# Agenda Report

November 23, 2015

**TO:** Honorable Mayor and City Council

**FROM:** City Manager's Office

**SUBJECT: BUDGET WORKSHOP TO CONSIDER PRIORITIES FOR FISCAL YEAR 2017 BUDGET PREPARATION**

## RECOMMENDATION:

The following report has been prepared to assist the City Council in setting priorities for the Fiscal Year (FY) 2017 Operating and Capital budgets.

## BACKGROUND:

This past October, staff initiated the preparation of the recommended operating and capital budgets for Fiscal Year (FY) 2017. As part of the process, actual and projected revenues and expenses in the City's various major funds are carefully analyzed to determine available resources for the next several fiscal years. The main focus of this effort as well as tonight's workshop is the City's General Fund, which pays for most City services. The main vehicle used to monitor the General Fund is the Five Year Financial Forecast.

As indicated by the Five Year Financial Forecast (Attachment A), following several years of negative net income, necessitating the need to draw upon fund balance, the General Fund returned to positive net income in FY 2013. This trend has continued through the close of FY 2015 which had a net income of $11.5 million, even after the transfer of $5 million back to the Water Fund to settle litigation involving the utility transfer, and $1 million allocated to reduce the OPEB liability. The significant positive outcome last fiscal year was primarily the result of an improving economy, a one-time increase in property tax revenues as the result of the dissolution of redevelopment in California, the benefit of structural cost reductions made in response to the Great Recession and savings from staff vacancies.

Taking advantage of the increase in net income, in June 2015, the City Council directed staff to apply $10 million to the General Fund Reserve. In addition, staff has set aside $2.5 million for possible obligations associated with the sunset of SB481.

The City is approximately halfway through Fiscal Year 2016. Based on current projections, the General Fund is anticipated to finish the current fiscal year with positive net income of under $1 million; far less than the FY2015 results, which were extraordinary. However, tax revenue estimates may be understated for FY2016 so staff will continue to monitor income and adjust revenue projections as appropriate. Looking forward over the next several years, the General Fund is currently projected to have negative net income in later years. There are a number of factors that influence both expenses and revenues and staff will continue to evaluate projections to see if the assumptions should be modified for future years, which would impact net income, hopefully to the positive.

Personnel-related costs such as salaries, benefits and contributions to California Public Employees Retirement System (CalPERS) represent the majority of expenditures in the General Fund, accounting for almost 70% of total expenses. Consequently, increases in labor costs have a significant compounding impact on future year expenses. By way of example, a 1% increase in CalPERS rates for all employees translates to an increase of nearly $1 million per year. Typically CalPERS notifies cities of rate changes in October, however, this year CalPERS has indicated that this information will be delayed until December, or later, creating greater uncertainty in financial planning. To be conservative, the Five Year Financial Forecast assumes a five percent increase in overall personnel costs for FY 2017, which includes salary increases, workers compensation, general liability, personnel leave time in addition to salary, medical and retirement contributions. The other major categories of expenses; services and supplies, equipment, and internal service charges are projected to have a modest two percent increase in future years.

Several other expenses could also impact the General Fund. Additionally, the reserve levels for the Benefits Fund and the Workers Compensation Fund are currently below the target level called for in the City's cash reserve policy. Rebuilding these reserve levels should be a priority.

In regard to revenues, taxes account for nearly 67% of General Fund revenues; with Property Tax, Sales Tax and Utility Users Taxes accounting for 50% of the total. The remainder of tax revenue comes from Transient Occupancy Tax, Business License Tax and other taxes. In recent years Sales Tax revenues have been steadily rebounding but have not yet reached pre-recession levels. The Five Year Financial Forecast currently assumes an annual growth rate of 4% in Sales Tax revenues. However, as consumer shopping patterns continue their shift to on-line sales, and increased retail competition appears in neighboring communities, it may not be possible to sustain this level of growth. Staff will continue to closely monitor this key revenue source.

Throughout the last decade the City never experienced a reduction in property tax revenues, testament to the strong market values of property prior to the recession. With the dissolution of California's redevelopment program, the City is now receiving additional property tax revenues which were previously designated to its redevelopment project areas. However, the dissolution process has been complex and the rules have changed overtime as the Legislature and State Department of Finance make modifications to the requirements and procedures. Additionally, the sunset of special legislation (SB 481) passed for the benefit of the City's Fire and Police Retirement System may result in additional financial commitments. As a precaution, the current Forecast includes a reserve of at least $2.5 million annually. Once the full financial implications of the dissolution process and SB481 are complete, the City can reassess the need for this reserve.

Utility Users' Tax revenues are anticipated to remain flat, even though the cost of water and energy continue to rise. This is the result of increasing efficiency and conservation efforts by customers, as well as the shift away from cable television to satellite, to which the City's utility users' tax doesn't apply.

The Transient Occupancy Tax (TOT) continues to grow steadily as average daily rates in area hotels increase. Moreover, as various hotel projects currently underway or planned for development are completed and absorbed into the marketplace, these revenues will increase. While a General Fund revenue, the City transfers the majority of this revenue to the Pasadena Center Operating Company to help fund operations and support the debt service on bonds issued for the conference center expansion.

The Five Year Financial Forecast indicates that in FY 2020 there will be a reduction of approximately $3 million in debt service as a result of defeasance of several infrastructure bonds. If the City were to maintain its current debt service levels after those bonds mature in 2019, it is estimated that approximately $50 million in bond proceeds could be realized. This creates a potential opportunity for the City Council to consider issuing bonds in the future to pay for high priority capital projects and unfunded needs identified in the CIP budget. Currently some of the high priorities with projects include:

- Fire station replacements, expansions and upgrades
- Computer Aided Dispatch system replacement for the Police Department
- Improvements to the City Yard facilities
- Transportation Maintenance Facility

Alternatively, the Council could consider expanding services funded by the Operating Budget, however, given the rather tight margins it does not appear at this time that there would be room to pursue both an expanded capital program and enhanced services. To illustrate this point, a comparison of actual revenues and expenses for FY 2015 (excluding operating transfers in and out and debt service) to anticipated revenues and expenses in FY 2020, indicates that while revenues are anticipated to grow 11% over the five year period, expenses are expected to grow 18%. Moreover, projected net income is positive in only one of the next five years. In order to avoid the risk of returning to a structural deficit of the type that existed prior to the recession, it is critical that spending remain bounded by available revenues.

**COUNCIL POLICY CONSIDERATION:**

Prioritizing initiatives in preparation for the budget process is an essential part of strategic planning. Each initiative is intended to enhance the City Council Strategic Planning Goals—noted below.

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

**FISCAL IMPACT:**

The budget workshop is not intended to have recommendations resulting in a direct fiscal impact, although the initiatives will have a fiscal impact if they are pursued through the FY 2017 budget process and such impact will be identified at that time. It is important to note there are limited opportunities to create new or enhance existing initiatives without the identification of new funding sources.

Respectfully submitted,

MICHAEL J. BECK
City Manager