

# Agenda Report

October 17, 2016

**TO:** Honorable Mayor and City Council  
**FROM:** City Manager  
**SUBJECT:** Mid-Year General Fund Budget Reductions and Discussion of Potential Future Budget Actions

## **RECOMMENDATION**

It is recommended that the City Council amend the Fiscal Year 2017 Operating Budget to implement General Fund expenditure reductions totaling \$2,113,057 as outlined in the Background Section of this report.

## **EXECUTIVE SUMMARY**

On May 9, 2016 staff presented the City Council the Recommended Operating Budget for Fiscal Year 2017 (FY17), which was subsequently adopted on June 27. As discussed in the budget Transmittal Letter, while the operating budget is balanced for the current fiscal year, trends indicate that beginning in FY18 and continuing for the foreseeable future, the City's General Fund will spend more than it receives in revenues thereby creating a structural deficit that will grow larger over time. It is vital that the City address this issue as well as build and maintain reserves strong enough to weather future unforeseen events and circumstances.

To provide for the City's long term financial stability, a key City Council goal, staff proposed that following adoption of the Operating Budget, a comprehensive effort be undertaken to: (1) determine the appropriate and sustainable level of City services; (2) ensure that any realignment or reduction in services be managed to minimize negative impact, and (3) take every reasonable measure to enhance City revenues. Accordingly, this is the first in what will be series of reports and actions presented over time to resolve the anticipated deficit.

## **BACKGROUND**

### *Current Projections*

At the time the City Council adopted the FY17 Operating Budget, the General Fund Five Year Forecast anticipated a gap between revenues and expenses for FY18 of \$7.6 million as indicated on Attachment A. Since that time, the Forecast has been updated (Attachment B) to include actual revenues and expenses for FY16. Additionally, future revenue and expense projections have been carefully reviewed and refined.

Property tax, one of the General Fund's most important sources, continues to show strong growth, and with several large projects under construction and expected to be on the tax rolls in the next year, the immediate projections assume continued robust growth for at least the next two years, with the Five Year Forecast using a 4% growth rate. Due to the timing of when the tax rolls are finalized each year, it can take up to twelve months for a new property's tax assessment to be realized by the City. In FY16 the City also received approximately \$3.4 million in one-time tax revenues related to a legal settlement with the County of Los Angeles as well as funds related to the abolishment of redevelopment agencies.

Transient Occupancy Tax (TOT) experienced tremendous growth in FY16; growing by more than twelve percent or almost \$1.7 million, as average daily rates continue to climb. This level of growth is unlikely to be sustained. For the next several fiscal years staff is assuming a growth rate in the range of 3.2%. Expansion of this key revenue source is likely to come from the opening of new hotel properties such as the recently opened Residence Inn. While the City looks forward to the opening of other hotel projects, until such time as they are actually under construction, staff is not including related revenues in the Five Year Forecast. Nevertheless, as new hotels are constructed, the recent changes in TOT sharing arrangements with the Pasadena Center Operating Company will provide significant benefits to the General Fund.

Sales and Use tax revenues were stable in FY16 and did realize a one-time boost of approximately \$2 million with the unwinding of the State's "Triple Flip" borrowing. After backing out these one-time funds, sales tax grew by 3.5%. The anticipated closing of Avon next calendar year will have a significant impact on this revenue source, dragging down growth over the next several years unless another significant sales tax generating business opens to offset the loss. Additionally in FY16, the City realized some stronger than anticipated growth in Business License Tax, Overnight Parking Permits and Parking Citation revenue. All three of these are trending upward and have helped to improve the revenue forecast going forward.

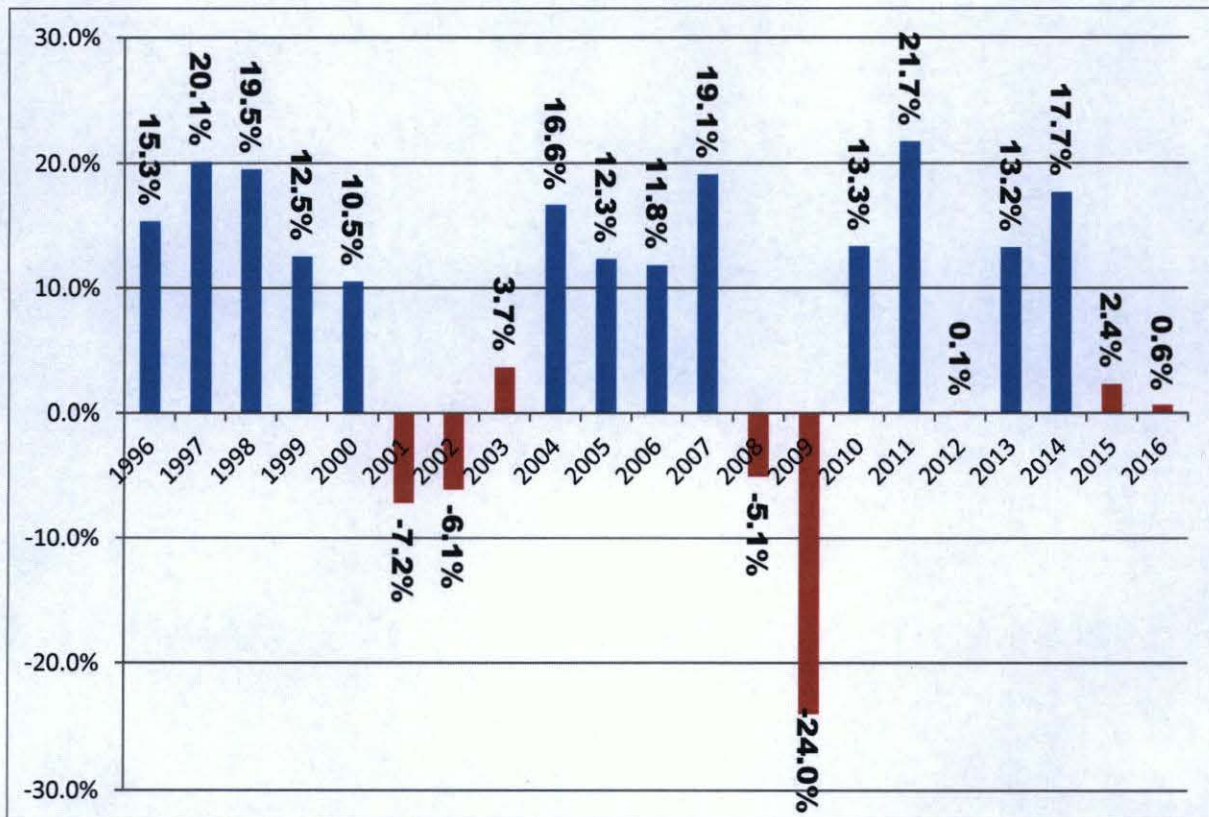
On the expense-side, expenses other than personnel are anticipated to grow moderately for the foreseeable future, growing at around 2% per year. Personnel costs

make up the single largest category of General Fund expenses, 63%, and if debt service is excluded this percentage rises to 67%. In recent years as the California Public Employee Retirement System (CalPERS) has sought to address growing unfunded liabilities, it is requiring ever increasing contributions from member agencies.

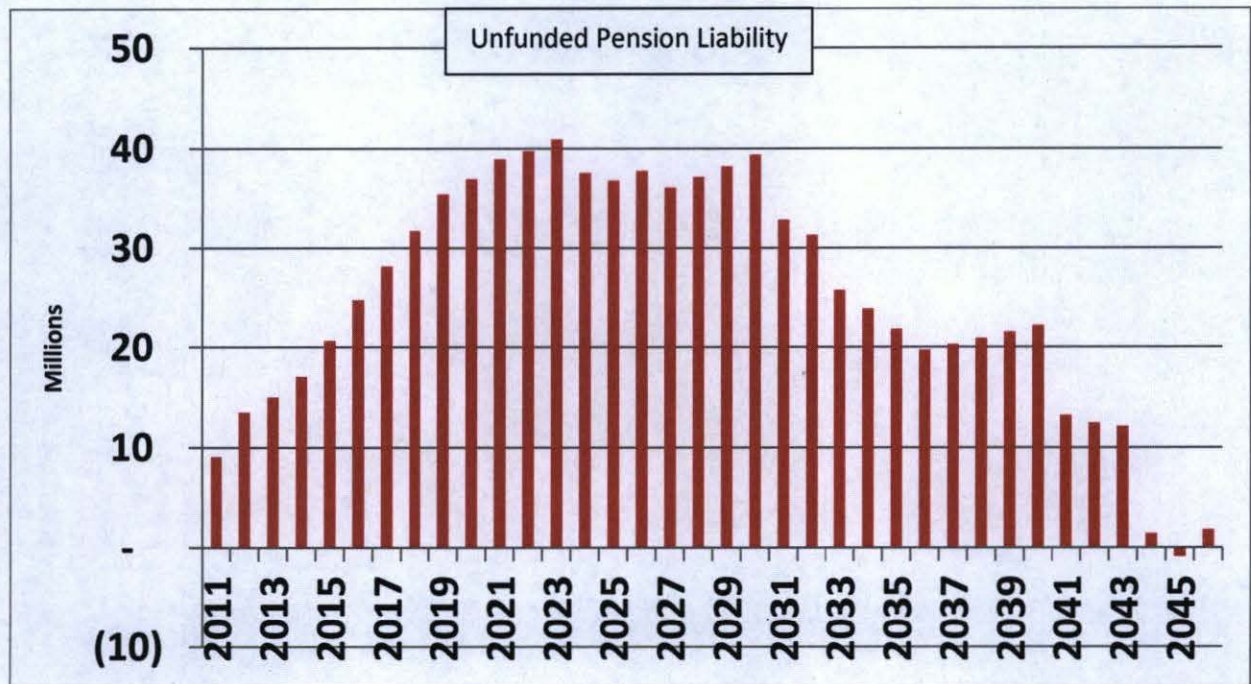
Tellingly, beginning in FY18 CalPERS will begin collecting contributions from member agencies towards the System's unfunded liability as a fixed dollar amount rather than a percentage of employee payroll. Ironically, this is being introduced to account for the fact that many cities are reducing their overall workforce in part to offset the impacts of rising pension contributions.

The City's current unfunded liability to CalPERS is \$388.5 million based on CalPERS actuarial valuation for the period ending June 30, 2015. Based on CalPERS earning only 0.61% in the ensuing year, as opposed to the actuarially assumed rate of 7.5%, Pasadena's unfunded liability is expected to be even higher when CalPERS releases the actuarial valuation as of June 30, 2016.

The following chart illustrates historical annual returns of CalPERS for fiscal years ending on June 30. Beginning in 2002, the figures are reported as gross of investment/management fees.



Based on the June 30, 2015 actuarial valuation, the City's annual unfunded liability payment to CalPERS of \$28.1 million is projected to increase to \$40.9 million by 2023. Based on the aforementioned 0.61% return in FY16, this figure will certainly increase. Moreover, CalPERS future projections assume that its investment portfolio will return on average 7.5% per year, every year over the next 30 years. Given recent and current market conditions, this seems very unlikely. Should CalPERS' investment returns continue to fall short of actuarial assumptions or should the System further reduce its expected rate of return, as some have suggested it should to reduce volatility, the liability will grow even larger.



*Where Things Currently Stand*

Taken as a whole, modest revenue growth brought on by local economic activity and a moderately expanding economy coupled with sound fiscal management would normally be expected to keep the General Fund operating budget in balance. However, the upward pressure on personnel costs, most particularly as related to pensions discussed above, may require the City to examine the sustainability of its current level of municipal services.

Beyond the need to simply bring expenses in line with revenues, ensuring positive net income in the General Fund is necessary for a variety of reasons. The City's infrastructure: fire stations, community centers, streets and sidewalks are aging and in need of repair, upgrade and in some cases replacement. In order to address these needs there must be sufficient financial capacity to either fund projects directly or support related debt service. As noted in the current Five Year Forecast, beginning in

FY20 the City will see a reduction in debt service payments of \$2.6 million. However, unless overall revenues increase or expenses decrease, or some combination thereof, the savings from this reduced debt will be consumed by the ongoing cost of operations.

Fortunately, the City does have reserves which can be called upon in times of emergency, or to cushion the impact of economic downturns as well as to take advantage of unique one-time opportunities to benefit the community. Currently, the General Fund's Designated Reserve stands at \$33.5 million. However, this amount is below the 20% of appropriations policy goal adopted by the City Council. Based on that policy, the reserve should be \$47.6 million. Notably, during the last economic recession the City depleted roughly \$25 million in reserves, in addition to making significant expenditure reductions, over a period of approximately four years in order to avoid potentially devastating reductions in services. While the next recession is unlikely to be as severe as the Great Recession, it is important for the General Fund to have sufficient reserves to manage through such an eventuality without putting critical City services at risk. Because of projected negative income beginning in FY18, the current General Fund Forecast does not anticipate any further contributions towards reserves.

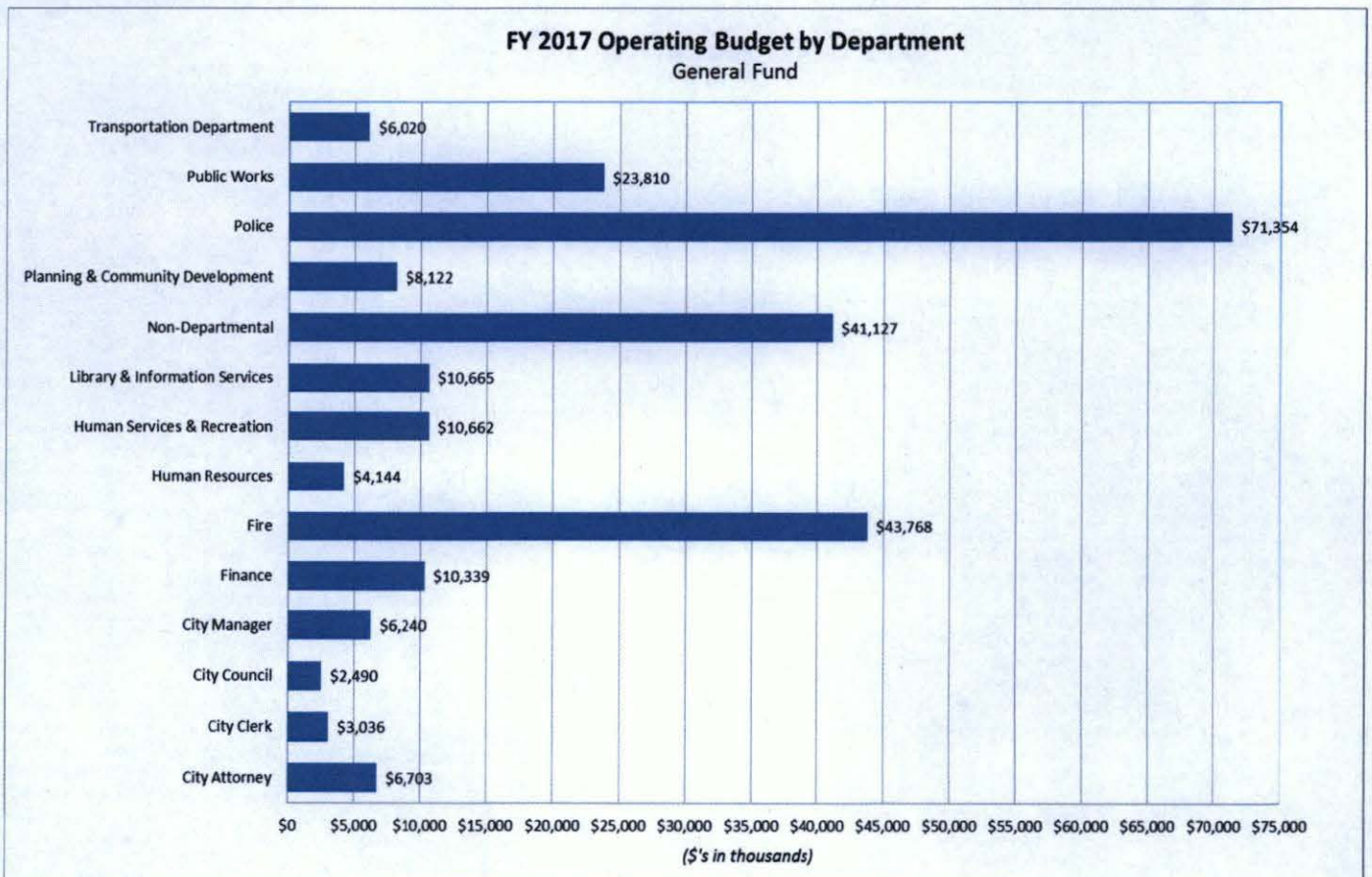
For all these reasons, staff is moving forward with the plan outlined with the adoption of the current operating budget. It should be recognized that this effort will be ongoing and accomplished over time. While staff is proposing some immediate cost reductions, other potential savings will take time to identify and consider the implications thereof. As it relates to generating new or additional revenues, these often require a number of actions before being realized. The balance of this report discusses these efforts.

#### *Reducing Expenses*

Rather than wait for the preparation of the Fiscal Year 2018 Recommended Operating Budget to identify reductions, staff is recommending that reductions in the General Fund totaling \$2,113,057 be implemented at this time. While every budget reduction impacts the resources available to provide City services, these immediate reductions have been determined to have less than significant impact on City operations and can be implemented immediately. These reductions will carry forward and therefore reduce anticipated expenses in FY18. A portion of these General Fund reductions, \$884,356, are actually shifts in expenses to non-general funds where it has been determined that it is appropriate for the other fund to cover the cost.

Department	Description	FTEs	Amount
City Manager's Office	Eliminate Project Manager	1.00	\$ 161,546
	Eliminate Public Information Coordinator	1.00	\$ 111,332
Finance	Eliminate Management Analyst II	1.00	\$ 103,405
Public Works	Reallocate a portion of Engineering cost to CIP		\$ 117,980
	Reduced water cost from conservation		\$ 300,000
	Service and supply reductions		\$ 60,000
	Eliminate Maintenance Assistant in Parks Division	1.00	\$ 65,015
	Reduce budgeted but unused overtime		\$ 133,097
Planning	Reallocate personnel costs to Building Services Fund		\$ 465,377
	Eliminate Management Analyst IV (50% General Fund/50% Building Fund)	1.00	\$ 71,354
Transportation	Reallocate costs to various parking funds		\$ 300,999
	Eliminate Transportation Administrator (50% General Fund/50% various Parking Funds)	1.00	\$ 109,976
Human Srvc & Rec	Eliminate Management Analyst II	1.00	\$ 112,976
<b>TOTAL</b>		<b>7.00</b>	<b>\$2,113,057</b>

Moving forward, identifying additional reductions will become more difficult as they are likely to result in service reductions. Some reductions will be based upon structural changes, requiring realignment of service delivery mechanisms and even the elimination of programs that, while effective, may be outside of those the City Council may deem to be core services. Nevertheless, such actions may become necessary in order to ensure a balanced budget. In considering where further expenditure reductions might be made, it's important to understand how General Fund expenditures are currently programmed.



As indicated by the chart above, roughly half of the General Fund is devoted to the Police and Fire Departments. This is not surprising given that for most cities, Pasadena included, public safety is regarded as the first and foremost priority. Given minimum staffing levels for sworn personnel, the opportunities for cost reduction are more limited than the size of the respective budgets might suggest. Within the Police Department the Air Operations unit has been identified as one area worthy of further analysis to determine if greater cost efficiency/cost recovery when flying on behalf of other agencies can be made. Staff has engaged a consulting firm to assist in this effort, the results of which will be included in future budget reports.

For the Fire Department, emergency medical calls account for more than 75% of all calls for service. The Department currently operates five Advanced Life Support ambulances staffed with Fire Fighter Paramedics. This model provides for a very high level of service as well as ensuring the Department has significant depth of resources. In some other jurisdictions, such as neighboring Glendale, the provision of emergency medical services (EMS) is provided by Emergency Medical Technicians operating Basic Life Support (BLS) ambulances. Other models exist in other communities and recently Pasadena experimented with a single BLS ambulance. Staff intends to undertake an assessment of the various EMS delivery models to identify options that might be worth considering for Pasadena.

In various departments, programs are being reviewed/evaluated to assess how well they are serving current community needs relative to other priorities. For example, in the Planning and Community Development Department, it might make sense to discontinue the City's Occupancy Inspection Program relative to the sale of single family homes, a program which the state of California as well as local realtors have been critical of, and instead shift the staff resources into Code Enforcement to address quality of life issues. While this program was progressive when developed decades ago during the era of redlining and residential property dumping, thorough buyer inspections conducted by skilled private inspectors are now the norm in the real estate market. Alternatively, if deemed of continuing value and an appropriate cost recovery methodology established to recover full-cost, the program might continue, but not rely on the General Fund.

The Human Services and Recreation Department is assessing the future viability of Neighborhood Connections; an office that was created to assist neighborhoods seeking to organize. With the advent of web-based services such as Nextdoor, residents have discovered their own means of connecting without support from City Hall.

Another area of examination is the Career Services Division of the Housing Department. Although organized as a Division within the Housing Department with 23 Full Time Equivalent staff members, the Career Services Division operates as the Foothill

Workforce Development Board (FWDB) serving six communities in the San Gabriel Valley and reporting to a 32 member non-profit board. The FWDB provides a variety of job training and placement services which are of considerable value to the community at large. The area of exploration is whether it should continue to operate as part of the City structure, shift to another partner agency or operate as a standalone non-profit as some other Workforce Development Boards do.

It is anticipated that these and other analysis will inform the development of the recommended operating budget for FY18 and provide options should additional cost reductions be necessary. It should be emphasized that at this time no conclusions have been reached or are recommendations being made on any of the above-discussed structural changes. They are presented as examples of the type of inquiry currently underway.

Thinking longer term, some consideration will need to be given to the City's library system. Pasadena's boasts a world-class library system with ten branches and a total budget that well exceeds that of other communities with larger populations.

City	Population	Facilities	FTE	FY16 Appropriations in Millions of \$
Thousand Oaks	129,349	2	69.00	\$8.3
Pasadena	141,510	10	104.95	\$14.1
Torrance	148,427	6	74.00	\$7.7
Ontario	168,777	2	50.00	\$4.9
Rancho Cucamonga	174,064	2	51.00	\$5.0
Glendale	199,182	7	69.78	\$11.0
Anaheim	351,433	6	92.79	\$10.5

The voters of Pasadena have on three occasions approved parcel taxes to support the operations of the library. However, the parcel tax provides only about 20% of the total revenue requirement to operate the system, with the other 80% coming from the General Fund. It should be noted that the libraries are currently operating at a level of service greater than that set forth in the library special tax, with the Central Library open seven days a week and each branch operating six days. The Library special tax commits the City to operate the branches five days a week.

With the current parcel tax expiring at the end of Fiscal Year 2023, about six and a half years from now, plans for the future funding of the library system can be properly studied and deliberated before the need for any action. In preparation for 2023, the Council will need to decide whether to ask the voters to renew the tax, and either way, there must be a clear vision as to the continued future role of Pasadena's superb library system into the future.



With Pasadena's aging population and the library's ten locations strategically located throughout the City, one concept that might be worth pursuing is to augment the use of library facilities as senior centers. As envisioned these facilities would continue to function as libraries but take on new roles as well to meet growing service demands, perhaps in partnership with non-profit agencies.

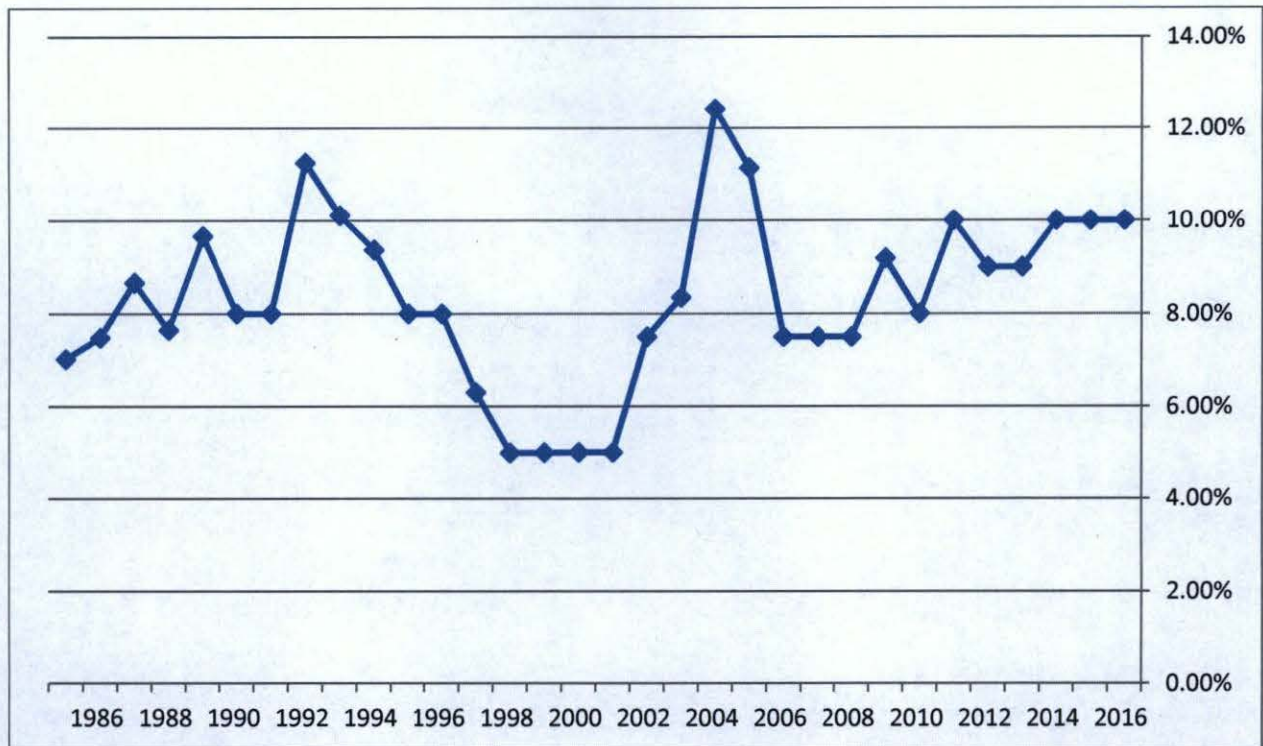
#### *Revenue Enhancements*

Increasing revenues reduces the need to make expenditure reductions. In order to ensure that City funds, including the General Fund, are recapturing the full cost of providing services for which fees have been established, a Cost of Service Study will be undertaken in calendar year 2017. Somewhat related to this is a Cost Allocation Study that will be performed to ensure the City's non-General Funds appropriately reimburse the General Fund for various central services including Finance, Human Resources, City Attorney, and City Manager.

Additionally, other efforts such as improving billing collection rates and exploring the potential for charging auto insurance when Fire personnel respond to vehicle accidents are being explored.

Any full discussion of revenues would be incomplete without mentioning the annual transfer from the City's Light and Power Fund. Prior to 2015 the General Fund also received a transfer from the Water Fund equal to 6% of gross income. However, as part of a legal settlement, the General Fund no longer receives this revenue and, in fact, paid back to the Water Fund the transfer for Fiscal Year 2015. As it relates to the Light and Power Fund, the City Charter sets forth the annual amount to be transferred to the General Fund.

In combination, City Charter Sections 1407 and 1408, establish that each year the Light and Power Fund transfers to the City's General Fund 16% of gross income of the electric works received during the immediately preceding fiscal year, not to exceed net income. The City Council may by resolution transfer a different amount. As indicated in the following chart, except for difficult economic times, the City has maintained the transfer level well below the threshold established by the City Charter.



In recent years the transfer has been held constant at 10% of gross revenues and the current General Fund Forecasts anticipates maintaining this level of transfer for the foreseeable future. Staff does not recommend increasing the transfer except for unique, one-time situations. Moreover, the transfer is limited by net income on a year-by-year basis. In Fiscal Year 2015 the Power Division's net income was \$171,849,000 and as a result the actual amount transferred to the General Fund was \$685,305 less than budgeted, \$17,870,224 and \$17,184,919 respectively. Moving forward, given the General Fund's reliance, it will be important to ensure the Power Utility has sufficient net income to make the full anticipated transfer.

Pasadena's budget challenges are not unique, many local governments struggled through the recession and many continue to struggle. Consequently, it is not surprising that the upcoming November 8<sup>th</sup> General Election contains a record number of local revenue measures. Statewide, 150 cities are asking voters to consider general and special taxes. There are 37 local measures directed at creating taxes on recreational marijuana for local cities and counties in anticipation of its legalization.

As the City seeks resources to maintain and expand municipal services, the City Council may want to consider whether some form of voter approved measure makes sense. Past discussions at the Council level regarding potential revenue measures considered the following types of sources.

*Parcel Tax* - Parcel taxes are a tax on real estate parcels, not the value of those parcels. For example, all property zoned single family residential would pay the same amount, regardless of size or value of the lot or improvements. The City's Library Special Tax is a parcel tax, which like many other parcel taxes has a different rate for differing types of property usage i.e., single family, multi-family and commercial/industrial use. Parcel taxes may be used for operating expenses, as is the case with the Library Special Tax.

*Real Property Transfer Tax* - The State of California Revenue and Taxation Code authorizes the imposition of a fee (\$0.55 per \$500 of sale value for sales above \$100) on the transfer of real property. Through the adoption of Pasadena Municipal Code Chapter 4.36, the City of Pasadena receives half of this amount, or \$0.275 per \$500 of sales value. Over the last two fiscal years, the Real Estate Transfer Tax has generated on average \$1.3 million.

Cities are permitted to levy their own transfer taxes. The cities of Los Angeles and Culver City have transfer taxes of \$2.25 per \$500 of value. However, if a city implements a transfer tax that exceeds the \$0.275 rate, it must forfeit the first \$0.275 to the county. An appealing feature of this tax is that only buyers of real property pay it and it represents a very small fraction of the overall transaction costs.

*Sales Tax* - Based on receipts for fiscal years 2015 and 2016, were the City to implement a quarter percent local sales tax it could be expected to generate between \$7.4 and \$8.1 million per year. A half-percent tax would be expected to generate double that, \$14.8 to \$16.2 million annually.

*Parking Tax* - Another possibility is the imposition of a tax on every paid parking space in public and privately owned or operated parking garages and lots, somewhat akin to the Transient Occupancy Tax on hotel rooms. The city of Los Angeles currently has a 10% parking occupancy tax. This tax would not be imposed on parking meters and thus would not impact parking meter rates. The City currently operates eight garages and three surface lots with a total number of 7,000 spaces. It is estimated that there are approximately 11,000 privately controlled spaces that would be subject to the tax, for a combined total of approximately 18,000. A tax rate of 10% would be expected to generate about \$2 million annually. Further study would be needed to develop more precise estimates.

*Business License Tax* - The City's Business License tax is levied on one or more factors e.g., number of employees, flat rate, type of business. In Fiscal Year 2016 the City's business license tax generated just over \$6 million in revenue. In analyzing data available from the California Municipal Revenue and Taxation Association (CMRTA), it appears that a number of cities which are comparable to Pasadena in many ways, e.g.

Santa Monica, Beverly Hills, and Culver City, generate significantly more revenue, because they utilize a gross receipts method of applying business license taxes.

Voter approval would be required before any of the above referenced measures could be put into effect. Moreover, depending on the proposed use of the revenue, the measure would be classified as either a general or special tax, each of which has its own threshold for voter approval. General taxes are defined as those that generate revenue for the general operation of government. Pasadena's Utility User's Tax is a general tax and therefore when voters reapproved it in 2008, the required threshold was 50%+1; actual approval was 58.4%. In other words, revenues from a General tax may be used for any purpose the governing body chooses to spend it on.

A special tax is one whose proceeds can only be used for a specified purpose. For example, a city might levy a parcel tax on property to pay for library services, as Pasadena has done, or a county could vote to levy a sales tax for jails. The State Constitution requires that such special taxes be approved by two-thirds of voters.

#### *Outreach both Internal and External*

The City Manager's Office has made communicating with employees about financial issues affecting the City a priority. Last spring several meetings were held with employees regarding the recommended operating budget. Subsequent to tonight's presentation additional staff-level presentations will occur.

Part of the overall budget strategy relies on using the knowledge of City employees to identify cost-reducing efficiencies or potential new revenues. Employees have been encouraged to share their ideas and recently a labor-management group was established with representation from every bargaining unit. While not exclusively related to the budget effort, it is hoped that this group will help to find solutions to issues such as reducing the cost of workers compensation claims, which impact the overall financial performance of the City.

Educating the public about City Finances and making information accessible and comprehensible is important as well, and was one of the key recommendation of the Task Force on Financial Administration and Internal Controls. Last January, the Mayor took a major step by explaining, in clear and simple terms, where General Fund revenues come from and where they go. He posed important questions to the public regarding the appropriate and sustainable level of City expenditures. Building on this effort, staff is planning a series of public outreach efforts regarding the budget and City finances to commence after the State of City presentation. A special edition of Pasadena In-Focus, devoted solely to the City's budget, will be distributed as part of this effort.

As stated at the beginning of this report, this is an ongoing process and future reports as well as the recommended operating budget for FY18 will be presented to the City Council for its consideration.

**FISCAL IMPACT**

The proposed actions contained in this report will reduce FY17 General Fund appropriations by \$2,113,057 and reduce the total number of Full-Time Equivalents by 7.0. As a result of the proposed shifts to non-general funds the Capital Improvement Fund appropriations will be increased by \$117,980, the Building Fund appropriations will be increased by \$465,377 and the Parking Fund appropriations will be increased by \$300,999.

Respectfully submitted,



Steve Mermell  
City Manager