eliminate this offset starting in 2015. The plan does not take into account the significant financial obligations that will fall on the General Fund in

2015 when we will no longer be permitted to make transfers from PCDC to cover the FPRS debt service and actuarial payments.

Additionally the five-year financial plan includes approximately $7 million of increased debt service costs starting in FY2010 resulting from the new amortization schedule caused by the refunding of various bonds. On average, the new five-year financial plan assumes an expenditure growth rate, excluding transfers out, of -3.1% in FY2010, 7.3% in FY2011 (large FPRS subsidy increase), 3.7% in FY2012, 3.6% in FY2013, and 2.9% in FY2014. This represents a low of approximately $175.3 million, excluding transfers out, in FY2010 to a high of $207.8 million, excluding transfers out, in fiscal year 2014.

Balancing the Budget

In order to present a budget that is fiscally responsible, dramatic reductions must be made, resulting in impacts to services and programs. Staff is committed to finding operational efficiencies, but this alone will not reverse the current spending trends. We need to reevaluate what we as a city can provide and look how we provide those services, which could include new private/public partnerships. The harsh reality for this year is we need to right size our budget so that we begin to live within our means. It is essential that City Council goals and objectives guide staff recommendations for programmatic changes.

The primary budget direction to all departments, not just those in the General Fund, was to submit their fiscal year 2010 budgets at a level 10% below their 2009 adopted funding levels. This would equate to a savings of approximately $22.4 million. As mentioned earlier, reducing budgets by this amount would result in some significant service level reductions. Discussions with the various bargaining units are underway to suspend previously negotiated wage increases. If successful, this could save approximately $5 million. Implementing these options, however, only partially addresses the on-going structural deficit. Additional measures will need to be implemented on a go-forward basis to fully address the anticipated financial problems. If staff assumptions prove to be correct and something is not done quickly, Pasadena's fiscal condition could deteriorate to a level that would be very difficult, if not impossible, to recover from. Therefore, close and regular monitoring of the budget is taking place. Detailed budget recommendations will be presented to the City Council starting the week of April 13th.

As previously discussed, the attached five-year financial plan has been revised to be interactive. Consequently, the various assumptions can be changed to reflect different sensitivities and the results can be seen, immediately, in the plan summary. This interactive process will demonstrate the severity of our current fiscal situation and the challenges associated with resolving our structural deficit problem.

Respectfully submitted,

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City Manager