



Office of the City Manager

INFORMATION CALENDAR

October 10, 2006

To: Honorable Mayor and Members of the City Council

From:  Phil Kamlarz, City Manager

Subject: FY 2006 Year-end Results and Updated FY 2007 Budget Information

INTRODUCTION

This report presents to Council a summary of the FY 2006 budget performance, and an update of FY 2007 budget issues and initial fiscal projections for FY 2008; focusing primarily on the General Fund. No specific action is requested at this time.

CURRENT SITUATION AND ITS EFFECTS

FY 2006 Year-end

The FY 2006 budget cycle ended on June 30, 2006. Based on the FY 2006 Adjusted Budget, revenues came in almost \$3 million over revised projections and expenditures coupled with projected carryover obligations were approximately \$200,000 under spent. Since the FY 2006 Adjusted Budget included the planned use of the General Fund reserve of approximately \$7.4 million (based on revenues as adopted by Council), this revenue surplus will reduce the use of the Reserve by \$3.1 million.

General Fund	Revenue	Expenditures & Obligations
FY 2006 Adjusted Budget*	\$ 128.8	\$ 132.4
FY 2006 Actuals	\$ 131.7	\$ 132.2
TOTAL:	\$ 2.9	\$ 0.2

*Includes Planned use of the Reserve

Revenue

The \$3 million in new revenue (from the revised FY 2006 projections presented to Council on May 16, 2006) is mostly attributable to Property Transfer Tax (+\$758,731); Supplemental Property Tax (+\$473,543); Vehicle-in-lieu (VLF) (+\$556,690); Parking Fines (+\$339,505); and interest income (+\$542,396). Economic-based revenues, such as sales tax, remained relatively flat.

Most of these revenues are property-based and reflect the real estate market performance over the past year. As will be discussed in the FY 2007 First Quarter Budget Update planned for November 14, 2006, Property Transfer Tax revenue and thus, future property tax revenue growth, are trending down significantly. Increases in parking fine revenue are a direct result of the successful implementation of the Parking Improvement Plan; and interest revenue is benefiting from higher interest rates.

It should be noted that the largest of these revenues, Property Transfer Tax, represents 1-time revenue. Total Transfer Tax revenues increased \$702,221 in FY 2006 to \$14,358,730 from \$13,656,509 in FY 2005, despite a decline in property sales and Transfer Tax revenues from those sales (residential Transfer tax revenues increased \$355,733, but commercial Transfer Tax revenues declined \$572,937, for a total reduction of \$217,204 in revenues from property sales). This net increase is due to largely the seismic retrofit rebate liability of \$723,009 in FY 2005 and \$186,836 in forfeited rebates in FY 2006.

Expenditures

Actual expenditures are \$5.4M less than the Adjusted Budget (as shown on Attachment A), but the expenditure total does not include approximately \$5.2M in unexpended project funding that will be recommended for carryover into FY 2007 as part of the First Amendment to the Appropriations Ordinance set for the November 14 agenda. Based on the projected carryover amount, approximately \$200,000 in savings was realized as originally projected in the February 2006 Mid-Year Budget Update.

General Fund Reserve

The City Council’s policy is to maintain the Reserve at 6% of gross General Fund revenues. During the FY 2007 budget discussions, Council expressed a desire to increase the Reserve. We will revisit the policy during the FY 2008 & FY 2009 Biennial Budget process. The total Undesignated Reserve is currently at approximately 10%, with liquid reserves at 6%. Liquid reserves represent available cash, and the balance includes receivables due to the General Fund from other funds for grants and loans fronted by the General Fund.

The Reserve provides some flexibility to help balance the budget, to smooth out economic swings, revenue reductions, i.e., possible UUT revenue loss, and address emergencies. As a part of the 5-Year Plan, the Reserve will be used to buffer revenue and expenditures. As a point of reference, an 8% reserve provides only 30 days of funding for citywide operations in the event of a major disaster. When considered in the context of the entire City budget, total undesignated reserves are at 4%.

FY 2007 Budget Update

We have ended the first quarter of FY 2007, and plan to present Council with a first quarter update on November 14, 2006. While staff has not completed a full analysis, some revenues are showing signs of performance beyond the adopted projections, including Interest and Supplemental Property Tax revenues (similar to FY 2006). However, based on revenues received the first three months of the year (July – September 2006), the Property Transfer Tax revenue is trending down and may result in lower than projected revenues for FY 2007.

FY 2007 Revenue to Date	Change from Last	
	Year	% Change
July	\$ (444,619)	-26.6%
August	\$ (104,931)	-7.2%
September	\$ (589,192)	-37.4%
First Quarter Total Change	\$ (1,138,742)	-17.8%

If this trend continues, it will have a significant impact on the FY 2007 budget, as \$12.5 million in Transfer tax revenues are built into the budget, \$2 million of which are considered one-time and dedicated to one-time capital improvement allocations. A more detailed analysis will follow in November.

FY 2008 & FY 2009 Biennial Budget Process

Staff has already commenced the FY 2008 & FY 2009 Biennial Budget development process, updating projections and scheduling workshops. A separate item on tonight's agenda asks Council to adopt FY 2008 & FY 2009 Biennial Budget schedule. As we update our financial projections, a number of factors will impact the health of the City's budget such as the stability of revenues and labor costs.

Revenues

In addition to the trending down of Property Transfer Tax revenues, the reduction of recurring revenues in the areas of Utility Users Tax (UUT) and Sales Tax are also real possibilities. FY 2008 –FY 2010 revenue for UUT is forecasted to be flat in anticipation of some losses. However, even this may be an optimistic assumption. The future of telecommunications revenues is uncertain and elimination of cellular phone revenues alone would result in a loss of \$3 million a year to the General Fund. This is not reflected in our current 5-Year Forecast.

Labor Costs

In the next several years, we look to prudent fiscal decisions with the re-negotiation of the City's labor contracts. The City recently received bad news that the projected Medical rate increase effective January 2007 is 24% over last year's rates. This increase and the possibility of future increases of this nature will have a significant impact on the budget.

Attachment B to this report provides a "what if" analysis on the impacts of various levels of Cost of Living Adjustments (COLAs) following the conclusion of the City's labor contracts. While implementation of zero COLAs maintain a positive fund balance through FY 2010, implementation of a 3% COLA each year would send the General Fund into a \$2.4 million deficit by FY 2010, which will grow each year thereafter, necessitating recurring expenditure reductions or new revenue.

As we move into this next two-year budget cycle, the Council will face choices regarding limited funding for programs and the resultant service impacts to the public.

CONTACT PERSON

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Attachments:

Attachment A = FY 2006 Year End General Fund Expenditures

Attachment B = General Fund Forecast COLA Scenarios

FY 2006 Year End General Fund Expenditures

Department	FY 2006 Adopted	FY 2006 Adjusted	Year-End Actual	Surplus/ (Deficit)	Percent Over/Under
Mayor & Council	1,311,261	1,339,497	1,463,357	(123,860)	-9.2%
Animal Care Services	1,246,058	1,273,645	1,215,474	58,171 *	4.6%
Auditor	1,612,530	1,617,150	1,410,328	206,822	12.8%
City Attorney	1,554,484	1,974,159	1,981,898	(7,739)	-0.4%
City Clerk	1,739,204	2,058,073	1,386,706	671,367 *	32.6%
City Manager	3,063,762	3,002,294	2,983,493	18,801	0.6%
Economic Development	1,496,076	1,545,623	1,437,964	107,659	7.0%
Finance	6,617,399	6,723,320	5,492,567	1,230,753 *	18.3%
Fire	20,695,922	21,170,127	21,130,551	39,576	0.2%
Health and Human Services	8,988,384	8,951,464	8,960,409	(8,945)	-0.1%
Housing	1,748,342	1,920,642	1,769,450	151,192	7.9%
Human Resources	1,635,257	1,661,491	1,691,494	(30,003)	-1.8%
Information Technology	5,397,157	5,451,214	3,167,040	2,284,174 *	41.9%
Parks and Waterfront	3,979,082	4,095,710	4,523,705	(427,995)	-10.4%
Planning	741,361	887,562	752,147	135,415	15.3%
Police	42,625,267	42,665,282	42,838,572	(173,290)	-0.4%
Police Review Commission	543,482	545,718	461,893	83,825	15.4%
Public Works	1,332,286	1,834,485	1,319,048	515,437 *	28.1%
Non-Departmental	22,953,882	23,663,489	23,001,517	661,972 *	2.8%
Totals	129,281,196	132,380,945	126,987,613	5,393,332	4.1%

*Some/all of balances to be recommended for carryover into FY 2007

Significant Variances

- Mayor & Council: -\$123,860 is due to unbudgeted Legislative Aide benefits.
- City Clerk: +\$671,367 is primarily unspent Elections funding that will be recommended for carryover into FY 2007 for the November elections.
- Finance: +\$1,230,753 is primarily for the Customer Service Initiative (CRM) project that has not yet been encumbered. This will be recommended for carryover into FY 2007.
- Information Technology: +\$2,284,174 is for funding for the new Public Safety System. This funding will be recommended for carryover into FY 2007.
- Parks Recreation & Waterfront: -\$427,995 is due to largely to unbudgeted Worker's Compensation costs for hourly employees (a financial management system glitch that has been corrected for FY 2007), and the over hire of a manager position for the full year during the Recreation Division's reorganization.
- Public Works: +515,437 partially due to unexpended project funds. A portion of this balance will be recommended for carryover into FY 2007 for expenditure.
- Police: -\$173,290 due to Police Officer overtime and over hires to achieve "full" staffing.
- Non-departmental: +\$661,972 due to mid-year allocations for program funding (including PG&E street lighting bills and fuel costs). About \$400,000 will be recommended for carryover into FY 2007 for expenditure.

**General Fund Forecast
Cost of Living Adjustment (COLA) Scenarios**

	Projected* FY2007	Projected FY2008	Projected FY2009	Projected FY2010
Revenue				
Recurring	\$ 129.0	\$ 132.7	\$ 135.9	\$ 139.2
1-Time	\$ 2.1	\$ 1.0	\$ 0.5	\$ 0.5
Total	\$ 131.1	\$ 133.7	\$ 136.4	\$ 139.7
Expenditures				
@ Zero COLAs	\$ 133.1	\$ 134.5	\$ 134.8	\$ 136.8
Deficit/Surplus	\$ (2.0)	\$ (0.8)	\$ 1.6	\$ 2.9
@ 2% COLAs	\$ 133.4	\$ 135.3	\$ 137.0	\$ 140.2
Deficit	\$ (2.3)	\$ (1.6)	\$ (0.6)	\$ (0.5)
@ 3% COLAs	\$ 133.5	\$ 135.7	\$ 138.2	\$ 142.2
Deficit	\$ (2.4)	\$ (2.0)	\$ (1.8)	\$ (2.5)

**FY 2007 Projected Revenue includes increased projections for some revenues, including Interest and Supplemental Property Tax.*

COLA assumptions are phased and based on the expiration dates of the various labor contracts.

Major assumption: 1-Time Capital funding decreases from \$10 million in FY 2007 to \$5 million in FY 2010.

Analysis

The above chart reflects the structural deficit between revenues and expenditures and does not take into account the use of the General Fund Reserve. Reserves can be used to balance the budget, but since the Reserve represents one-time funding, its use does not address the structural deficit. The growing structural deficit will require deeper reductions or increased revenues generated by economic development strategies or voter approval in future years. A balance between the one-time use of the Reserve and recurring expenditure reductions is delicate.

The total Undesignated Reserve is presently at about 10%, and includes the planned use of 3.5% of the Reserve (\$4.6 million) per the adopted 5-year plan for one-time capital projects.

Every 1% of Reserve equals approximately \$1.3 million.