

Agenda Report

TO: CITY COUNCIL
FROM: CITY MANAGER
SUBJECT: BUDGET UPDATE

DATE: OCTOBER 5, 2009

RECOMMENDATION:

It is recommended that the City Council:

1. Direct staff to begin the process to allow for a one-time additional transfer from Power Fund to General Fund in the amount of \$2 million in lieu of additional reduction to public safety and health programs; and
2. Provide staff with direction on proposed budget strategies outlined in the body of this report.

EXECUTIVE SUMMARY:

During the FY 2010 budget process, it was estimated that the General Fund would end FY 2009 with a deficit of approximately \$9.5 million. As of the latest financial information, which is more final than what was presented at the August 17th meeting, the anticipated deficit will be closer to approximately \$9.1 million, which is in line with the original estimate. A number of major reductions were made during the development of the FY 2010 operating budget totaling over \$19 million in city-wide reductions including the elimination of 68 vacant positions and the de-funding of over 22 additional vacant positions. General Fund reductions represented over \$8.3 million of the city-wide reduction and over 49 positions. Additionally, all employees either gave up or postponed previously negotiated wage increases. This will save the General Fund almost \$24 million over the next five years.

Unfortunately, additional challenges have been identified which will require further adjustments to the FY 2010 budget. Due primarily to additional declines in sales tax and property tax revenues and State actions, approximately \$5.5 million of additional General Fund reductions and/or revenue enhancements must be identified in FY 2010. Estimates are that approximately \$3.5 million of this adjustment is structural (on-going) and approximately \$2 million could be a one-time adjustment. Absent this adjustment, the goal of erasing the General Fund structural deficit by FY 2014 will not be achieved.

Unanticipated State actions also impacted the Pasadena Public Health Department (PPHD). The PPHD was able to address all but \$369,644 of the additional \$700,644 of revenue reductions caused by State actions approved subsequent to the adoption of Pasadena's FY 2010 budget. Given the reductions already made by PPHD, it is recommended that an additional General Fund subsidy be used to address this remaining anticipated shortfall.

Staff has explored and continues to explore numerous areas where additional adjustments can be made, including reduction in personnel costs, informal suggestions of labor groups, department program reductions, and revenue enhancements. These areas are discussed in more detail later in this report and in the staff presentation.

The following chart provides a summary comparison of the General Fund 5-year Financial Plan as adopted for FY 2010, as revised based on current information excluding additional adjustments, and including adjustments.

	Original Estimate		Revised Estimate (exc adjustments)		Revised Estimate (inc adjustments)	
	FY 10	FY 14	FY 10	FY 14	FY 10	FY 14
General Fund						
Revenues	\$ 220.3	\$ 259.6	\$ 216.9	\$ 256.0	\$ 216.9	\$ 256.0
Expenses	\$ 225.9	\$ 258.0	\$ 227.0	\$ 258.6	\$ 221.5	\$ 255.1
Operating Surplus / (Deficit)	\$ (5.6)	\$ 1.6	\$ (10.1)	\$ (2.6)	\$ (4.6)	\$.9
Estimated Ending Fund Balance	\$ 14.5	\$ 3.0	\$ 9.0	\$ (16.6)	\$ 14.7	\$ 3.0

****Amounts in millions****

As reflected in the above chart, if nothing is done to address the expected revenue shortfalls, the General Fund will not only continue to have a structural deficit, but a negative fund balance.

BACKGROUND:

This report provides a more detailed discussion of the revised financial information for FY 2009; an update of FY 2010 based on the recent trend information and the resulting financial impacts to the budget; and the proposed strategy identified to address the impacts identified.

Revised FY 2009 Year-End Actuals

FY 2009 sales tax revenues continued to show larger than anticipated declines. The actual activity for the past two quarters, unlike the first quarter of the fiscal year, reflects an accelerating negative impact on the Pasadena economy. There is an approximately five month delay from the end of a quarter until the City receives actual sales tax data from the State. This delay and the current volatility of the economy makes estimating year end sales tax results very difficult. Given the current unprecedented economic climate, traditional trend analysis is less dependable. Pasadena, as is the case with most municipalities, contracts with a sales tax consultant to help maximize revenue collections, identify trends, and develop annual estimates for budgeting purposes. The most recent actual sales tax information received from our consultants is for the third quarter of the fiscal year 2009 (first quarter of the 2009 calendar year). Collections for this quarter were 15.3% or approximately \$1.1 million below the same quarter in the prior year. All major sales tax categories reflected significant quarter over quarter declines. Based on this latest information, it is anticipated that sales taxes will be approximately \$3.2 million below what was estimated for FY 2009. This decline was partially offset by increases in utility users tax revenues and investment earnings, in addition to savings by departments, who held vacancies longer, reduced other expenses such as travel, training, equipment purchases, and other expenses in an effort to help improve operating results in all funds.

Although no significant changes to the General Fund are anticipated at this point, these numbers are still subject to review by the external auditors.

FY 2009 activity in other funds appear to also be on target with expectations

Update on the FY 2010 Budget

Included in the adopted FY 2010 operating budget are significant reductions implemented to eliminate the General Fund structural deficit by 2014 and address issues in other funds. In all, the adopted budget reflects over \$19 million in reductions. Included in these reductions were the elimination of 68 vacant positions and the de-funding of over 22 additional vacant positions. Cuts in the General Fund represented over \$8.3 million of the city-wide reduction and over 49 positions. Examples of specific program impacts resulting from these reductions include:

- Reduced staffing for trial preparation and court rooms

- Defunding of 8.5 police officer positions, 3 youth advisors, 3 cadets, and 1 police specialist
- Reduction of investigative services
- Reduction in administrative support for ad-hoc committees
- Reduction of "In Focus" publications to 7 from 12
- Reduced internal audits
- Reduced staffing to perform site visits to businesses to ensure compliance
- Reduction of city-wide technology upgrades
- Increase work-loads for claims examiners
- Reduction of EOC training
- Increased processing time for housing clients
- Increased wait times at Central Library Circulation Desk
- Elimination of visits to daycares servicing less than six children per facility
- Reduction in proactive code enforcement
- Reduction in public out-reach for Open Space Element
- Delay in getting development-related cases to hearing by 6 weeks
- Reduction in nuisance abatement
- Increased wait times for health clients
- Reduction in pruning for trees, weeding, and seasonal plantings
- Increased response times for park repairs and maintenance
- Reduction of parking enforcement
- Elimination of 3 red light camera (not installed)

The chart below reflects the reductions, by fund, implemented to finalize the FY 2010 budget. The Amount column reflects the cost for FTE, services and supplies, and capital reductions.

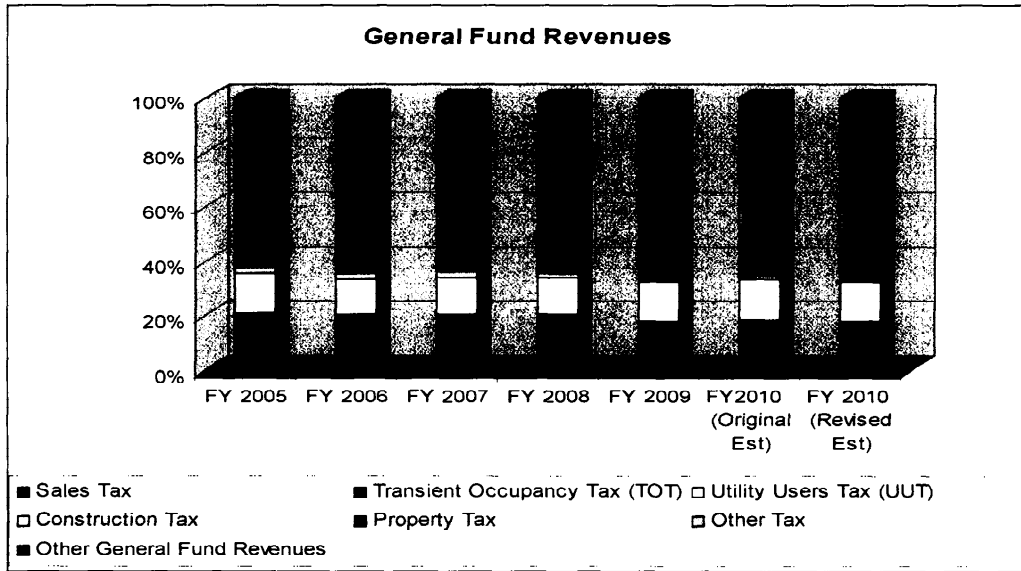
Fund	FTEs	Amount
General Fund	49.0	\$ 8,343,325
Library Fund	5.5	662,018
Health Fund	11.9	993,821
Building Services Fund	5.0	1,242,234
Housing Fund	5.0	629,813
Transportation Sales Tax Fund	0.0	-
Proposition C Fund	0.0	-
Civic Center Parking Meter Fund	0.0	10,000
Computing & Communications Fund	4.5	757,556
Building Maintenance Fund	3.0	758,930
Fleet Maintenance Fund	1.0	1,080,674
Benefits and Insurance Fund	1.0	74,500
Workers Compensation Fund	0.0	50,000
Printing Services Fund	0.0	91,850
Water & Power Funds	3.5	4,223,007
PCDC Funds	1.0	331,711
Total	90.4	\$ 19,249,439

Employees play a key role in maintaining the service levels desired by Pasadena residents. Approximately 77% of Pasadena's General Fund operating budget consists of personnel. The current state of the economy, however, has forced significant reductions in this primary source of service level provision. Over the past two years, Pasadena has reduced its labor force by 172 positions or 7%, including current vacancies. Additionally, approximately 35 individuals have notified the City that they plan to retire by December 31st of this year. These positions will be carefully analyzed to determine if additional savings can be generated by leaving them vacant or restructuring the positions. Additionally, during the FY 2010 budget process all employees agreed to either give up or delay previously negotiated wage increases. This will save Pasadena's General Fund almost \$24 million over the next five years. In addition to personnel reductions, contracts and other services and supplies have been reduced by \$15 million or 5.89%. Initiation of capital projects has been limited to only those projects which have dedicated funding that must be used for a specific project or where funds have been accumulated over a number of years.

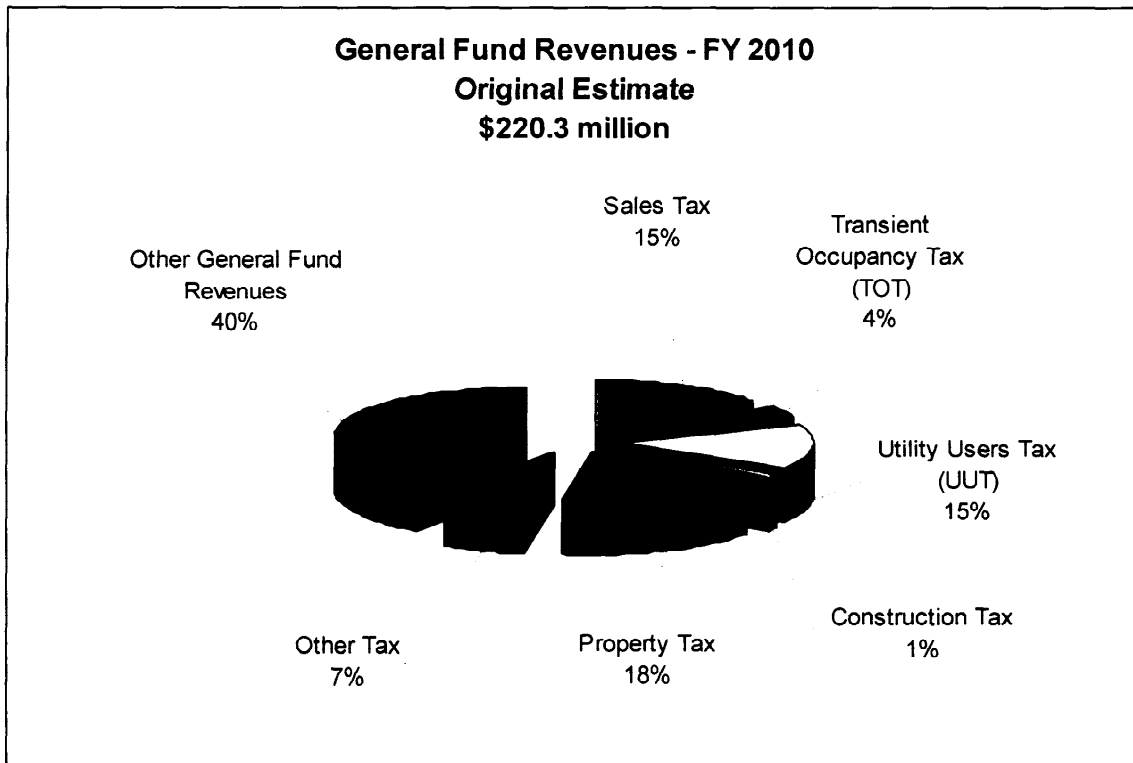
Local Economy Impacts

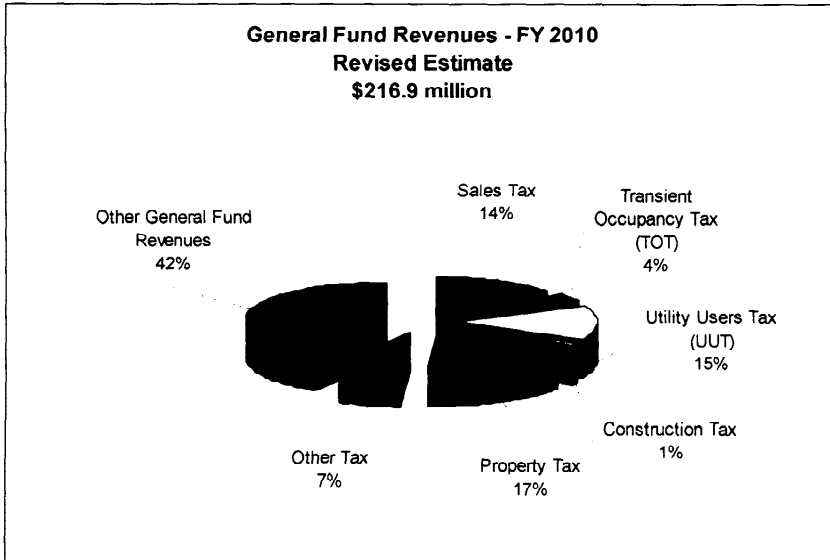
Based on information received subsequent to the start of FY 2010, it is anticipated that an added decline in property tax and sales tax revenues will occur by the end of the fiscal year. Recently released information from the County Assessor reflects that the City of Pasadena overall assessed value (AV) will be reduced by 0.2% from last year. Pasadena's AV growth has averaged 10% over the previous two years. As a result, staff believed that assuming a 4% growth in property tax revenues was a fairly solid estimate, especially when you consider that many of the residential property assessed values are much lower than even current market values. The anticipated impact of this action will be approximately \$1.3 million less in revenues than previously anticipated during the budget process. In addition to the economic decline, the timing of a very large exemption was a major factor in Pasadena's reduced AV. Additionally, continuing declines in sales tax revenues indicates that the sales tax revenue estimate for FY 2010 will be between \$2.5 million to \$3 million below estimates. Other General Fund revenues seem to be tracking to their original estimates at this time. Budget strategies identified later in this report will address this anticipated shortfall going forward; however, additional downward slides in AV and/or sales activity will require a re-examination of future budgets.

The following graph provides and illustration of the trend of the various General Fund revenue categories.

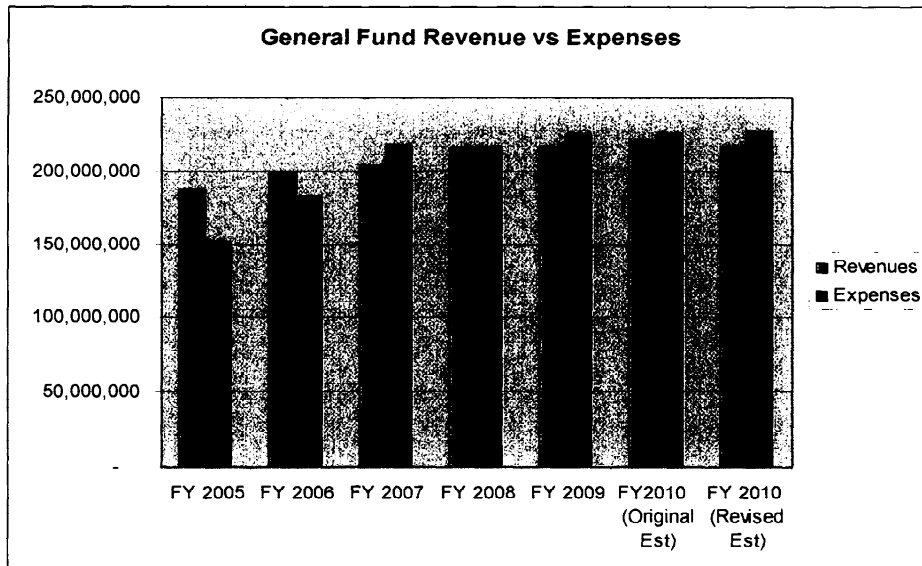


The following graphs shows the changes in the General Fund revenues from the original estimate adopted for FY 2010 and the revised estimate based on current information for FY 2010.





In the past, Pasadena has been fortunate to have been somewhat sheltered from the full impacts of the economic downturn. This shelter, however, is no longer there as can be seen in the graph below. Given the anticipated additional revenue shortfalls and the reductions implemented by the State, it is estimated that an additional General Fund budget deficit of approximately \$5.5 million will have to be addressed during FY 2010. Although the economy is beginning to show signs of stabilization, estimates are that sustained improvement is still twelve to eighteen months away.



State Budget Action Impacts

Unidentified State budget actions also remain as a threat to Pasadena's financial future. Previous actions by the State, which began in FY 2010, will cost Pasadena over \$19 million over a two-year period. Approximately \$4.6 million of this amount would be repaid within three years including interest in accordance with the provisions of Prop 1A (2004). The State has developed a securitization program similar to the one used for the Vehicle Licensing Fee (VLF) borrowing a few years ago to help ease the economic burden of their actions on local government. Under the program, Pasadena would sell its State receivable to the California Communities non-profit. Pasadena would be made whole and all interest and cost of issuance charges would be absorbed by California Communities. A major factor in analyzing whether or not to take advantage of this securitization program is the interest rate that the State will pay to borrow funds under the Prop 1A (2004) provision. If the Pasadena can earn a higher interest rate than the State is willing to pay and if there are no arbitrage yield restrictions, it would make sense to take advantage of the securitization program. On September 25, 2009, the State announced that the interest rate for the borrowed Prop 1A (2004) funds will be 2%. Staff is convinced that Pasadena can find an investment that earns more than 2%; however, the State is still in the process of finalizing the details of the securitization program. SB 67, which was introduced as clean-up language to help finalize the program, was not adopted before the end of the last legislative session. Consequently, a final analysis at this time is difficult. Per existing rules, local agencies have 30 days after the announcement to decide whether or not to take advantage of the securitization program. This deadline may change, however, as the details of the securitization program are finalized.

Approximately \$12.8 million of the \$19 million two-year reduction relates to Pasadena PCDC tax increment revenues. It is estimated that the action taken by the State will reduce Pasadena redevelopment tax increment revenues by approximately \$10.6 million in FY 2010 and an additional \$2.2 million in FY 2011. Pasadena, along with other redevelopment agencies supports the efforts of the California Redevelopment Association in filing a lawsuit challenging the constitutionality of this transfer. It is anticipated, however, that the final determination of the lawsuit will not be for a year or more, long after the State has taken the money. Fortunately, staff had anticipated this type of State action and had retained revenues and not added new projects so the impacts on current projects are minimal. However, future initiatives will clearly be impacted if the revenue is not returned to the Pasadena PCDC.

State budget actions adopted subsequent to the adoption of Pasadena's FY 2010 budget will cost the Pasadena Public Health Department (PPHD) approximately \$700,644 in the FYY 2010 beyond what was originally estimated. The PPHD has been so severely impacted by State budget balancing actions that its overall function has been severely impacted. The budget of the PPHD

has been reduced \$944,215 or 7.2% over the past two years including the elimination of ten positions. In an effort to help minimize further service level impacts and the impact to the General Fund, PPHD staff applied for and received two grants totaling \$331,000. This will reduce the new FY 2010 budget gap to \$369,664.

An additional reduction of \$369,664 would inhibit the provision of basic health services programs such as CalWORKs Substance Abuse, MCAH Outreach/Allocation, Medi-Cal Prenatal Clinic, and County Healthy Kids Program. As a result, it is recommended that the \$369,664 budget gap be addressed through an increased General Fund subsidy.

State legislators have already voiced objections to some of the last minute measures implemented by the Governor and are attempting to reverse these actions. This, in addition to other measures taken by the State which are doubtful as to their success, will undoubtedly require the State to re-evaluate the budget within the next few months. This could result in additional actions which will be adverse to local government. Staff continues to monitor State legislation in order to minimize further cuts to local governments.

Other Fund Issues

Issues in other funds caused by the continuing economic downturn will also require adjustments during FY 2010. The following is a discussion of the more severe issues not previously discussed.

Water & Power

The Water and Power Department is facing significant challenges related to the cost and availability of clean, renewable resources. Pasadena's groundwater and purchased water supplies are facing restrictions due to contamination, ongoing drought conditions and judicial rulings that limit the amount of water available from northern California. Although the Department is embarking on an aggressive program to treat perchlorate contamination in local groundwater with construction and operation of the Monk Hill treatment facility during fiscal 2010, it expects to remain dependent on the Metropolitan Water District (MWD) for approximately 65% of water supplied to Pasadena's customers. MWD is expected to increase its price for water supplied to Pasadena and other member agencies by as much as 40% over the next two years. In spite of prudently implemented spending reductions, the Water Fund anticipated a structural deficit of approximately \$5.4 to cover ongoing fixed and operating costs bringing the cumulative deficit to approximately \$25 million if a rate increase had not been approved in July 2009

The Water and Power Department will also be implementing the recently adopted Integrated Resource Plan (IRP) for energy, which calls for procurement of increased amounts of renewable energy at significantly higher costs and limited availability. The IRP includes goals for Pasadena to increase its renewable

energy mix to 15% by 2010, 33% by 2015 and 40% by 2020, which will require the replacement of less expensive coal-generated energy with renewable resources such as wind, solar and geo-thermal projects. Pending Federal legislation to develop a cap-and-trade policy would increase the cost of all fossil-fueled energy resources, especially

Fire & Police Retirement System (FPRS)

Over the past several years the City has been required to make supplemental contributions to the System in order to meet the actuarial funding requirements set forth in a contribution agreement between the City and the System. Supplemental contributions are estimated to exceed \$10 million annually over the next several years and extend beyond the 2014 timeline when the ability to utilize tax increment funding expires. Without the use of tax increment dollars, supplemental contributions would have to be provided by the City's General Fund. In August, the City Manager created the FPRS taskforce consisting of citizens and staff. Their task is to explore potential funding options for the City Manager to consider before the end of the year.

Budget Strategies

Based upon the latest financial information, it is anticipated that a General Fund structural adjustment of approximately \$3.5 million and a one-time adjustment of approximately \$2 million will be required this fiscal year to achieve the City Manager's goal of eliminating the General Fund structural deficit by 2014. Structural adjustments have a compounding effect over time. For example, a \$3.5 million structural decrease in expenses in FY 2010 will result in a cumulative decrease of \$17.5 million by FY 2014. One-time adjustments have no cumulative effect over time because they are restored the next year. For example, a \$2 million one-time adjustment will only affect the ending fund balance by \$2 million by FY 2014.

The information listed below is intended to provide target areas to achieve the adjustments needed.

Structural (on-going) and one-time General Fund adjustments

In developing department reductions, all departments were tasked with evaluation of their respective programs to identify reductions from their FY 2010 adopted budget. Departments were also directed to focus on programs that could be eliminated and not merely across the board cuts that would reduce quality of the entire department. Departments had to justify their recommended reductions and discuss the impact on service levels.

In addition to the departments reviewing their respective programs, a labor brainstorming team was also established to help develop strategies to address the additional shortfall. Although significant reductions were not identified during this process, staff believes that the door has been opened to make meaningful future

strides in addressing issues and identifying measures to improve overall City operations.

Pasadena employees have done a great job over the past year in making significant reductions while minimizing service level impacts. The continuing economic downturn and the on-going state actions, however, will force even more drastic reductions where more severe service level reductions will be unavoidable. These more severe actions are necessary to maintain Pasadena's fiscal health.

The items being reviewed to address the \$5.5 million structural or on-going adjustments for FY 2010 include;

Program/Service Reductions	\$ 3,250,000
Transfer from the Power Fund	\$ 2,000,000 *
Labor Group Reductions	\$ 200,000
Revenue Enhancements	\$ 50,000
Total Budget Impact for FY 2010	\$ 5,500,000

* denotes one time

During FY 2009, the Power Fund realized a larger than anticipated operating surplus in power generation and acquisition savings resulting from a significant decrease in fuel prices. Consequently, a one-time increase in the transfer from the Power Fund to the General Fund can be accomplished without impacting operations. This one-time transfer would be used to offset reductions that would have otherwise been required in the police, fire departments and public health related to the General Fund revenue shortfalls previously discussed.

At this time, Pasadena must face the reality that it can no longer maintain current service levels in this economy. All programs need to be evaluated to determine their viability and/or whether modifications are required. Absent this evaluation and change where necessary, the overall quality of the services being provided is diminished. Delayed responses in direct customer contact areas, concentration on priority services, reduced ability to address special requests, increases in reactive operations, and reduced employee morale will more than likely be a consequence of these additional reductions; however this is what is required to maintain financial stability.

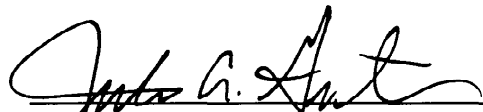
Next Steps

If the budget strategy outlined above is accepted, staff would return to Council on November 2nd with final details and to get necessary action to implement the approved adjustments. Additionally, staff will provide quarterly financial updates on financial activity including recommended changes to address positive and negative changes to staff's financial assumptions.

FISCAL IMPACT:

A combination of the worsening economy and impact of State budget reductions will force the City to take very difficult measures to maintain financial strength. Additional reductions of approximately \$5.5 million will be required to address the financial issues based on current information.

Respectfully submitted:


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City Manager

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