



MID-YEAR BUDGET REPORT

Staff Report

February 8, 2005

TO: City Council
FROM: Paul Navazio, Finance Director
SUBJECT: FY 2004/2005 Mid-Year Budget Update.

Recommendation

This Informational Item presents revenue and expenditure results through the first seven months of fiscal year 2004/2005, as well as provides an update to the revenue and expenditure results for fiscal year 2003/2004, preliminarily presented last November in the first quarter budget update. No action is requested as a result of this report.

Fiscal Impact

As this is an informational item, there is no fiscal impact from this item.

Summary

This report summarizes the final, audited year-end General Fund revenue and expenditure results for FY2003/2004, and presents General Fund revenue and expenditure results through the first seven months of FY2004/2005.

Highlights of the report include:

- ❑ *Final results for FY2003/2004 reflect a General Fund operating deficit of \$2.07 million. This result is in comparison to the expected draw down of \$2.67 million assumed in the development of the FY2004/2005 budget.*
 - ❑ *The General Fund Unreserved Fund Balance as of June 30, 2004 was \$5.83 million, and represents an increase in the reserve of \$600,000 as compared to the reserve level assumed in the development of the FY2004/2005 budget. The year-end \$5.83 Unreserved Fund Balance as of June 30, 2004 represents 20.5% of General Fund revenues, (See Table 1).*
 - ❑ *Year-to-date FY2004/2005 General Fund revenues stand at \$17.51, or 54.1% of budgeted revenues; the year-to-date results suggest the need to revise our year-end General Fund operating revenue projections downward by \$760,000. The anticipated "early" receipt of \$980,000 in one-time Vehicle License Fee loan proceeds is expected to offset the impact of*
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this projection for FY2004/2005; however a downgrade in the General Fund revenue forecast will negatively impact the projected FY2005/2006 General Fund budget shortfall.

- *Sales Tax revenue projections are being downgraded by \$1.1 million as a result of slower-than-anticipated growth as well as a significant revision to the revenue estimated to be generated by the City's Measure P Half-Cent Sales Tax, which became effective July 1, 2004.*
 - Year-end sales tax receipts for FY2003/2004 were \$5.46 million, \$200,000 below the budget estimate, and slightly below the level of sales tax received in FY2002/2003. Mid-year sales tax shows no growth in year-to-year receipts, over the same period.
 - The FY2004/2005 budget included an estimated \$2.8 million in additional sales tax stemming from the passage of Measure P, the new half-cent sales tax override. This tax was assumed to increase the City's sales tax "base" by 50%, by adding an additional ½% to the City's existing 1% Bradley-Burns sales tax allocation. In fact, while the Bradley-Burns sales tax is applied to all taxable sales occurring in Davis, the Measure P half-cent sales tax, which is effectively a Transaction and Use Tax is only applied to sales of goods consumed in Davis, and does not apply, for example, to sales of automobiles and equipment purchased in Davis by non-Davis residents. The result is that the City, through the first seven months of FY2004/2005 has received Measure P sales tax on only 18% of the overall automobile sales generated in Davis. Staff is in the process of analyzing sales tax data with the Board of Equalization in an effort to ensure that the City is receiving its appropriate share of sales tax, and that the half-cent sales tax is being correctly reported and collected.
- *Property Tax revenues continue to show strong growth, partially offsetting the reduction in Sales Tax revenue estimates. Year-end property tax revenues were \$7.38 million, \$272,000 over the budget estimate, and 12.6% higher than previous year results. Year-to-date property tax receipts for FY2004/2005 appear consistent with the budget assumptions related to annual growth in City-wide assessed valuation (6.9% versus 6.0%). It is too early to estimate the impact of the supplemental property tax, which could further improve the overall revenue estimates.*
- *Through the January (Period 8), FY2004/2005 General Fund expenditures (including encumbrances) were \$21.12 million, or 60.6% of the adjusted budget of \$34.86 million. Personnel expenditures are tracking below budget (49.6%) through seven months while citywide non-personnel expenditures were at 43% of budget. Preliminary projections of year-end General Fund expenditures stand at \$32.67 million - or \$2.2 million below the adjusted budget for FY2004-FY2005.*
- *Staff is in the process of establishing the initial baseline for the FY2005/06 budget, which, in turn, will form the basis for the Update to the five-year forecast to be presented at the Budget Workshop of March 22. The "deficit" projected one year ago for FY2005/2006 is expected to increase as a result of the impact of downgraded revenue projections as well as the increase in costs for pension benefits relative to the increases assumed in the FY2004/2005 Five-Year Forecast.*

Conclusion

This informational report represents the Mid-Year Budget Update for FY2004/2005, and has been prepared in response to the City Council's objective of establishing regular quarterly budget updates. While the information provided in this report includes year-to-date General Fund results as well as preliminary projections for year-end results, staff is still in the process of updating the Five-Year Forecast. It is anticipated that the forecast will be updated in conjunction with the City Council's first workshop on the FY2005/2006 budget, scheduled for March 22, 2005.

Attachments:

- Attachment A – Summary of General Fund Operations
- Attachment B – General Fund Revenues
- Attachment C – General Fund Expenditures

Attachment A

Summary of General Fund Operations

Table 1 presents a summary of the City's General Fund fiscal condition through the year ended June 30, 2004 as well as budget and year-to-date results through the first seven months of FY2004/2005:

*Table 1: General Fund Summary
 2003/2004 Results and 2004/2005 Projection*

Description	2003/2004 Ending Budget	2003/2004 Budget Projection	2003/2004 Actual Results	2004/2005 Beginning Budget	2004/05 Adjusted Budget	2004/2005 Year-to-Date Results	2004/2005 Year-end Projection
Beginning Unreserved Fund Balance (6/30/02)	\$7,000,463	\$7,894,730	\$7,894,730	\$5,225,794	\$5,225,794		\$5,825,847
Revenues	31,058,944	27,289,585	28,380,937	31,869,729	32,391,286	17,508,096	32,609,224
Expenditures	(33,064,672)	(29,958,521)	(30,606,791)	(34,292,127)	(34,861,537)	(21,120,962)	(32,669,194)
Transfers			(11,211)	2,285,787	2,285,787		
Change in Reserved Fund Balance **			168,182				(200,000)
Ending Unreserved Fund Balance (6/30/03)	\$4,994,735	\$5,225,794	\$5,825,847	\$5,089,183	\$5,041,330		\$5,565,877
Percentage (E.U.F.B./Revenues)	16.1%	19.1%	20.5%	16.0%	15.6%		17.1%
* This line item is included to link the Audited Financial Statements with Budget Estimates and also includes changes in encumbrance balances.							

FY2003/2004

While the adopted FY2003/2004 budget projected a decrease in the General Fund's Unreserved Fund Balance of \$2.67 million (to \$5.225 million, or 19.1% of General Fund revenues), actual results saw a decrease in the fund balance of \$2.07 million to \$5.825 million, or 20.5% of General Fund reserves. This result is favorable relative to the FY2003/2004 projections used in the development of the FY2004/2005 budget.

Overall the year-end unreserved fund balance equal to 20.5% of General Fund revenues compares favorably to the Council's General Fund reserve policy of 15%, and reflects a slight improvement over the preliminary results (\$5.2 million, 17.1%) reported in the first quarter report, presented to the City Council in November.

The year-end fund balance reflects a correction in the Change in Reserved Fund Balance due to prior year encumbrances included in the prior year's fund balance.

FY2004/2005

The Adopted FY2004/2005 budget resulted in an expected General Fund unreserved Fund Balance of \$5.09 million, or 16% of General Fund revenues. This assumed a beginning fund

balance of \$5.225 million and an anticipated draw-down of fund balances totaling \$136,000 built into the FY2004/2005 budget.

Updates to FY2004/2005 revenue and expenditure projections, combined with the revised, final year-end results for FY2003/2004 result in an updated projection for the General Fund reserve expected at June 30, 2005. The revised estimates yield a projected year-end fund balance of \$5.56 million, or 17.1% of General Fund revenues. This projection compares favorably to the Council's policy of maintaining a 15% reserve balance. Net of reserve funds recently committed for the construction of the Manor Pool upgrades (\$200,000), the General Fund reserve level is expected to exceed the level required by the Council policy by approximately \$673,000. This favorable fund balance, however, is largely attributable to the anticipated receipt of a one-time \$980,000 payment, this fiscal year, representing the discounted value of the City's Vehicle License Fee Loan from the State.

Attachment C

General Fund Revenues

Table 2 presents a summary of major General Fund revenue sources. FY2003/2004 revenues were \$28.38 million which is \$2.68 million below the original budget, but \$1.09 million above the revenue estimate used in the development of the FY2004/2005 budget.

*Table 2: General Fund Revenues
 2003/2004 Results and 2004/05 Projections*

Revenue by Source	2003/2004 Final Budget	2003/2004 Estimate	2003/2004 Actual	Variance Favorable / (Unfavorable)	Variance Percentage	2004/2005 Adjusted Budget	2004/2005 Year to Date	2004/2005 Projection	Variance Favorable / (Unfavorable)
Property Taxes	\$7,054,600	\$7,104,700	\$7,377,021	\$272,321	3.8%	\$6,857,340	\$3,875,702	\$6,910,077	\$52,737
Sales & Use Tax	6,100,000	5,666,000	5,464,627	(\$201,373)	-3.6%	8,753,970	2,692,907	7,660,000	(\$1,093,970)
Motor Vehicle In Lieu	3,830,000	2,176,841	2,869,967	\$693,126	31.8%	3,757,000	1,672,688	3,935,098	\$178,098
Parks Services	1,689,713	1,752,434	1,864,655	\$112,221	6.4%	1,742,502	1,393,958	2,722,502	\$980,000
Municipal Services Tax	1,830,000	1,854,000	1,853,167	(\$833)	0.0%	1,922,000	1,428,567	1,916,000	(\$6,000)
Business License Tax	1,130,000	1,080,000	1,075,340	(\$4,660)	-0.4%	1,157,000	841,550	1,109,400	(\$47,600)
Construction Permits	1,137,000	891,500	877,532	(\$13,968)	-1.6%	1,038,000	535,639	1,038,000	\$0
Transient Occupancy Tax	998,000	972,000	981,074	\$9,074	0.9%	932,860	449,092	930,600	(\$2,260)
Planning & Building Inspec	1,192,232	1,461,577	1,498,026	\$36,449	2.5%	1,749,648	1,317,431	1,761,548	\$11,900
Fire Dept. Services	585,726	609,776	608,941	(\$835)	-0.1%	594,585	96,182	594,585	\$0
Franchise Fees (PG&E)	430,000	476,000	487,998	\$11,998	2.5%	450,000	0	450,000	\$0
Investment Earnings	65,893	65,768	48,351	(\$17,417)	-26.5%	39,399	0	39,399	\$0
Property Transfer Tax	250,000	250,000	270,800	\$20,800	8.3%	250,000	172,710	270,800	\$20,800
All Other Sources	4,765,780	2,928,989	3,103,438	\$174,449	6.0%	3,146,982	3,031,670	3,271,215	\$124,233
Total	\$31,058,944	\$27,289,585	\$28,380,937	\$1,091,352	4.0%	\$32,391,286	17,508,096	\$32,609,224	\$217,938

General Fund revenues for FY2003/2004 reflect an increase of only \$96,000, or .33%, from prior year results. Growth in Property Tax revenues (12%) were offset by lower receipts in Sales Tax, Motor Vehicle License Fees (due to loss of backfill payments from the State), and Construction Permits.

The FY2004/2005 budget assumed growth in General Fund revenues of \$5.1 million, or 18.7%, largely due to continued growth in property tax revenues, moderate growth (3%) in Sales Tax Revenues, and the advent of the Measure P half-cent sales tax (\$2.8 million).

In light of revenue results for FY2003/2004 as well as year-to-date results for FY2004/2005, several adjustments to this year's revenue estimates appear warranted:

- Property Tax revenues continue to reflect robust growth in assessed real property valuations, and reflect the continuing strength of the real estate market. Information from the County Assessors Office indicates that FY2004/2005 assessed values will increase by 6.9% over prior year, which is consistent with the 6% growth assumption used in the budget. While it is too early to evaluate, supplemental property taxes (received later in the year) could further increase property tax revenue receipts.
- Sales tax receipts for FY2003/2004 and through the first half of FY2004/2005 suggest are essentially "flat" when compared to FY2002/2003 results, and fall significantly short of the budget estimates that assumed a 3% annual growth rate. The major factor contributing

to this unfavorable result is receipts from auto dealers which reflected a reduction of 3% from FY2002/2003 to FY2003/2004, and are “flat” when comparing FY2004/2005 year-to-date receipts to the same period one year ago.

- Another major factor impacting the sales tax revenue projections for FY2004/2005 is revenue related to the City’s Measure P half-cent sales tax. Initial data on revenues resulting from this measure are well-below budget estimates. Staff is in the process of analyzing the first quarter sales tax data from the Board of Equalization to ensure that the City’s sales tax override is being properly reported and collected. If our initial reporting is proven to be accurate, the annualized sales tax revenue resulting from Measure P will be approximately \$1.9 million as compared to the \$2.8million estimate used in the development of the FY2004/2005 budget. This issue will not only have implications for the current year budget, but will likely require a downgrade of our sales tax estimates in the Five-Year forecast and is likely to result in an increase in the City’s projected structural budget deficit.
- Motor Vehicle License Fee (VLF) revenues received from the State outpaced projections by nearly \$700,000, or 31% in FY2003/2004. This result reflected strong statewide auto sales as well conservative estimates issued by the State Controller at the beginning of the fiscal year. The net reduction in VLF revenues from prior years reflects the loss of three-month backfill revenues which the State is treating as a loan to be repaid in FY2006/2007

For FY2004/2005, the budget reflects full restoration of the backfill, however the 2004/2005 State Budget agreement provides for the backfill to be replaced by increased allocation of property tax revenues. In addition, the revised projection for FY2004/2005 VLF revenues includes an estimated \$980,000 one-time payment to the City related to the VLF Gap Loan (*see below.*)

Note: Also appearing on tonight’s council agenda is a staff report recommending that the City participate in the statewide VLF Gap Loan Program which would result in receipt of a discounted VLF value in the current fiscal year.

There are a number of factors that impact the City’s FY2004/2005 revenue picture and complicate the analysis required to update revenue projections. As such, the revised projections will continue to be evaluated and will be updated, as necessary, throughout the year. In addition to the Measure P half-cent sales tax – imposed by the City for the first time this fiscal year – the State Budget includes several provisions which – in addition to further complicating the City’s revenue picture – result in significant delays in the receipt (and therefore, analysis) of major tax revenues. Staff is still working to fully assess our General Fund revenue outlook in light of new wrinkles which include: a) the State’s Triple-Flip mechanism for funding its debt service on the FY2003/2004 deficit bonds, b) the Property Tax / VLF Swap, and c) the additional Education Revenue Augmentation Fund (ERAF) provisions.

Attachment D

General Fund Expenditures

Tables 3 and 4 summarize General Fund expenditure results for all departments. FY2003/2004 expenditures ended the year at \$30.6 million, or \$2.5 million (7.9%) under the final budget of \$33.1 million. This result represents an increase of 13.5% over FY2002/2003 expenditures. Year-end General Fund expenditures were \$648,270 or 2.20% percent above the budget estimates prepared at mid-year and used in the development of the FY2004/2005 budget.

Expenditure by Department	2001/2002 Actual	2002/2003 Actual	2003/2004 Final Budget	2003/04 Budget Estimate	2003/2004 Actual	Difference Favorable / (Unfavorable)	2003/2004 Budget vs Actual
City Council	\$ 107,673	\$ 114,662	\$ 120,962	\$ 118,518	\$ 115,393	\$ 3,125	95.4%
City Attorney	220,873	247,803	256,188	256,188	372,155	(115,967)	145.3%
City Manager	1,404,199	1,452,692	1,732,067	1,644,230	1,608,381	35,849	92.9%
Finance	1,075,013	1,027,395	1,298,142	1,103,517	1,154,318	(50,801)	88.9%
Community Development	2,219,566	2,626,386	2,949,640	2,835,171	2,746,569	88,602	93.1%
Parks & Community Services	6,963,038	7,985,894	8,825,174	8,306,973	8,449,122	(142,149)	95.7%
Public Safety - Fire	4,420,458	4,813,682	5,758,787	5,591,876	5,852,278	(260,402)	101.6%
Public Safety - Police	7,145,454	7,831,812	8,655,283	8,765,082	8,787,657	(22,575)	101.5%
Public Works	517,695	753,059	864,178	718,238	873,509	(155,271)	101.1%
Capital Improvements	700	104,735	2,604,251	618,728	647,409	(28,681)	24.9%
<i>Salary Savings Adjustment</i>							
Total	\$ 24,074,669	\$ 26,958,120	\$ 33,064,672	\$ 29,958,521	\$ 30,606,791	\$ (648,270)	92.6%

FY2003/2004 General Fund results for most operating departments mirror the results on an All-Funds basis, with most departments realizing savings in personnel costs (through vacant positions) and prudent management of non-personnel resources.

Expenditure by Department	2004/2005 Final Budget	2004/2005 Adjusted Budget	2004/2005 Year-to-Date Results	2004/2005 Year End Projections	Variance
City Council	\$ 120,755	\$ 120,755	\$ 63,061		
City Attorney	311,188	311,188	111,295		
City Manager	1,940,163	1,985,060	1,063,272		
Finance	1,413,090	1,413,090	791,941		
Community Development	3,400,948	3,471,659	1,876,834		
Parks & Community Services	9,065,183	9,078,978	4,938,730		
Public Safety - Fire	6,082,198	6,082,198	3,572,249		
Public Safety - Police	9,475,208	9,895,215	6,543,795		
Public Works	875,743	875,743	761,433		
Capital Improvements	1,907,651	1,927,651	1,398,352		
<i>Salary Savings Adjustment</i>	(300,000)	(300,000)			
Total	\$ 34,292,127	\$ 34,861,537	\$ 21,120,962	\$ 32,669,194	\$ 2,192,343

Through the January (Period 8) accounting close, FY2004/2005 General Fund expenditures (including encumbrances) were \$21.12 million, or 60.6% of the adjusted budget of \$34.86 million. Personnel expenditures are tracking below budget (52%) through seven months while citywide non-personnel expenditures (incl. encumbrances) were at 74% of budget.

Preliminary projections of year- end General Fund expenditures stand at \$32.67 million - or \$2.2 million below the adjusted budget for FY2004-FY2005.

