

Staff Report

February 12, 2002

TO: City Council

FROM: Kelly Fletcher, Interim Operations Administrator

SUBJECT: Budget Update

Recommendation

1. Receive budget update report.
2. Receive the Comprehensive Annual Financial Report (CAFR) and Memorandum on Internal Control Structure for the Fiscal Year Ended June 30, 2001.

Fiscal Impact

None from this item.

Background and Analysis

This report summarizes the mid-year budget position of the City. It also updates prior estimates of the City's financial position for the current budget year, and provides a glimpse of where the City is heading as we are developing the preliminary 2002-2003 budget. The CAFR provides a detailed statement of last year's financial operations.

2000/2001 General Fund Budget Summary

Table 1 summarizes estimated revenues, budgeted expenditures and change in fund balance for the City's General Fund when the 2000-2001 Budget was adopted in June.

Table 1: General Fund Budget Summary – 2000/2001

	2000/2001 Budget Estimate
Estimate Beginning Fund balance (6/30/00)	2,950,901
Estimated Revenues	25,285,120
Estimated Expenditures	(23,926,504)
Transfers	(22,078)
Estimated Ending Fund Balance (6/30/01)	4,287,439

At that time, the City faced a difficult dilemma. On the one hand, local economic activity was resulting in natural growth in property and sales tax revenues, among other important

discretionary revenues. On the other hand, future expenditure projections combined with anticipated declines in development activity indicated serious financial challenges in the next two to three years. In particular, Council direction to move forward with construction of new community parks, and the desire to construct and staff a fourth fire station, among other issues, is projected to generate costs in excess of available resources starting in the 2001-02 budget year. With this backdrop, Council adopted the 2001-02 budget, that included about \$200,000 in General Fund expenditure reductions, \$280,000 in committed savings from position vacancies and no significant program expansions.

Since the estimates in Table 1 were done, the books have been closed on Fiscal Year 2000/01 and our independent audit completed. Copies of the Comprehensive Annual Financial Report (CAFR) and the Memorandum of Internal Control Structure are attached for your information and reference. The projected June 30, 2001 fund balance of about \$4.3 million that we expected to start the current budget year with, actually was about \$5.7 million. This increase in fund balance reflects a combination of prudent expenditure practices and extraordinary revenue changes, both of which have helped to stabilize the budget in the current year.

Several factors drove the change in fund balance from our estimate nine months ago. On the revenue side, as summarized in Table 2 below, increases in our major General Fund revenue categories contributed approximately one million dollars to the General Fund balance.

Of this total, nearly half is due to a one-time accounting adjustment to Sales Tax revenue, wherein receipts normally reported in the current year must now be recorded in the prior year. The effect of the adjustment is that for last year only, 13 months of revenue were recorded instead of 12. Transient Occupancy Tax revenue was also affected by this change, but we were aware of the effect on TOT at the time we prepared last year's mid-year estimate.

The remaining increase is primarily due to Property Tax and Motor Vehicle In-Lieu (VLF) exceeding our estimates. Most other General Fund revenue came in approximately where projected. Attachment 1 provides a more detailed comparison of General Fund budget estimate versus actual revenues.

Table 2: Major General Fund Revenues – 2000/2001 Budget to Actual Comparison

Revenue Source	2000/2001 Final Budget	2000/2001 Midyear Estimate	2000/2001 Actual	Difference (Actual less Budget)	Difference (Actual less Estimate)
Property Taxes	5,534,625	5,900,624	6,038,814	504,189	138,190
Sales & Use Tax ⁽¹⁾	4,374,000	4,998,000	5,485,683	1,111,683	487,683
Motor Vehicle In Lieu	2,821,350	2,937,000	3,334,379	513,029	397,379
Municipal Services Tax	1,541,000	1,615,000	1,616,317	75,317	1,317
Business License Tax	803,000	962,000	1,000,234	197,234	38,234
Transient Occupancy Tax ⁽¹⁾	737,000	1,118,000	1,148,552	411,552	30,552
Franchise Fees (PG&E)	353,000	366,704	366,704	13,704	0
Property Transfer Tax	243,500	247,000	234,032	(9,468)	(12,968)
AB 1396 ERAF Return	-	214,611	214,612	214,612	1
Total	16,407,475	18,358,939	19,439,327	3,031,852	1,080,388

⁽¹⁾ Revenues for 00-01 increased by the effect of a one-time accounting change (GASB 33). Sales Tax \$478,300 and Transient Occupancy Tax \$257,864.

General Fund expenditures, as recorded on the CAFR, came in below the revised budget by nearly \$1.2 million. While \$900,000 of these savings were already anticipated and included in the projected ending fund balance, the additional \$300,000 is reflective of a continued effort by departments to minimize spending and freeze unfilled positions. Attachment 2 presents a detailed break down of General Fund budget estimate to actual expenditure figures.

Again, the combined effect of these events led to a General Fund balance of about \$5.7 million as of July 1, 2001, as summarized in the following table.

Table 3: 2000/2001 Budget Estimate to Actual Comparison

Fiscal Year 2000/2001 Changes in General Fund Balance	2000/2001 Budget Estimate (1)	2000/2001 Actual
Beginning Fund balance (July 1, 2000)	2,950,901	2,950,901
Revenues	25,285,120	26,182,660
Expenditures	(23,926,504)	(23,056,806)
Transfers	(22,078)	7,950
Net Change in Restricted Fund Balance	0	43,112
Ending Unrestricted Fund Balance (June 30, 2001)	4,287,439	5,743,017

(1) Budget estimate does not include approved budget adjustments.

Revised 2001/2002 Budget Projection

When the 2001/2002 budget was adopted last summer, it projected a drawdown of General Fund balance. Revenues were anticipated to grow, but not at a rate adequate to correspond with expenditure increases. General Fund revenues were estimated at about \$25.1 million, while budgeted expenditures were about \$25.6 million. In addition, Council approved to continue a staff recommended set-aside of \$350,000 in anticipation of future increases of PERS contributions above the current zero employer rate, as well as \$280,000 in savings committed by a hiring freeze of unfilled positions. The combined effect of these figures indicated a draw down of General Fund balance of about \$600,000.

As of this writing, it appears that the draw down of fund balance is projected to be as expected. Based on the latest information and analysis of this year's major General Fund revenues, we are estimating nearly flat growth overall from the figures originally budgeted. Table 4 below summarizes our estimates.

Increases in property taxes and motor vehicle in-lieu fee subventions from the state comprise the majority of anticipated revenue increases. Property tax revenue increases reflect the strong local real estate market. However, development projections indicate a decline in new residential development, therefore future revenues are likely to level off. Motor vehicle in-lieu fees, which are derived from fees imposed on vehicle registrations, reflect prior increased consumer spending on automobiles. Once again, the slowing economy will undoubtedly result in much slower growth in this revenue for next year.

Reduced estimates for sales tax and transient occupancy tax reflect the slowing economy and our own conservative outlook. The State Department of Finance and the State Board of Equalization have calculated a statewide average growth factor for Sales Tax revenue of *negative* 3.97% for the remainder of our fiscal year. While acknowledging that our local experience can vary widely

from the statewide average, we thought it best to use the State's estimate until more of the year has elapsed.

Table 4: 2001/2002 Midyear Revised Major General Fund Revenue Estimates

Midyear Revenue Estimate Revisions (net changes)	Final Budget	Revised Estimate	Increase / (Decrease)	% Increase Over Budget
Property Taxes	6,198,825	6,438,864	240,039	3.9%
Sales Taxes	5,248,000	4,842,000	(406,000)	(7.7)%
Transient Occupancy Tax	918,000	850,200	(67,800)	(7.4)%
Business License Tax	1,010,100	1,010,100	0	0.0%
Municipal Services Tax	1,700,000	1,712,000	12,000	0.7%
Motor Vehicle In-Lieu	3,142,000	3,400,000	258,000	8.2%
Totals	18,216,925	18,253,164	36,239	0.2%

At this time, departments are preparing revised estimates of current year expenditures. Although these figures have not yet been completed, we are confident that the continued freezing of unfilled positions and departmental commitments to thoughtfully evaluate the need for expenditures will generate a minimum of the \$280,000 in savings already built into the fund balances. Therefore, projected undesignated fund balances as of June 30, 2002, as shown in Table 5, do not reflect changes in expenditures.

Table 5: Estimate of Changes in General Fund Balance (2001/2002)

7/1/01 Unreserved Fund Balance (actual)	5,743,017
2001/02 Budgeted Expenditures	(25,701,266)
2001/02 Budgeted Revenues (Including Fees & Grants)	25,156,115
Frozen Position Savings	280,000
PERS Set-aside	(350,000)
Subtotal – Preliminary 6/30/01 Fund Balance	5,127,866
Budget Adjustments	
Approved Budget Adjustments (as of 2/11/02)	(73,696)
Subtotal – Budget Adjustments	(73,696)
Midyear Revenue Estimate Revisions (net changes)	
Property Taxes	240,039
Sales Taxes	(406,000)
Transient Occupancy Tax	(67,800)
Business License	0
Municipal Services Tax	12,000
Motor Vehicle In-Lieu	258,000
Subtotal - Net Revenue Change	36,239
Estimated 6/30/02 Fund Balance	5,090,409
Estimated 6/30/02 Fund Balance as % of Revenue (Budget plus revised estimate)	20.2%

We project that we will end the current year with an unreserved and undesignated General Fund balance of about \$5.0 million. While the General Fund balance forecast for 2001/2002 appears favorable, the uncertainty of economic impacts from September 11, as well as continued State

threats for additional raiding of local government revenues, could change this outlook significantly.

Preliminary 2002/2003 Budget Projections

We are now well under way with the development of the preliminary 2002/03 budget. Departments have been directed to prepare relatively flat budgets with allowances to accommodate current contractual obligations with employee bargaining groups and city service providers. Although the preliminary revenue projections for 2002/03 show some growth, projected expenditures continue to out pace revenues, and thus would require drawing down the General Fund balance. The primary assumption driving this projection was that no new revenue (beyond projected growth in the existing base) would be available in the coming budget year.

In addition to the continued disparity between revenues and expenditures, the City faces the potential loss of our current Park Maintenance Tax which is due to expire on June 30, 2002. While we continue to explore additional new revenue sources, Measure D has been placed on the March 5 ballot to renew the existing Park Maintenance Tax. In the event the measure passes, the revenue derived will continue to support a portion of the costs needed to supply a basic level of maintenance at community parks, greenbelts, open space, pools and related public facilities. The failure of this measure would result in a loss of \$1.3 million, which would necessitate General Fund budget reductions to offset the lost revenue.

Significant costs for new facility maintenance requirements (e.g., Walnut Park and Mace Ranch Park) are anticipated in the coming year. Measure D will not cover expenses for these facilities maintenance and operations. Also, existing revenues are not sufficient to cover additional facilities or higher costs. As Council considers new programs or facilities, the necessity to analyze ongoing maintenance and operation costs and find new revenue sources is critical.

Summary

Although we have entered 2001/02 fiscal year with a fund balance higher than our goal of 15%, it is important to remember the implications of pending circumstances. The current Park Maintenance Tax sunset, the passage or failure of Measure D, expenses from anticipated new facilities and the overall uncertainty of the current economic environment will all influence the sustainability of general fund reserves.

Attachments:

1. Comparison of 2000/01 Budgeted to Actual General Fund Revenue
2. Comparison of 2000/01 Budgeted to Actual General Fund Expenditures
3. Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2001.
4. Memorandum on Internal Control Structure for the Fiscal Year Ended June 30, 2001.

Attachment 1: Comparison of Budgeted to Actual General Fund Revenue

Revenue Source	2000/01 Estimate	2000/01 Actual	Over / (Under)
Taxes			
Property Taxes	5,900,224	6,038,315	138,091
Sales Taxes	4,998,000	5,485,683	487,683
Municipal Service Tax	1,615,000	1,616,317	1,317
Business License Tax	962,000	1,000,234	38,234
Transient Lodging Tax	1,118,000	1,148,552	30,552
Franchise Taxes	366,704	366,704	-
Real Property Transfer Tax	247,000	234,032	(12,968)
Other Taxes	-	3,747	3,747
Total Taxes	15,206,928	15,893,584	686,656
Licenses & Permits			
Construction & Installation Permits	1,062,238	1,273,341	211,103
Other Permits	8,000	3,586	(4,414)
Total Permits	1,070,238	1,276,927	206,689
Revenue from Use of Money			
Investment Earnings	69,282	51,892	(17,390)
Royalties, Rents & Concessions	166,589	460,440	293,851
Total Revenue from Use of Money	235,871	512,332	276,461
Intergovernmental			
State Motor Vehicle In Lieu Taxes	2,937,000	3,334,379	397,379
State Property Tax Reimbursements	214,611	214,612	1
State & Federal Grants	417,326	342,062	(75,264)
Other State Shared Revenues & Taxes	314,201	318,267	4,066
Total Intergovernmental	3,883,138	4,209,320	326,182
Charges for Current Services			
Parks & Community Services	1,455,807	1,580,402	124,595
Planning & Building Inspection Svcs	840,201	205,198	(635,003) ⁽¹⁾
Fire Department Services	458,872	509,712	50,840
Property Development Services	469,251	290,551	(178,700)
Other Services	533,292	602,952	69,660
Total Current Services	3,757,423	3,188,815	(568,608)
Other Revenue			
From City Enterprise Funds	640,278	650,907	10,629
Sales of Real/Personal Property	3,425	11,935	8,510
Reimbursements	163,412	74,432	(88,980)
Donations & Pledges	12,000	10,488	(1,512)
Other	312,407	527,283	214,876
Total Other Revenue	1,131,522	1,275,045	143,523
Total General Fund	25,285,120	26,356,023	1,070,903

(1) Includes net effect of prior and current year deferred revenue.

Attachment 2: Comparison of Budgeted to Actual General Fund Expenditures

Department/Division	2000/01 Estimate	2000/01 Actual	Savings / (Impact)
City Council			
City Council	95,012	97,124	(2,112)
Total City Council	95,012	97,124	(2,112)
City Attorney			
City Attorney	310,005	292,482	17,523
Total City Attorney	310,005	292,482	17,523
City Manager			
Administration	733,738	643,654	90,084
City Clerk	293,155	281,963	11,192
Personnel	328,638	353,466	(24,828)
Information Technology	23,440	8,302	15,138
Total City Manager	1,378,971	1,287,385	91,586
Finance			
Finance	1,103,664	1,101,976	1,688
Total Finance	1,103,664	1,101,976	1,688
Planning & Building			
Administration	195,568	182,339	13,229
Planning	754,661	657,628	97,033
Building & Zoning	1,631,180	1,500,013	131,167
Total Planning & Building	2,581,409	2,339,980	241,429
Parks & Community Services			
Administration	548,668	370,940	177,728
Community & Neighborhood Service:	590,824	631,204	(40,380)
Social Services	250,461	271,741	(21,280)
Parks & Open Space Mgmt	2,560,920	2,227,068	333,852
Public Facilities Maintenance	981,215	1,078,855	(97,640)
Administrative Facility Maintenance	63,342	38,398	24,944
Recreation	1,997,217	2,072,015	(74,798)
Cultural Services	116,617	104,788	11,829
General Services	65,669	87,292	(21,623)
CDBG	-	2,350	(2,350)
Total Parks & Community Services	7,174,933	6,884,651	292,632
Public Safety - Fire			
Administration	324,649	345,601	(20,952)
Operations	2,931,369	2,898,203	33,166
Prevention	320,549	290,581	29,968
Training Services	736,734	614,529	122,205
Total Public Safety - Fire	4,313,301	4,148,914	164,387
Public Safety - Police			
Administration	1,029,633	1,079,533	(49,900)
Patrol	2,830,172	2,760,131	70,041
Investigative Services	1,500,349	1,423,726	76,623
Records & Communications	1,147,569	1,120,996	26,573
Technical Support	136,194	144,827	(8,633)
Total Public Safety - Police	6,643,917	6,529,213	114,704

Attachment 2: Comparison of Budgeted to Actual General Fund Expenditures

Department/Division	2000/01 Estimate	2000/01 Actual	Savings / (Impact)
Public Works			
Administration	46,645	49,435	(2,790)
Transportation	109,831	97,830	12,001
Support Services	361,725	383,892	(22,167)
Total Public Works	518,201	531,157	(12,956)
Capital Improvements			
Administration	-	-	-
Transportation	260,675	5,983	254,692
Public Facilities	123,038	34,774	88,264
Parks & Recreation	8,378	6,803	1,575
Total Capital Improvements	392,091	47,560	344,531
Debt Service			
Debt Service	-	52,619	(52,619)
Total Debt Service	-	52,619	(52,619)
Total General Fund	24,511,504	23,313,061	1,198,443