DEPARTMENT OF FINANCE

May 21, 2012

TO: Honorable Mayor and City Council

FROM: Andy Green, Director of Finance

SUBJECT: Adoption of Fiscal Year 2013 Operating Budget

On May 7, 2010 the City Manager submitted the Recommended Fiscal Year (FY) 2013 Operating Budget in compliance with the requirements of the city charter. This budget represents the City's financial plan for the coming fiscal year and furthers the City's mission to deliver exemplary municipal services responsive to our entire community and consistent with the City's history, culture, and unique character. Adoption of the City's annual budget on or before June 30th, is required as set forth in Section 904 of the City Charter. In addition to the City's anticipated operating revenues and expenses, the FY 2013 Recommended Budget includes the appropriations for FY 2013-2017 Capital Improvement Program (previously adopted by the City council on May 14, 2012) and the City's Operating Companies (Rose Bowl Operating Company, Pasadena Center Operating Company, and Pasadena Community Access Corporation).

Subsequent to the delivery of the FY 2013 budget document, it was discovered that corrections were required to the budget transmittal letter. A revised transmittal letter incorporating these changes is attached. The changes consist of:

1. Incorrect salary and benefit distribution for all funds in the graph on the page "ii" of the budget transmittal letter. The total amount for salary and benefits combined is correct, but the distribution between the two needs to be corrected. The revised salary distribution for the General Fund should be salaries $82.1 million or 38%; benefits $42.6 million or 20%. The all other funds distribution should be salaries $86.6 million or 12%; benefits $31.6 million or 4%.

2. Incorrect amounts listed for the General Fund revenues and appropriations. The amounts in the detailed document are correct, but the amounts placed in the transmittal letter were rounded incorrectly. The amounts should be General Fund appropriations $215.7 million as opposed to $215.6 million and General Fund revenues $215.8 million instead of $215.7 million. The operating surplus amount is unchanged. The graphs on pages "ii" and "iii" were also changed to reflect this correction.

Attachment B

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05/21/2012
Item 7

Attachment B

OFFICE OF THE CITY MANAGER

May 7, 2012 (Revised May 21, 2012)

Honorable Mayor and City Council Members:

It is my pleasure to present the Fiscal Year (FY) 2013 Recommended Budget. This budget represents the City's financial plan for the coming fiscal year and furthers the City's mission to deliver exemplary municipal services responsive to our entire community and consistent with our history, culture and unique character.

<u>Executive Summary</u>

The economic shocks of the past several years, recession followed by anemic growth, has significantly impacted local, state and federal government. Today, nearly three years after the official end of the great recession a number of cities, large and small, continue to struggle, some on the verge of insolvency. In contrast, over the course of the past four years, with the guidance provided by the City Council and the willingness to make difficult but necessary decisions, Pasadena finds itself in a healthy fiscal position with a balanced General Fund budget recommended for FY 2013 and a recently re-affirmed AAA credit rating.

The FY 2013 Recommended Budget totals $740.4 million. This includes an operating budget of $612.5 million, capital appropriations of $88.5 million and appropriations of $39.4 million for the City's three operating companies; the Rose Bowl Operating Company, Pasadena Center Operating Company and Pasadena Community Access Corporation. Included in the operating budget is the recommended budget for the City's General Fund of $215.7 million. General Fund revenue is estimated at $215.8 million, making FY 2013 the first balanced recommended budget in over ten years.

Much of the expenditure reductions over the past several years have come through a reduction in the size of the City's workforce. The magnitude of reductions made over the past several years can be seen in the following tables, which provide a comparison of actual expenditures and full time equivalents (FTEs) for FY 2009 as compared to the current fiscal year of FY 2012 and the recommended budget for FY 2013. That the City has been able to reduce its overall level of expenditure is even more significant given that since FY 2009, it has had to absorb roughly $12 million in increased operating costs associated with the cost of employee medical coverage and pension contributions required by the California Public Employee Retirement System.

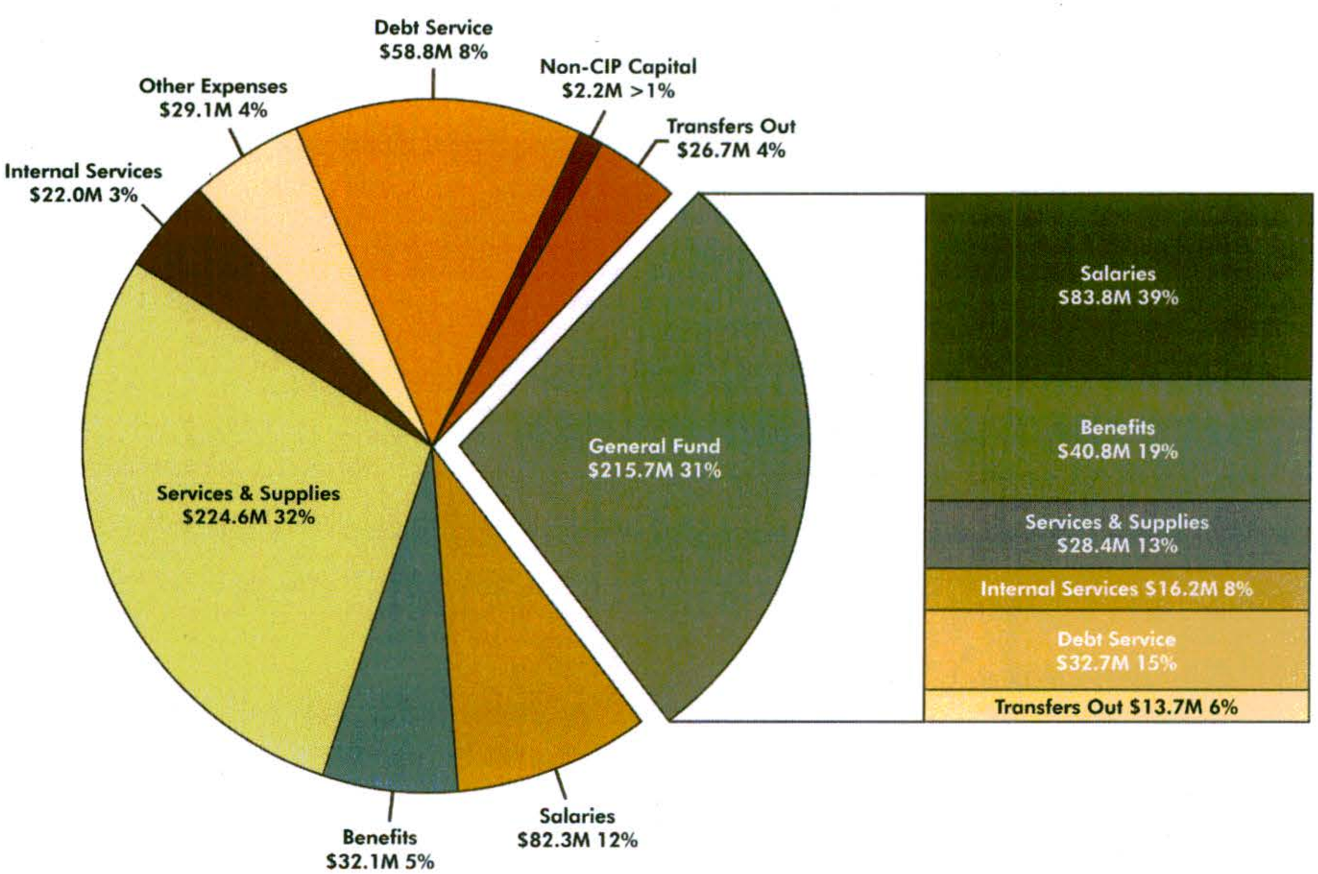
Total Appropriations (including affiliated agencies and CIP)

	FY 2009 Actual	FY 2012 Adopted	FY 2013 Recommended
All Funds	$759.5 million	$776.7 million	$740.4 million
General Fund	$225.1 million	$215.8 million	$215.7 million

Full-Time Equivalent Positions

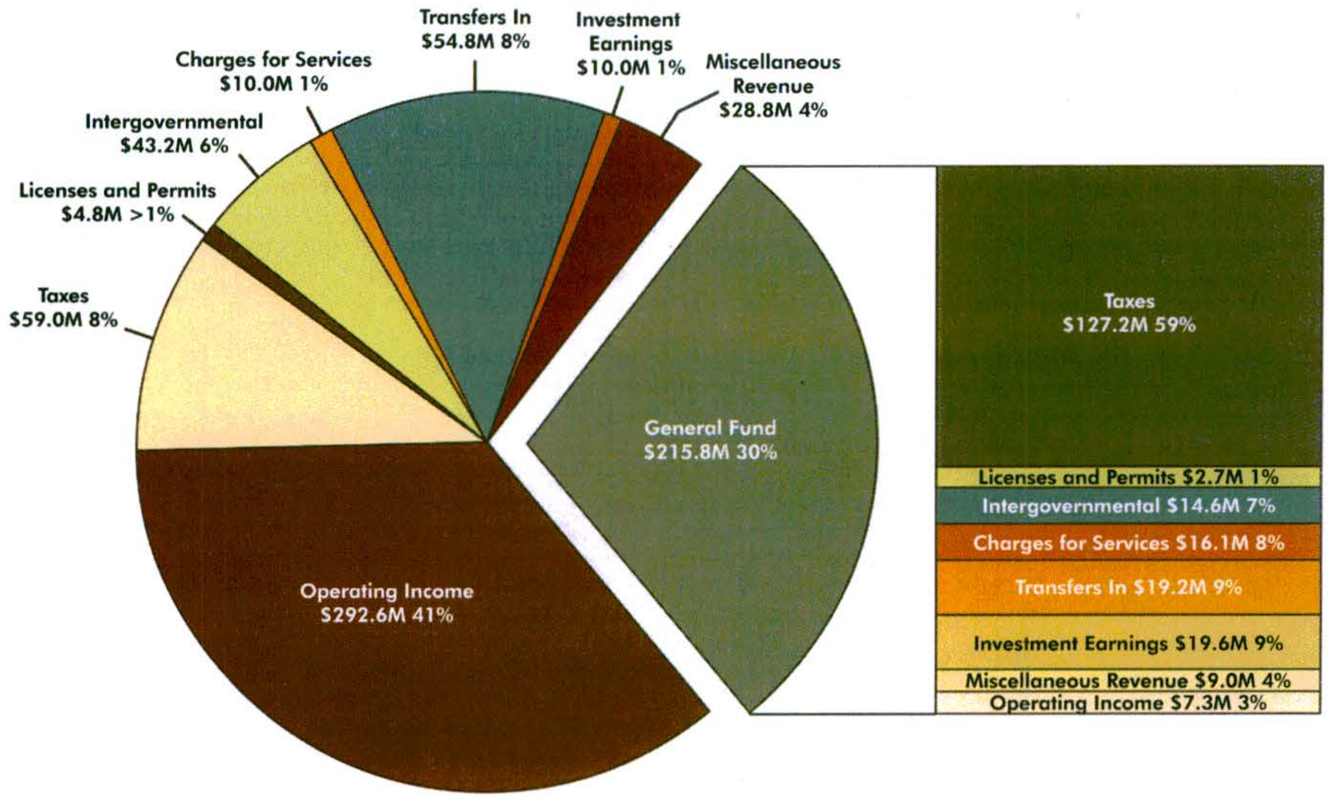
	FY 2009 Budget	FY 2012 Revised	FY 2013 Recommended
All Funds	2,427	2,146	2,107
General Fund	1,099	964	950

FY 2013 Recommended Net Operating Appropriations by Category



Note: Chart data includes anticipated capital labor costs ($25.6 Million) and interfund transfers ($55.3 million).

FY 2013 Recommended Operating Revenues by Category



Note: Chart data does not include affiliated agencies or revenues associated with CIP.

Pasadena's Recent Past

Historically, the City of Pasadena has experienced strong economic growth. As City revenues grew, new services to the community were implemented and existing services enhanced. Wages and benefits for the City's workforce also increased, keeping pace with other cities with whom Pasadena competes for talent. Over time, however, the cost of providing City services began to outpace revenues, creating a structural deficit in the City's General Fund.

Under normal circumstances, this situation would have been addressed through a modest combination of cost reductions and revenue enhancements, consistent with Pasadena's history of sound fiscal management. However, the profound impact of the national recession, which began in 2008, created very significant fiscal challenges.

As a result of the recession, the City experienced substantial reductions in its tax base, particularly in sales, transient occupancy and construction taxes. In response, beginning in Fiscal Year 2009, the City launched a five-year plan to bring expenses in line with revenues and eliminate the structural deficit in the General Fund by the end of Fiscal Year 2014 (June 30, 2014). Key elements of the plan included: the use of approximately $25 million of unallocated General Fund reserves to mitigate service level impacts and workforce reductions; agreements with employee bargaining groups to forgo previously contracted salary increases, and limited revenue increases, most significant of which was an increase in the amount of transfer from the City's Power Utility Fund, as discussed later.

In addition, reductions in the size of the City's workforce have been necessary in order to achieve the goals of the five-year financial plan. Over the course of the past four years, the City's total workforce has been reduced 13 percent, representing the elimination of 320 full-time equivalent positions. Of this total, a net of 28 were actual layoffs of full-time regular employees, as 9 of the affected employees were able to fill vacancies in other City departments. The balance was the result of voluntary separation incentives and the elimination of positions that had become vacant.

The Current Economic Climate

The great recession, as it has been termed, technically ended once the U.S. Economy began to experience positive growth in July, 2009. And while growth has been slow, there are continuing signs that the economy is recovering. Key City revenues such as sales tax, construction tax, property tax and transient occupancy tax have yet to retain their pre-recession levels, but are all trending upward. Other economic factors, such as increases in building permits demonstrate cause for cautious optimism.

Unemployment rates have declined over the past year, although rates remain relatively high. The California Employment Development Department reports that as of March 2012 unemployment rates stood at 8.2 percent nationally, 11.5 percent in California, and 11.9 percent in Los Angeles County. Pasadena's unemployment rate was 9.1 percent for the same period; the third lowest rate of the top 10 LA County cities by labor force and a testament to the City's diverse economic base.

Housing, another indicator of economic stability, is improving. In Los Angeles County, as of March 2012 the California Association of Realtors reported that home sales rose 1.2 percent over the prior year. While this increase will help reduce the inventory of homes on the market, prices continue to be weak, as the median home sales price in Los Angeles County declined 3.3 percent over the same period. Locally, Pasadena's housing market has held its value relative to other areas of the state. Additionally, the demand for multi-unit housing has fed an increase in construction activity across the country, which is being felt in Pasadena as well.

The State of California continues to struggle financially. Heavily dependent on income tax revenues, the downturn in the economy dramatically impacted the state. The adopted state budget estimated a $9.2 billion shortfall for FY 2013, which many analysts feared was overly optimistic. Unfortunately, these fears appear to be coming true as the magnitude of the problem appears to be closer to the $16 billion range per the Governor's recently released, May-revised budget. On May 15th the Governor will release the May-revise budget which is expected to include a more cautious outlook on state revenues.

History has shown that when the state needs to balance its budget, it's often at the expense of local government through the diversion of local revenues. Recently, in order to reduce the cost of the state prison system, the state introduced a program through Assembly Bill 109 that releases non-violent felons back into the community without the benefit of supervised parole. While this "parole realignment" effort is relatively new, it remains to be seen whether such actions will increase the cost for local law enforcement. As a precaution, the Police Department has developed a new program (Parolee Reintegration Enforcement Program) to address the impacts of the potential influx of parolees to the City.

Last fiscal year staff reported that the State's then budget plan included proposals which could effectively end redevelopment agencies in California. At the time there was optimism that a compromise agreement would be reached to preserve redevelopment while providing much needed financial support to the state. Unfortunately, through legislation and subsequent court action the more than 400 local redevelopment agencies in the California were dissolved as of February 1, 2012, thereby eliminating a critical mechanism to improve communities and create jobs through the elimination of blight and support for economic development.

For Pasadena the unwinding of redevelopment has been difficult due to the uncertainties that still exist in the interpretation of the new law. As an example, through special legislation, Senate Bill 481 (SB481) approved in 1987, the majority of tax increment received by the City's former redevelopment agency's Downtown Project Area, in excess of $20 million annually, is used to pay bonded indebtedness associated with the City's closed Fire and Police Retirement System. While the City believes SB481 to be an enforceable obligation that should remain in effect until the legislation's sunset date in December, 2014 the state has yet to render a final determination as to how it views the law in light of the dissolution of redevelopment. The FY 2013 Recommended Budget anticipates the City will receive sufficient tax increment to meet its enforceable obligations. Resolving the SB481 question and ensuring that the tax increment is retained to make bond and other enforceable obligation payments is crucial in maintaining Pasadena's financial health.

The FY 2012 State Budget also ended the per capita allocation of Motor Vehicle License Fees to municipal governments. While this revenue has been in decline for a number of years, the loss to the City for FY 2013 is approximately $530,000.

The growing federal deficit is also likely to impact City finances, as most federal budget reduction has come at the expense of domestic spending in federal programs, primarily in the areas of housing, community development block grants, public transportation, and public safety. This trend is expected to continue regardless of the outcome of November's national election.

Fiscal Year 2013 Recommended Budget Overview

The recommended operating budget is prepared with the City Council's Strategic Plan Goals in mind as virtually all activities of the municipal organization fall under one or more of these, which are to:

- Maintain fiscal responsibility and stability
- Improve, maintain and enhance public facilities and infrastructure
- Increase conservation and sustainability
- Improve mobility and accessibility throughout the city
- Support and promote the local economy
- Ensure public safety

Typically, the City begins its annual budget process early on in the calendar year; however, for the FY 2013 budget the process got underway in September, 2011 when forecasts indicated that annual revenues were falling short of budgeted levels. In response, City departments were directed to develop proposals for cost reductions and/or revenue enhancements to fully resolve the anticipated shortfall and balance the budget for FY 2013. These proposals were presented to the City Council at a special budget workshop held in November 2011. The Council accepted a large number of these proposals, which have been carried forward into the FY 2013 Recommended Budget along with additional actions to ensure a balanced budget for the coming fiscal year.

The proposed budget continues the practice of conservative revenue estimates, especially in the General Fund. Overall, the FY 2013 Recommended Budget anticipates modest increases in most revenues. For the General Fund this translates into a projected 2.8 percent increase over FY 2012 projected revenues.

An element of any budget strategy is to consider enhancements to revenue streams within the City's control. However, any such increases must be weighed against the impact on City residents and businesses. For fiscal year 2013 a modest increases to a number of City fees and charges are being recommended to better reflect the true cost of providing services. An example of this approach are fee increases for Human Services & Recreation programs aimed at achieving a greater level of cost-recovery as well as to generate funds to provide scholarships for those whose family income makes it otherwise difficult to participate in the City's recreation programs.

The General Fund revenue budget for fiscal year 2013 anticipates a level of transfer from the Power Fund equal to 9 percent of gross revenues or $14.3 million Pursuant to City Charter Sections 1407 and 1408; the City makes annual transfers from the Power Fund to the General Fund to support municipal operations and capital improvements. In combination the provisions of the Charter limit the annual transfer to the lessor of 16 percent of gross revenue or the net income of the Power Utility. Historically, the transfer has averaged 8 percent. Based on current forecasts, staff anticipates it will be necessary to make a 9 percent annual transfer through FY 2015 to maintain a balanced General Fund budget.

The FY 2013 Recommended Budget also includes a one-time transfer of $1 million from the Workers Compensation Fund to the General Fund. The Workers Compensation Fund has sufficient balance to sustain this on a one-time basis and over time will rebuild its fund balance through charges to the General Fund and other City funds and anticipated operational savings resulting from program improvements recently implemented.

On the expense-side, General Fund expenses are projected remain relatively flat when compared to the FY 2012 Adopted Budget. Given that personnel-related expenses account for approximately 75 percent of all General Fund operating expenditures, achieving this low level of expense growth necessitates that no funding for salary increases be included in the budget. For most employees this will mean a fourth year in a row with no cost of living increase. Importantly, however, in contrast to other jurisdictions that have been forced to implement salary reductions, Pasadena has been able to maintain salary levels through these difficult financial times. On a go-forward basis, it is recognized that the City must provide a competitive salary and benefit package to recruit and retain the talent it requires. Accordingly, the five-year financial plan anticipates a 2 percent cost of living adjustment in fiscal year 2014. Importantly, the Recommended Operating Budget anticipates no additional staff layoffs.

A major factor in ensuring that Pasadena remains diligent in maintaining financial stability is long range planning. The 5 year General Fund Financial Plan, initiated in FY 2009, was developed to address this objective. The Plan utilized a balanced approach of spending reductions and use of $25 million of undesignated fund balance to minimize impacts on City services and avoid devastating programmatic reductions that would have otherwise been necessary to balance the budget. Had this action not been taken, the projected gap between revenues and expenses in the General Fund would have grown to more than $28.5 million by FY 2014.

As noted above, it was only through prudent financial management and adherence to sound fiscal policies that the City of Pasadena was able to build-up the $25 million in reserves used to cushion the impacts of the past several years. As Pasadena's economy improves, it is critical that reserves be increased to guard against the next downturn or other unexpected catastrophe. Maintaining healthy reserves also helps to reduce borrowing costs to the benefit of taxpayers. Future budget recommendations will include a plan to increase these reserves as quickly as possible.

The 5 year General Fund Financial Plan is continually revised based on analysis of current trends to help minimize reactionary decisions that may negatively impact future financial stability. As a result of the strategies implemented though the Plan, it is estimated that Pasadena will avoid over $200 million of General Fund costs between FY2009 and FY 2017.

The table below summarizes the revised Plan for the next five year period based on current trends.

General Fund 5-year Financial Plan
May 2, 2012

	FY2013 Recommended	FY2014 Projected	FY2015 Projected	FY2016 Projected	FY2017 Projected
Beginning Amount Available for Appropriations	4,183,474	4,347,272	4,723,771	4,834,352	5,373,068
REVENUES					
Tax Revenues	127,177,900	131,266,499	136,791,419	142,399,082	148,246,512
Other Revenues	88,644,102	80,424,944	73,160,224	73,200,749	75,189,139
TOTAL REVENUES	215,822,002	211,691,443	209,951,643	215,599,830	223,435,652
EXPENDITURES					
Personnel	124,623,151	128,586,186	131,825,626	135,604,773	140,878,428
Debt Service	32,683,497	23,174,674	17,556,931	18,075,736	18,069,278
Contributions to Other Funds/Misc	13,679,864	14,354,618	14,724,769	15,106,024	16,659,626
Other Expenses	44,671,692	45,199,467	45,733,736	46,274,582	47,200,073
TOTAL EXPENDITURES	215,658,204	211,314,945	209,841,061	215,061,114	222,807,405
Net Income/(Loss)	163,798	376,498	110,581	538,716	628,246
Ending Amount Available for Appropriations	4,347,272	4,723,771	4,834,352	5,373,068	6,001,314

Looking beyond the General Fund, the upcoming fiscal year holds both promise and challenges for a number of key City funds. Pasadena is one of only three cities in California with its own Health Department and in recent years, reductions in state funding resulted in a restructuring of service, staff layoffs and the need for subsidy from the City's General Fund. After restructuring the Pasadena Health Department, no subsidy from the General Fund for FY 2013 will be necessary,

As a result of the elimination of the redevelopment funding, declining local Inclusionary revenues and cuts in federal housing and community development funds (Section 8 administration, HOME, CDBG), the City's Housing Department FY 2013 Recommended Budget of $25.1 million is $8.7 million or 26 percent lower than the FY 2012 Revised Budget. The dissolution of redevelopment has eliminated approximately $3 million in tax increment housing revenues which historically have been relied on to support affordable housing projects/programs, debt service on housing loans/bonds and program administration.

Federal program reductions, including cuts in program administration support, are: HOME (-46%), CDBG (-15%) and Section 8 (-7%). The impact of these reductions over the past few years has required staff reductions of 45 percent. To maintain its primary service responsibilities, the Housing Department's FY 2013 Recommended Budget includes an increase of the General Fund subsidy to the Housing Department of $500,000 to partially compensate for the loss of these key funding sources. Over the course of the next fiscal year, as the true impact of the redevelopment wind-down becomes clear, the long-term viability of the Housing Fund will be assessed.

Reduced local demand for water is resulting in continued challenges for sufficient funding for capital programs in the Water Fund. The recent adoption of the Water Integrated Resources Plan (WIRP) and corresponding rate increases add renewed focus to improving local water supplies through conservation and investment in projects that will improve access to groundwater. The rate increases have begun to address the cash flow issues experienced over the past few years and the WIRP continues to provide the roadmap for the development and implementation of future water supply projects and water conservation programs to meet the needs of customers. In FY 2013, the first phase of the Well Collector Pipeline project will begin. This project will facilitate the collection and distribution of well water to Jones Reservoir for customer use on the east side of Pasadena and will also improve the capability to treat water to meet compliance regulations and blend with water from Metropolitan Water District.

In November 2011, Pasadena was hit by an unprecedented windstorm. The resulting damage required the removal of approximately 50,000 tons (100 million pounds) of trees, limbs, and debris from city streets, caused the loss of power of an estimated 6,330 customers, and damaged city facilities, parks, and water and power infrastructure. The total cost of the damage to the City totaled approximately $14.5 million, of which less than 4 percent will be reimbursed by State and Federal agencies. The balance of the costs must be absorbed by the City's Refuse, Water and Power Funds, negatively affecting their relative cash positions, which may impact future rates.

Prior to the great recession, the City's Building Services Fund, which accounts for development related income and expenses, including building permits and plan check fees, was in surplus. The dramatic reduction in building activity which occurred as part of the recession caused Building Fund revenues to plummet, while expenses continued to grow. As a result the Building Services Fund shifted into a deficit position, hitting its lowest point in Fiscal Year 2009 when the fund stood at roughly $2.8 million in deficit. Aggressive cost-cutting has narrowed this gap considerably. The recommended FY 2013 operating budget anticipates a deficit of less than $770,000. As development activity picks up and the benefits of prior cost reductions continue the Fund is expected to return to a positive position.

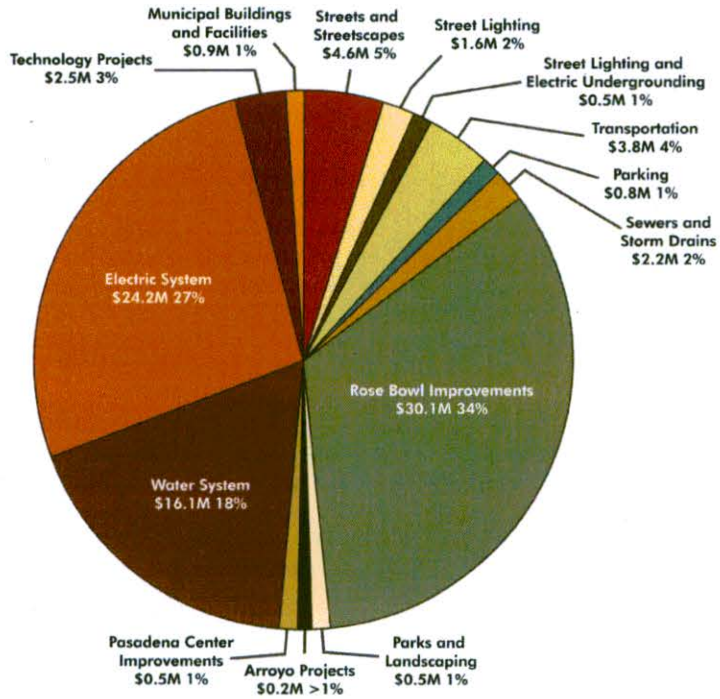
Looking to the Future

Pasadena has a rich history and a bright future. The City's Capital Improvement Program (CIP) Budget is one important way in which the City plans for the future. The CIP is a compilation of new construction and major maintenance projects designed to preserve and expand the City's infrastructure. This five-year plan contains 218 active projects with a total estimated cost of $960.4 million. In FY 2013, $88.5 million is recommended for appropriation to 90 projects, of which 19 are new projects. In addition to the City Council's Strategic Plan Goals discussed above, the following considerations are made with developing and prioritizing the CIP:

- Is the project needed to address a particular safety concern;
- Is the project necessary because existing maintenance efforts are no longer satisfactory and repairing exceeds the replacement cost; and
- Is an existing facility or system no longer adequate to meet needs/demand.

The CIP document provides a detailed description of each project being recommended for funding, as well as a Future Projects section that identifies an additional 164 projects with a total estimated project cost of $635.6 million which are slated for the future but are yet funded. Identifying these projects as part of the program, allows staff to pursue funding opportunities when, and if, they become available.

FY 2013 Recommended Capital Improvement Program Appropriations



An effective CIP will assist the reduced and dedicated City's workforce to provide services efficiently and effectively, which is critical to the future of Pasadena. Staff at virtually all levels of the organization is involved in ongoing efforts to improve service-delivery, increase efficiency and effectiveness. Indicative of these efforts is the smart phone app released earlier this year which enables users to advise of new issues or track existing customer issues until resolution. To date, the system has logged 503 customer contacts and has obtained closure rate of 94 percent. Approximately 82 percent of the contacts were made over the web. Moreover, the recommended CIP includes funding for the establishment of a complete 311 customer relationship management system that will further expand the City's abilities to receive, track and respond to customer-service issues.

Thinking more broadly, the City has recently completed an Economic Development Strategic Plan which assesses Pasadena's comparative advantages, economic strengths, weaknesses, opportunities and threats in order to help guide future economic development. To maximize the value of this process an Economic Development Task Force has been assembled consisting of prominent community members drawn from a broad range of professional interests and backgrounds. The Task Force will be meeting monthly, including a meeting to take input from a number of key stakeholder groups, through the end of 2012 as it works to develop an implementation strategy for the Strategic Plan. Information about the

Economic Development Strategic Plan and Task Force has been posted on the City's website at:

www.cityofpasadena.net/EconomicDevelopment/Economic_Development_Strategy/

Conclusion

Over the course of the past four years the City of Pasadena has faced the daunting challenge of continuing to provide high-quality public services while addressing the most serious fiscal crisis in recent memory. That the City has been able to resolve the General Fund deficit one year earlier than originally planned, restructure and reorganize City departments and work efforts for greater efficiency, all while staying true to those values which make Pasadena unique is a testament to the leadership of the City Council and the commitment of the all City employees. Through continued partnership with the community we serve, the City of Pasadena will continue to be a leader in effective municipal governance and quality of life.

Respectfully submitted,

Michael J. Beck
City Manager