

June 1, 2004

Honorable Mayor and Members of the City Council:

Tonight I present for your consideration my Proposed Budget for fiscal year 2004/2005. This document presents a recommended spending plan which provides for a balanced budget for the coming fiscal year and begins to address the long-term structural deficit currently projected in the City's Five-Year General Fund forecast.

The Proposed Budget for FY2004/05 totals \$109,827,904 for all funds, representing an increase of \$2,573,350 or 2.4% over the FY2003/04 Adopted Budget. The Proposed General Fund budget for FY2004/05 is \$33,893,117, reflecting an increase of \$1,106,997, or 3.4% over the FY2003/04 Adopted Budget.

This budget maintains current service and staffing levels across all program areas, limits additional funding to selected high-priority, one-time needs, and maintains the General Fund reserve at a projected level of \$5.021 million, or 15.8% of discretionary General Fund revenues, consistent with City Council policy.

The economic and fiscal climate in which this budget has been developed continues to be characterized by a significant degree of volatility and uncertainty. Budget pressures stemming from the general economy continue to challenge the City's ability to maintain current service levels to the community. The City faces the prospect of projected deficits within the General Fund as well as a number of Special Funds. These deficits result from revenue growth failing to keep up with increasing annual expenditures, coupled with significant reductions in State and Federal funding in support of city programs.

The factors contributing to the City's budget problems are similar to those faced by nearly every municipality in the State. However, sound fiscal choices made by the City Council over the last several years have helped to mitigate some of the devastating impacts now being felt in other jurisdictions. In response to early indications of changing fiscal environment, the City Council has taken several proactive steps including increasing the General Fund reserve, limiting new funding to largely one-time expenditures, and seeking voter-approval for Measure P, a one-half percent increase in our local Sales Tax. Nonetheless, the City still faces a projected structural deficit requiring that additional balancing measures be implemented over the next 2-5 years.

In anticipation of these measures, I am once again proposing a “flat” budget for fiscal year 2004/05, with increased funding limited to contractual obligations for labor contracts, retirement contributions, insurance costs and debt payments. In addition, I will be re-imposing a selective hiring freeze – limiting new hires to positions deemed necessary to perform essential functions and preserve the community’s health and safety. While not built into the projections included in this budget, the hiring freeze should generate additional budgetary savings as well as provide the Council with increased flexibility in considering future program and staffing reductions.

**Budget Highlights**

- The FY2004/05 Proposed Budget provides funding required to maintain current service levels across all city program areas;
- One-time discretionary funding is included in the budget in support of high-priority projects, including:
  - Public Safety Radio System \$ 1,065,000
  - INET Wireless Telecommunications System 80,000
  - Fire Department Air/Light Unit 152,500
- The budget maintains a projected General Fund Reserve of \$5.021 million, or 15.8% of projected revenues; however the proposed spending plan results in a draw-down of the reserve totaling \$873,925, including \$661,000 stemming from the proposed shift of local property tax revenues to the State.
- The Proposed Budget addresses a portion of the structural deficit by establishing a “salary discount”, based on normal vacancy rates resulting from turn-over and attrition of staff positions. The budget includes a target General Fund savings of \$380,000 for FY2004/05, based on nominal vacancy rates of 3% for civilian positions, 1% for Police and 0% for Fire. Salary savings are one of the primary factors explaining the historical trend of departments’ under-spending annual appropriations. The imposition of a salary discount is a common practice used to re-capture anticipated savings at the “front-end” of budget development.
- The spending plan would result in a reserve level which exceeds the 15% Council policy by \$256,000, however, the proposed budget does not include discretionary augmentations for recurring funding needs. While strong consideration was given to three priority staffing areas (one additional sworn police officer, a Crime Analyst and an Integrated Pest Management position), the projected structural deficit and uncertainty surrounding the State Budget precludes my recommending any additional recurring funding at this time. I am recommending that these unfunded priorities be re-considered in February, based on the results of the mid-year budget update, final State Budget, and results of ballot measures expected to appear on the November ballot.

**Need for ongoing Budget Reform**

The FY2004/05 Proposed Budget and Five-Year forecast are largely based on the City's historical budget development process. Our Finance Director has been evaluating the budget development process and methodology and will be making recommendations to the Finance and Budget Commission and City Council to reform elements of the budget process for the coming year, consistent with the Council's stated priority of fiscal stability.

The following summarizes some of the issues that will impact development of future City budgets:

- *Reserve Policy* – The Council should re-assess its General Fund Reserve Policy, not only with regard to appropriate reserve levels, but the policy should clearly articulate appropriate uses of reserve funds to guide development of future budgets.
- *General Fund Support for Programs* – The General Fund budget is ill-defined. Historically the General Fund has been called upon to provide funding support not only for discretionary general government programs, but is also relied upon to provide subsidies to a variety of programs for depending on the availability of non-discretionary funding. This is particularly the case the areas with heavy reliance on State and Federal funding (Transportation/Street Maintenance), fee revenue (Recreation, and Community Development) and Special Revenues (Parks Maintenance and Public Safety).
- *Capital Program* – The City lacks a stable, dedicated funding source to address long-term capital improvement needs. The reliance on Development Impact Fees and Construction Tax revenues to fund capital improvements results in an over-reliance on new development activity. While these may be appropriate funding sources for new capital infrastructure related to the development activity, it fails to provide an adequate and stable funding source for capital maintenance and replacement of existing physical assets. We will be working to develop a comprehensive, citywide 5- or 10-Year Capital Improvement Program with identified funding needs and sources.
- *Internal Services* – We will undertake a comprehensive review of the City's internal services, with particular focus on City fleet operations, facilities maintenance and information services. Costs for these services should be appropriately distributed to program areas (and funding sources) in proportion to usage, and overall funding levels need to be evaluated to ensure that the City's assets are adequately maintained and replacement funding is in place.
- *Unfunded Liabilities* – Over the next year, staff will be reviewing the status of unfounded liabilities. These include the City's self-insurance fund, workers'

compensation and accrued leave balances. Adequate funding levels must be maintained in these areas so as to avoid major budgetary impacts in future years.

- *Mid-year Budget Adjustments* - The budget amendment process needs to be re-evaluated. Given the current fiscal pressures facing the City and the erosion of reserve funds available to fund unplanned expenditures, we can no longer allow for regular and routine budget amendments. It is important that the staff and the Council review budget amendments in the context of overall funding availability and needs. To this end, staff will be evaluating alternative procedures to limit the number of mid-year budget adjustments as well as provide a process whereby non-urgency items are reviewed at the same time and considered in the context of overall funding priorities.

### **Integrate Budget with Council Goals**

The City Council has recently initiated a goal-setting process aimed at establishing clear policy priorities and objectives across all program areas. This effort is expected to provide a clear articulation of the community's priorities and direction to staff in prioritizing workplan efforts and resource allocations. It is imperative that these priorities inform and, indeed, form the basis for future development of future budgets.

The work begun by the new Council is a significant first step. Over the next few months, the Council, with input from Commissions, City staff and the public, will be refining the goals and specific objectives. This exercise will necessitate a sound assessment of current resource capacity as well as identification of goals, which will require additional funding in order to complete.

Upon conclusion of this process, in the Fall of 2004, the Council will have provided significant and clear direction that will form the basis for development of the F2005/06 budget. Clear Council direction should provide the basis not only for my instructions to City departments, but the dialogue surrounding goals and priorities should continue throughout the budget development process.

Our goal is that future budgets be developed in such a way as to clearly articulate specific funding allocated in support of Council priorities, thereby aligning resources with Council and community expectations, and vice versa.

### **Ongoing Dialogue / Public Participation**

Another major priority for the coming year will be the development of a collaborative budget process, informed by participation by the City Council, City Commissions and the public. The Council will be presented with quarterly budget updates – not only to receive information on the current-year budget results, but to provide regular updates of budget projections. In addition, staff will explore means to engage City Commissions in a

review and feedback process for relevant areas of the budget under each commission's purview. Finally, as we work together to address our budget situation, it is critical that the larger community be informed and involved – particularly with regards to potential service reductions and/or revenue enhancement proposals.

I look forward to working collaboratively with the City Council, commissions, City departments and the community at large to ensure that the City of Davis continues to provide quality programs and services, and can address priority needs, despite the fiscal challenges that we must address.

Respectfully submitted,

James W. Antonen  
City Manager

