

May 12, 2014

HONORABLE MAYOR AND CITY COUNCIL MEMBERS:

It is my pleasure to present for your consideration the Fiscal Year (FY) 2015 Recommended Budget for the City of Pasadena. The budget document represents the City's financial plan for the coming fiscal year, July 1, 2014 to June 30, 2015, and was carefully developed to further the City's important mission of delivering exemplary municipal services to our entire community that is consistent with the City's history, culture and unique character.

While the budget document includes hundreds of pages full of facts and numbers, it is important to remember that the budget is really about how the City, as an organization, serves our residents, businesses and visitors. The budget defines how we operate as a city and sets our investment priorities based on the City Council's goals and objectives, but it is also the detailed financial story of the customer service we provide to our 140,000 residents, our schools, the thousands of businesses operating here and the millions of people who visit Pasadena.

The budget also provides the means to fund the ongoing maintenance and improvements to the City's infrastructure, including our streets, bridges, utilities and parks, plus providing the tools, training and equipment needed by our employees.

In short, the sum total of the budget is more than just a compilation of "bottom line" numbers. It is the foundation upon which we annually establish our connection to the public. It is the single most important document produced by the City and, as you read through the budget, I am sure you will agree that Pasadena is a truly outstanding organization and one of the finest cities in the country.

Pasadena benefits from its international reputation as a beautiful, innovative and creative destination city. In many ways, Pasadena is the model city that others try to emulate. As an organization and as a community, we cannot take for granted that great cities like Pasadena don't just happen. They are fashioned through the leadership of their elected officials, the hard work and dedication of their employees and the active engagement of an informed community.

The budget also should be viewed as a forward-looking document that shows how future investments in the City are

being made through the completion of work such as our General Plan and updates to our Specific Plans.

Overall, the FY 2015 Recommended Budget continues our focus on ensuring the City operates in an efficient and effective manner with a balanced plan as we define future municipal endeavors and governance based on Pasadena's storied history and past achievements.

FY 2015 RECOMMENDED BUDGET SUMMARY

The FY 2015 Recommended Budget totals \$675.2 million. This figure includes an operating budget of \$540.7 million, capital appropriations of \$72.3 million and appropriations of \$62.2 million for the City's three operating companies—Rose Bowl Operating Company, Pasadena Center Operating Company and Pasadena Community Access Corporation.

Also included in the Recommended Budget are General Fund appropriations of \$209.5 million and estimated General Fund revenue of \$209.6 million.

The Recommended Budget reflects a slight decrease from the previous year's adopted budget while also showing modest increases in funding for technology, direct service delivery, planning, employee safety and training and continued investments to Pasadena's municipal infrastructure.

Modest revenue growth allows for a few funding enhancements in the recommended budget, however, there are limited discretionary opportunities to enhance City programs and services. Although City departments continue to identify and track millions of dollars in funding requests to meet the needs of our community, available funds continue to fall far short of the need.

A comparative summary of appropriations and Full Time Equivalent (FTEs) positions is shown on the following tables. In order to provide a meaningful comparison across fiscal years, transfers to and from the City's General Fund relating to the former redevelopment agency, the Pasadena Community Development Commission, which occurred prior to the dissolution of redevelopment in FY 2012, do not appear in the table below.

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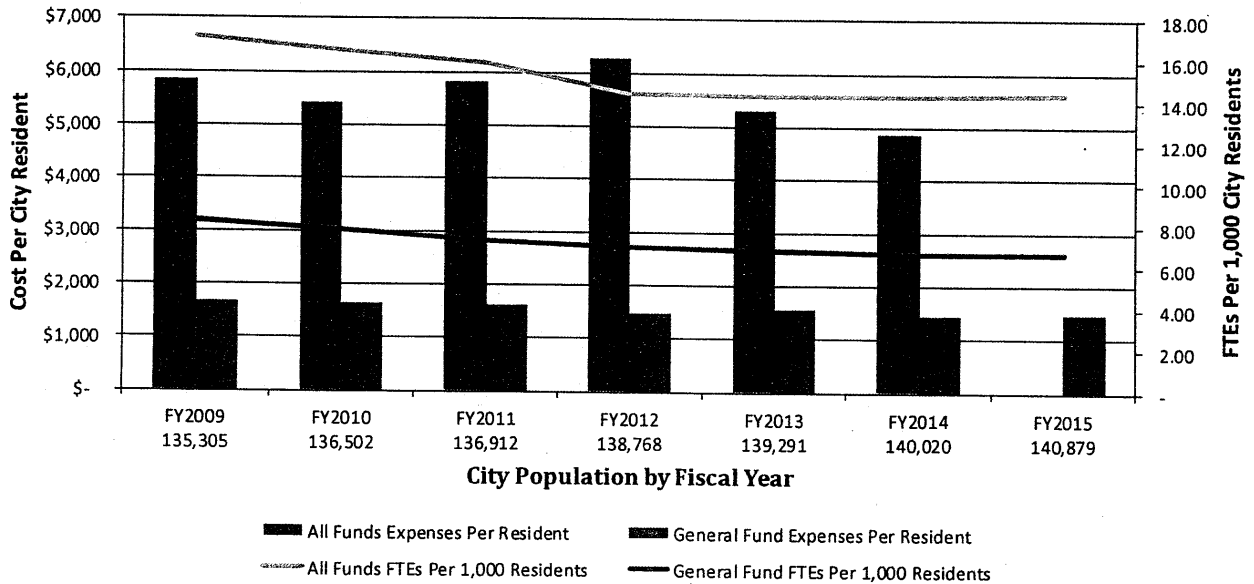
Total Appropriations (including Affiliated Agencies and CIP)

	FY 2013 Actual	FY 2014 Adopted Budget	FY 2015 Recommended Budget
All Funds	\$784.0 million	\$677.5 million	\$675.2 million
General Fund	\$206.1 million	\$202.7 million	\$209.5 million

Full-Time Equivalent Positions

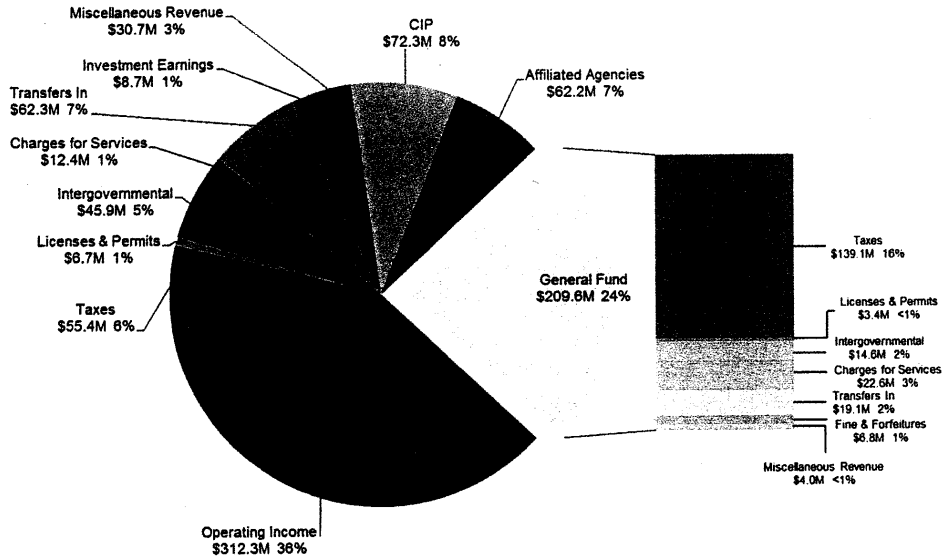
	FY 2013 Actual	FY 2014 Adopted Budget	FY 2015 Recommended Budget
All Funds	2,225	2,145	2,170
General Fund	949	937	945

Cost per Resident and FTEs per 1,000 Residents

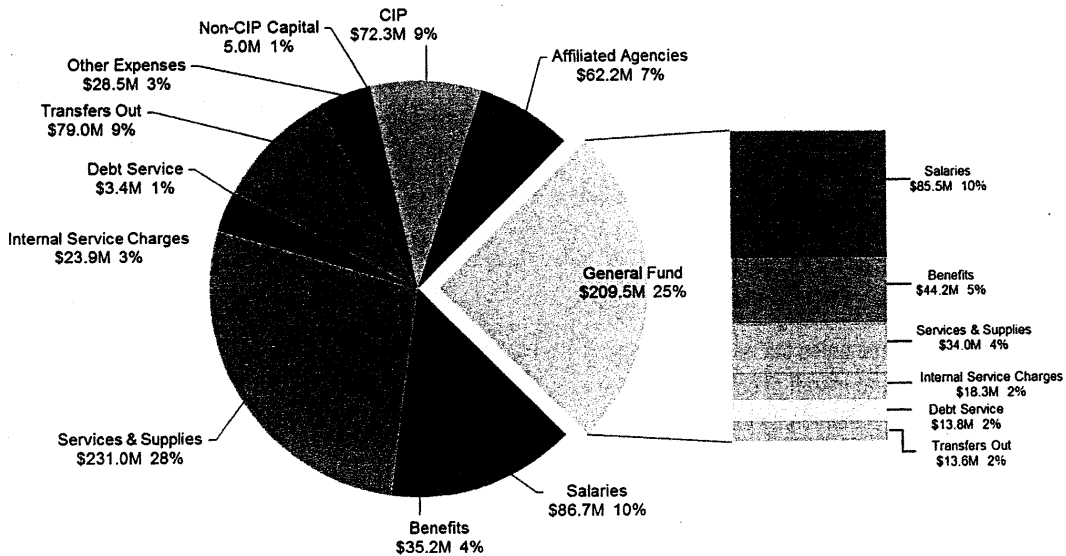


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FY 2015 OPERATING REVENUES BY CATEGORY



FY 2015 OPERATING APPROPRIATIONS BY CATEGORY



Note: Both the revenue and appropriations charts include inter-fund transfers totaling \$136.8 million. The appropriations chart includes \$26.9 million in capital-related salaries and benefits which are also included in the \$72.3 million of CIP appropriations due to current budget system limitations.

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THE CURRENT ECONOMIC CLIMATE

The national and state economies are expected to continue experiencing slow growth that has existed during the past few years, requiring the City to remain diligent in monitoring its revenues and adjusting expense patterns accordingly.

National GDP is anticipated to grow at a rate of 2.9 percent in 2015 as compared to 2.5 percent in 2014, according to the Los Angeles Economic Development Corporation (LAEDC). While this growth rate is better than anticipated in prior forecasts, results from the reductions required by the federal sequestration will continue to impact local programs such as the Community Development Block Grant (CDBG).

The California economy also continues to improve, according to the state Department of Finance. California's unemployment rates are at pre-recession levels and total private nonfarm employment has fully recovered, adding more jobs than were lost. The Governor's preliminary FY 2014/15 budget anticipates a \$3.5 billion year-end fund balance which includes a \$1.6 billion rainy-day reserve.

Prudent actions such as paying down the State's "Wall of Debt" and building up economic reserves are positive steps to improve the State's fiscal strength in the coming years. If these plans are realized, local city and county jurisdictions could be spared additional State take-away attempts.

Funding to replace money previously taken from local jurisdictions by the State is not anticipated, however, the Governor's budget proposal does recommend repaying outstanding economic development bonds issued in 2004 as a part of the "triple flip" program a year early. This will eliminate the very confusing and complicated "triple flip" calculation and return the full 1 percent point of sale sales tax revenues to local government. Eliminating the "triple flip" program could result in a one-time sales tax revenue windfall to Pasadena of approximately one month of collections at the time, or about \$2.6 million. It is uncertain as to the exact amount that will be realized and when it would be received.

The local economy also continues to perform well and there are more signs of renewed economic growth, including increases in retail sales activity, more tourism and business travel activity, lower unemployment rates, and a continued upswing in the residential and commercial real estate markets.

The California Employment Development Department reports that as of March 2014 Pasadena's unemployment rate was 6.6 percent versus 7.6 percent in neighboring Glendale, 7.1 percent in Burbank, 8.7 percent in Los Angeles County, and 8.4 percent for the state of California. This is down for Pasadena from 9.5 percent at the peak of the recession.

Total assessed property valuation for Pasadena in 2013 was \$23.11 billion, up 5.3 percent from the previous year, according to the Los Angeles County Assessor's Office. The increase is part of an overall trend for both residential and commercial property in Pasadena, one of the few regions in Southern California where property values have remained strong and highly desirable even during the economic recession.

In the coming year, Pasadena anticipates the opening of a new Tesla car showroom in the Old Pasadena District along with several new high-end gourmet restaurants, fashion stores and retail shops.

Commercial investment is showing signs of improvement. There are five new hotel projects in the planning phase and one under construction. Demand for new residential development remains strong with approximately 1,700 new units under construction or in the planning entitlement process. The first new office project in several years is under construction in the Playhouse District while Lincoln Properties is proceeding with entitlements for an exciting new development with more than 1 million square feet of new residential and commercial space at the Parsons Engineering headquarters site adjacent to Old Pasadena.

Design, high-tech and innovation companies along with academic institutions are continuing to thrive under the new Innovate Pasadena initiative. Pasadena's innovative ecosystem is already home to more than 100 technology, design companies and start-ups that are helping to change the way the world lives, works, connects and plays together.

FISCAL YEAR 2015 RECOMMENDED BUDGET OVERVIEW

The FY 2015 Recommended Budget has been developed based on the City Council Strategic Plan goals. All Department performance measures and City activities are tied to one or more of these goals:

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- 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

The FY 2015 Recommended Budget continues the practice of conservative revenue estimates, especially in the General Fund. Overall, the recommended budget anticipates modest increases in most revenues.

The City anticipates key tax revenues—including property tax, sales tax, and utility users' tax—will be approximately 4 percent above the FY 2014 revised estimates. The increase in property tax revenue is partly due to the sunset of SB 481 in December 2014, representing approximately \$1 million to the City.

Transient Occupancy Taxes (TOT) charged to visitors by hotels continues to show improvement over the prior year due to increased tourism, business travel and bookings at the Pasadena Convention Center. The FY 2015 Recommended Budget anticipates that TOT revenues will be approximately 7 percent higher than FY 2014 revised estimates. Overall General Fund revenues, however, are anticipated to only increase 2.5 percent over the prior year.

The City also anticipates ending the current fiscal year with positive General Fund net income of approximately \$1 million. This is approximately \$800,000 more than originally anticipated and is due, primarily, to a one-time payment of principal and interest for an outstanding debt due to the General Fund from the Parking Fund.

In order to ensure appropriate revenues from various city services are accurately accounted, a cost recovery policy is being prepared for City Council consideration during the FY 2015 budget hearing process.

General Fund expenses are estimated to increase by 2.5 percent due to increases in contract services and supplies and allocated charges from internal service departments.

FISCAL DRIVERS

The FY 2015 Recommended Budget is influenced by several fiscal drivers noted below that will also continue to influence future budget development.

These fiscal drivers expanded upon over the next few pages include:

- On-going & future increased costs for personnel and pensions.
- Slow revenue growth.
- Aging infrastructure & maintenance costs.
- Pending and future litigation.
- Elimination of redevelopment tools by the State.
- Fallout related to the federal government's budget reductions.
- Replenishing the City's fiscal reserves.

Personnel Costs

It is anticipated that planned CalPERS increases not under the City's control could add as much as \$8 million in annual pension costs for Pasadena beginning in FY 2017.

Due to productive negotiations for pension reform by the City with its various bargaining units, however, additional employee contributions toward the CalPERS retirement plan will help mitigate some of the City pension expenses.

To date, approximately 92 percent of the City's non-safety employees now contribute 8 percent toward their CalPERS retirement costs, (7.5 percent for PARS members).

For sworn employees, 58 percent will be paying two-thirds (about 66 percent) of the employee retirement contribution to CalPERS beginning in FY 2015 and that contribution will increase to their full 9 percent member contribution beginning in FY 2016. The remaining sworn employees are currently in labor negotiations with the City.

Even with these reform measures, personnel costs still remain at approximately 61.9 percent of operating expenses in the General Fund for FY 2015. Absent our successful, local pension reform, however, this figure would be significantly higher.

Slow General Fund Revenue Growth

Excluding one-time sources, revenue growth in the General Fund has averaged only 2.5 percent during the past two years. Businesses and consumers continue to be cautious about the economy. This is reflected in the fact that while sales tax revenues are up from last year, the dollar amounts are still at FY 2005 levels.

Aging Infrastructure

The current Five-Year Capital Improvement Program (CIP) has identified over \$643 million of necessary projects without identified funding sources. The longer these projects are delayed, the more expensive they become. The CIP is discussed in more detail later in this letter.

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Litigation & Impact on Revenues

Water Fund Transfers

On September 30, 2013, a complaint was filed in Los Angeles Superior Court against the City of Pasadena regarding routine transfers from the Water Fund to the General Fund already authorized by Section 1408 of the Charter. The General Fund could sustain a loss of several million dollars per year depending on the outcome of the litigation.

Claim for Partial Refund of Water Charges to Customers Outside City Limits

On March 24, 2014, the City received a claim seeking refunds for charges collected by the City from water customers who live outside the City limits. The City intends to deny the claim and vigorously defend against any litigation that may follow. Depending on the outcome, the General Fund could be facing a loss of up to \$2 million per year.

SB 481 Litigation

As much as \$40 million in General Fund revenue hangs in the balance of a pending State Court of Appeal ruling brought on as part of the State's dissolution of local redevelopment agencies.

Elimination of Redevelopment Tools

In early 2012, the State Legislature eliminated all redevelopment agencies created by California's cities and counties, ending one of the most effective and important economic development tools available to local government. Eliminating local jurisdictions' abilities to use the redevelopment principles of economic incentives combined with tax increment financing has significantly hampered the economies of California cities and counties and will continue to do so for the foreseeable future.

Federal Sequestration

Although the federal government approved a budget plan, sequestration reductions will remain at least through the current federal fiscal year. Particularly affected by these reductions will be our Community Development Block Grant (CDBG) program, the Build America Bonds (BAB) subsidy and HOME funding. Over the last three years, federal funding for these programs has been reduced by almost \$1.7 million.

Replenishment of the City's Reserves

Since FY 2009, approximately \$25 million of General Fund reserves has been used to help cushion the impact of the Great Recession on City service levels. Prudent fiscal planning and a commitment in the years leading up to FY 2009 had built up reserves that, absent their availability, would have resulted in catastrophic reductions in service levels that would have significantly reduced Pasadena's quality of life.

As the economy improves and funding becomes available, replenishment of reserves as a hedge against the next, inevitable, economic downturn must be a top priority. Under the assumptions of the budget forecast, very modest amounts should be available through FY 2019 for reserve replenishment in the General Fund and other applicable funds.

Unfunded Liabilities - Other Post-Employment Benefits

An actuarial study of Pasadena's Other Post-Employment Benefits relating to retiree health benefit liability was completed in 2014, reflecting a July 1, 2013 valuation date.

The report determined that Pasadena's actuarial liability was approximately \$35.8 million based on a 25-year amortization period. The annual required contribution (ARC) to address this liability was determined to be approximately \$2.9 million. Pasadena is currently using a pay-as-you-go methodology and is only paying about \$580,000 per year toward this amount. The current General Fund Five-Year Forecast assumes additional annual payments toward the ARC beginning in FY 2016 of \$200,000 and increasing to \$1 million in FY 2019. Although better than the current methodology, this amount still will not totally fund the future anticipated liability and will need to be revisited.

**FY 2015 CAPITAL IMPROVEMENT PROGRAM
APPROPRIATIONS**

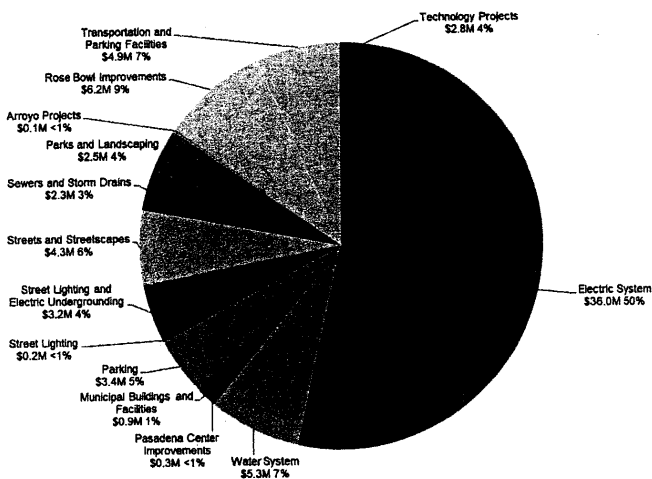
Protecting, maintaining and replacing the City's infrastructure such as roads, bridges, parks, public buildings, vehicles, utility systems and parking facilities is one of the most important aspects of running an efficient, responsible City. Pasadena will continue with both major and minor infrastructure improvements through the City's FY 2015 – FY

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2019 Capital Improvement Program (CIP) Budget. The CIP is the fiscal blueprint for new construction and major maintenance projects designed to protect and preserve Pasadena's outstanding quality of life.

The current five-year plan includes 226 identified projects with a total estimated cost of \$901.1 million. Additionally, there are 183 identified projects totaling \$551 million in the Future Projects section, bringing the total amount of unfunded projects to \$643 million. Identifying these projects as part of the program allows staff to pursue funding opportunities when, and if, they become available.

For FY 2015, the CIP includes \$72.3 million in appropriations for 79 projects, including 15 new projects. The following graphic illustration shows FY 2015 appropriations by major project category.



In addition to the City Council's Strategic Plan goals previously noted, the following criteria is also used for developing and prioritizing the CIP:

- Public safety concerns
- If costs of existing maintenance exceed projected replacement costs
- Whether the existing facility or system no longer meets City needs/demands

One of the most important categories of capital improvements are projects related to the City's water and power utilities. The City's Water and Power Department (PWP) continues to be proactive in making infrastructure investments as approved under the Water Distribution System Master Plan and the Water Integrated Resources Plan.

These investments not only protect the City's valuable investment in its utility infrastructure, but also help to improve water quality, supply, and reliability for customers as well as well production capacity. The system improvements also reduce dependency on imported purchased water and meet California's conservation requirements.

In FY 2015, the City anticipates completion of the Well Collector Pipeline project and continued work on the Recycled Water project and seismic retrofit of reservoirs.

PWP also will continue to explore projects and negotiate cost-effective contracts to augment its renewable portfolio standard and manage its California Greenhouse Gas (GHG) obligation through participation in the GHG Cap and Trade program.

PWP's Repowering Project is expected to begin in FY 2015 with construction of a 71 MW combined cycle electric power generating unit to replace an old steam-powered unit.

The complete FY 2015 – FY 2019 CIP document is posted on the City's website under the Public Works Department pages at: www.cityofpasadena.net/PublicWorks

CONCLUSION: LOOKING TO THE FUTURE

Pasadena has a rich history and a bright future. Under the City Council's leadership, Pasadena has achieved remarkable success and has overcome many of the recent financial challenges that have stymied other cities and counties across the country.

Over the past five years, the City has successfully faced these daunting challenges, and, as a result, Pasadena is looked upon as a national role model for prudent fiscal planning, local pension reform and sound, well-timed investments in infrastructure that makes it the envy of other local jurisdictions. Our policies and budget planning are now beginning to show a significant return on our efforts as Pasadena has been clearly identified and branded as a premier locale for private sector investment and development; a top travel and tourism destination and a perfect setting for cultural and artistic endeavors.

While acknowledging our success is important, it is vital that the City remains true to the policies, goals and values that have allowed us to maintain strong fiscal health. The City must also continue to address a wide variety of infrastructure-

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related projects and funding issues to protect our valued quality of life.

Another positive outcome from the past financial challenges has been for the City to reinvigorate its emphasis on organizational efficiency and to recognize the value of our most important resource: the men and women who work for the City and make Pasadena the world-class city that it is.

We are, after all, a customer service organization at all levels, and, as your City Manager, it is very important for me to lead by example and to help all City employees embrace the ideal that we are an organization of people serving people.

This FY 2015 Recommended Budget continues to recognize our core values and is a testament to the City Council's vision and leadership. The budget is a commitment to our residents, our businesses and City employees that we will strive to do the very best we can with the resources and tools available to us.

In that spirit, I submit the FY 2015 Recommended Budget for your consideration with the pledge that the City of Pasadena will continue to be a leader in effective municipal governance and maintain its outstanding high quality of life as a premier city in the United States to live, work, learn, play and do business.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Michael J. Beck", with a long horizontal flourish extending to the right.

Michael J. Beck

City Manager