



Agenda Report

TO: CITY COUNCIL

DATE: MARCH 30, 2009

FROM: CITY MANAGER

SUBJECT: STRATEGY TO ADDRESS OPERATING BUDGET DEFICIT

RECOMMENDATION:

It is recommended that the City Council endorse the strategy outlined herein to address the structural imbalance in the City's General Fund operating budget.

BACKGROUND:

Over the past several months, staff has made a number of presentations to the City Council regarding the fiscal challenges currently facing the City, specifically a widening structural deficit which has become more acute as a result of the current recession.

The most recent projections outlined in the General Fund Five Year Financial Forecast, which was presented to the City Council and Finance Committee on March 16th, indicate that unless actions are taken now the General Fund will essentially run out of money by fiscal year 2011 and could accumulate a negative fund balance in excess of \$95 million by 2014. Staff also illustrated how through a combination of expenditure reductions, modest revenue enhancements and careful use of reserves (i.e., existing fund balance) it is possible to balance revenues and expenses between now and fiscal year 2014. The following outlines in broad form the proposed strategy to achieve a balanced budget by 2014. Staff is seeking City Council endorsement of this approach as the fiscal year 2010 operating budget is formulated.

Expenditure Reductions

Although the General Fund is the main focus of the effort, virtually every City department/fund is experiencing financial pressure. In response, this past fall every department, General Fund and Non-General Fund, was directed to implement a managed savings plan goal of expending no more than 95% of current year appropriations. In order to achieve this, departments have reduced or eliminated discretionary spending in areas such as equipment replacement,

travel, training and use of outside contractors/consultants. This goal is complicated by the fact that direction to reduce expenses was not given until November and departments were also required to absorb more than \$3 million in approved salary increases across all funds without additional appropriations.

For fiscal year 2010 departments have been directed to identify potential savings equal to a 10% reduction from fiscal year 2009 appropriation levels. Although all the departments complied with the request to identify 10% reductions in their budget submittals, the reality of such significant reductions would result in service and program curtailments that are considered too drastic and as such not all of these reductions will be incorporated in the recommended fiscal year 2010 operating budget. Therefore a more gradual multi-year approach is being proposed.

Identifying and implementing efficiencies is key to reducing expenses. In the past few months dozens of potentially cost-saving suggestions have been submitted by employees through the *Budget Ideas* e-mail box or as a result of brainstorming sessions. Several teams are currently exploring those suggestions which upon initial assessment appear promising. Additionally, staff is currently evaluating opportunities to consolidate similar activities currently provided in multiple departments.

However, since Personnel-related expenses constitute 78% of all General Fund operating expenses, meaningful expenditure reduction cannot be made without focusing on this area. Accordingly, in the current fiscal year vacant positions will go unfilled as part of a hiring freeze and as part of the recommended fiscal year 2010 operating budget most, if not all, of these positions will be recommended for elimination.

Eliminating vacant positions alone will not be enough to close the projected gap between revenues and expenses. One proposal that has been identified as providing the single greatest value would be to reach agreement with the City's various labor groups to forego scheduled salary increases for calendar year 2009. Including unrepresented employees, such action would save an estimated \$7.9 million citywide and \$4.5 million in the General Fund alone, based on a projected 4% salary increase.

To date, several bargaining groups have indicated their appreciation of the situation and a willingness to forego scheduled increases. At this time, however, it is uncertain as to whether all the bargaining units will come to agreement and without unanimity it is possible that some who have signaled willingness may ultimately decide against it. To the extent that this concession cannot be reached, furloughs and/or layoffs will be inevitable as the City moves into fiscal year 2010. By way of example, using the median salary for fulltime employees (approximately \$80,000) achieving a level of savings in an amount equal to

foregoing a 4% salary increase would necessitate a layoff of roughly 60 fulltime positions in the General Fund alone.

To achieve the same level of savings through the use of furloughs would require ten days of unpaid leave per employee. Furloughs are less advantageous since they result in only one-time savings, while forgoing salary increases or layoffs result in ongoing savings and help address the structural nature of the deficit. Additionally, based on the Fair Labor Standards Act, furloughs may also create overtime liabilities for otherwise exempt employees and some City operations do not lend themselves to furloughs. To the extent that certain operations will by necessity be exempt from furloughs, the number of furlough days for other employees would be increased.

Revenue Enhancements

Increasing fees to the public and business community during a down economic time is not to be taken lightly. However, in some cases, as the cost of providing services has increased it is appropriate to pass the cost of service along to those who benefit from it. On April 20th the City Council will hold a public hearing on a proposed 2.97% increase in refuse rates to cover the increased cost of landfill charges as well as implementation of a \$0.79 monthly charge for street sweeping previously subsidized by the General Fund.

As a municipal utility the Pasadena Water and Power Department does not pay property tax or franchise fees to the City. Instead, the Water and Power Funds make an annual transfer to the General Fund pursuant to City Charter Sections 1407 and 1408. The transfer from the Water Fund is fixed at 6% of gross revenue and the transfer from the Power Fund shall not exceed 16% of gross revenue not to exceed net income. With few exceptions the transfer from the Power Fund has historically been 8%. At the time of adopting the current year operating budget the amount of transfer was set at 7.5%. As part of an upcoming budget amendment report, staff will recommend that the historic 8% level be reinstated beginning in the current year. The proposed increase would generate approximately \$795,000 in annual additional revenue to the General Fund.

Staff will continue to explore other opportunities for revenue enhancement while remaining cognizant of the impact on residents, businesses and visitors. Increases being considered that are unavoidable include water and power rates, and fees for Public Health services. Costs to purchase water and power resources are increasing at a dramatic rate and those costs must be absorbed by the ratepayers. Staff has proposed other cost reductions to the Water and Power Funds to help offset some of the increases, but rate increases are still inevitable.

Use of Fund Balance

Even under the best of circumstances, elimination of the deficit in the General Fund will be a multi-year effort. Fortunately, in addition to a 10% reserve, the City has undesignated fund balance totaling approximately \$28 million. This fund balance will enable the City to undertake a more gradual approach to resolving the structural deficit. Staff proposes that the unallocated fund balance be used to cover the budget shortfalls over the next few years while expenses and revenues are brought into alignment. However, as mentioned above, unless actions are taken now to reduce expenditures these funds will be depleted by 2011. The proposed comprehensive plan to right-size the General Fund, judiciously uses existing fund balance to partially offset the direct service impacts to the community.

FISCAL IMPACT:

The current FY2009 budget anticipated an operating deficit of \$14 million. Largely as a result of revenue shortfalls due to the current economic conditions the budget deficit this year could have swelled to nearly \$20 million if gone unchecked. As a result of the actions taken by staff and the City Council, the current year deficit is now projected at \$8.2 million. The successful implementation of the budget strategy defined in this report is expected to result in a balanced budget by FY2014 with a projected positive fund balance of \$2.9 million in addition to the 10% reserve.

On April 13th staff will present to the City Council the recommended fiscal year 2010 operating and capital budgets. At that time specific details on programs, services, and projects that will be impacted by budget reduction strategies will be presented.

Respectfully submitted,



MICHAEL J. BECK
City Manager