



City of Woodland

REPORT TO MAYOR AND CITY COUNCIL

AGENDA ITEM

TO: THE HONORABLE MAYOR
AND CITY COUNCIL

DATE: December 4, 2007

SUBJECT: Mid-year Adjustments & FY 08
Operating Budget & FY 08 & FY 09 Capital Budgets

Report in Brief

The economic impacts related to the real estate market are significantly worse than originally predicted. As with many jurisdictions throughout the state, the City is realizing significant shortfalls in permit fees, service charges, sales and property taxes, and development fee revenues.

Final analysis of FY 07 development fees based on year-end revenues showed that income was approximately 50-60% less than previous years and this trend is expected to continue throughout FY08 and FY09. Staff has also reviewed the original FY08 budget assumptions and factored in the storm water program's operational requirements. Based on this analysis, staff anticipates a \$2.658 million operational deficit in the General Fund, and a \$12 million deficit in the capital budget

Immediate expenditure reductions are needed to address this shortfall. Staff has reviewed the FY 08 budget and identified several one-time strategies that will address the shortfall without significant service level impacts or adverse impacts to City employees. However, it is important for Council to note that the strategies do not address the structural problem with City revenues and expenditures and more work will need to be done as part of the FY 09 budget and 10-year financial plan.

Staff recommends that the City Council approve the FY 08 operating budget adjustments and FY08 and FY09 capital budget adjustments as described herein.

Background

Preliminary FY08 Operating Budget

During the November 4, 2006 Strategic Fiscal Planning Session, Council reviewed the City's overall financial position and discussed several significant fiscal challenges facing the City:

- Existing fragile balance of City Services, and continued deferral of unmet service needs
- Reduction in Road Funding
- Storm drain services if rate increase is not approved by voters

- \$1.4 million annual costs of the City's fourth fire engine company, and the expiration of temporary funding effective June 30, 2007
- \$50 million unfunded liability for "Other Post Employment Benefit (OPEB)" which primarily consists of retiree healthcare premiums that requires an annual contribution of ~ \$4.3 million
- Unfunded maintenance of existing City facilities

Consistent with previous years, a six-year General Fund forecast was presented to Council, reflecting an on-going and growing annual structural operating deficit. Given the fiscal challenges noted above, the Council and City Manager imposed a hiring freeze and reduction of services and supplies in its FY07 budget.

In February 2007, Council provided the following guidance and direction for preparation of the FY08 Operating Budget:

- Continued balance of City services
- Labor and benefits assumptions consistent with Council Guidance and MOU guidance
- Limited staff augmentation
- Absorption of 4th fire engine company in the General Fund
- Controllable and discretionary costs contained at 3% increase
- FY08 General Fund budget shortfall to be covered with one-time projected savings from FY07 General Fund budget
- Storm Drain expenditures limited to fee revenues ~ \$176,000
- Dubach operations to cease in FY09
- Vehicle charges consistent with previously approved 5-year recovery plan.

On June 5, 2007, Council approved the FY 08 Operating Budget. The General Fund Budget was approved with a \$ 717,000 structural deficit to be funded with anticipated FY07 budgetary savings. The storm drain appropriations were restricted to the level of estimated annual revenues (approximately \$176,000); with Council to address additional requirements after resolution on the August 2007 vote for a storm drain rate increase. Funding toward the City's OPEB liability was deferred for future and further discussion.

Current Economic Condition

The City is currently projecting a \$2.658 million deficit in its FY08 General Fund operating budget, and a \$12 million deficit in its capital budget. These deficits are primarily attributable to (1) the significant economic downturn in the real estate market, and (2) the defeat of a storm drain rate increase.

- *Housing Market:* the economic impacts related to the real estate market are significantly worse than originally predicted. The reductions in development activity realized in FY07 and projected for FY08 are approximately 50-60% lower than budgeted based on historic trends. Consistent with state and national trends, municipal revenues are being hit hard in the areas of permit fees,

service charges, sales and property taxes, and development fee revenues. The City's current financial projections reflect a:

- \$2 million shortfall in General Fund revenue - consisting of \$1.5 million in permit fees/service charges, and \$500,000 in sales/property tax revenues.
- \$12 million shortfall in capital budget revenues – directly tied to reduced development activity realized in FY07 and projected for FY08. The City's FY07 revenues came in \$5 million short; revenues shortfalls in FY08 are projected at \$7 million.

➤ *Storm Drain Operations:* The August 2007 storm drain rate increase was defeated. As stated in the October 2, 2007 Council communication, certain operations are legally mandated or considered non-discretionary and critical. To the extent that annual storm drain revenues (~\$176,000) do not cover operational costs, the operational shortfall becomes a General Fund obligation. As such, these operational costs must compete for funding with other General Fund Services (Police, Fire, Library, Parks, etc.) Given the anticipated revenue shortfall in the FY08 General Fund budget, staff was directed to prioritize and minimize their operational requirements. These minimal operational requirements are estimated at an additional \$650,000 (over and above the approved \$176,000 in FY08) and comprised of the following expenses:

- \$262,000 in legally mandated requirements (e.g. NPDES permits, air quality permit, right of way annual fee, new Vac-Con lease, property taxes).
- \$386,000 to mitigate safety / liability risks

Recommended Mid-year Budget Adjustments

Given the uncertainty over the storm drain rate increase, Council imposed an early hiring freeze on new positions and vacancies to generate some savings in the FY08 General Fund Budget which would be needed for unfunded storm drain operational priorities.

The magnitude of the projected FY08 General Fund deficit has necessitated continued close scrutiny of all City positions, and the City Manager has directed staff to prioritize and minimize other operational expenditures.

The City Manager and staff have spent the last two months evaluating all programs and developing a recommended course of action to address the \$2.658 million General Fund Shortfall and the \$12 million capital budget shortfall. The actions to address the shortfall are “one-time” strategies that will relieve the current situation but will not correct the structural problem.

Discussion

The shortfall affecting the General Fund and Capital Projects are summarized as follows:

- General Fund Operating Deficit of \$2.658 million is comprised of
 - Projected Sales Tax / Property Tax Shortfall: \$ 428,000
 - Projected Fee Revenue Shortfall: \$ 1,572,000
 - Additional Storm Drain Operational Priorities \$ 658,000

- Capital Project Budget Shortfall of \$12 million is comprised of
 - FY07 Development Fee Revenue Shortfall \$ 5,000,000
 - FY 08 Development Fee Revenue Shortfalls \$ 7,000,000

FY08 General Fund Operating Budget

The City Manager and staff have evaluated their operational priorities and expenditures, and recommended the following actions needed to offset the anticipated deficits in both the General Fund and the Capital Budget:

- General Fund Operating Reductions:
 - Salaries / benefits \$ 809,000
 - Professional and Contract Services 373,000
 - Services and Supplies 433,000
 - Training 97,000
 - Equipment 72,000
 - Contributions to General Fund Capital 300,000
 - FY07 Excess Savings 169,000
 - General Fund Reserve Balance 315,000

The salaries/benefits reductions will be achieved by not filling ~ 14 existing vacancies, and restructuring certain staff positions, including the following:

Dept	Position
Admin	Human Resources Clerk
CDD	Assistant Planner, Associate Planner, CDD Technician. <i>NOTE: Some current vacancies will be reclassified and filled; action to be brought to City Council under separate cover.</i>
Finance	Accountant
Parks	Maintenance Worker
Police	Police Officer Trainee, Police Officer
Fire	Fire Prevention Specialist, Fire Captain
Library	Library Technician
Public Works	3-Engineer Technicians.

While not filling these positions will strain operations in the short term, staff believes the losses can be mitigated by shifting assignments and judicious use of overtime as situations require. However, current service levels will not be sustained if these reductions become permanent. Therefore, it is critical for staff to closely review the development of the FY09 budget in order to determine potential service delivery alternatives that will generate additional savings.

The balance of the reductions is associated with operational expenditures. Most of the reductions in Professional and Contract Services will be achieved because fewer consultants are needed to support development activity. Departments have closely reviewed each program's services and supplies and developed one time strategies to mitigate the reductions. The reduction in training was generated by the Fire Department which utilizes unexpended training dollars from the prior year. Equipment savings was generated by deferring the purchase of vehicles in the Parks & Recreation and Police Departments. Thorough analysis of the timing for the General Plan Update identified \$300,000 in scheduled expense that can be deferred until FY 09.

The application of additional savings generated by FY 07 provided \$169,000 toward the shortfall. Finally, the remaining gap of \$315,000 was covered by using a portion of the \$5.7 million General Fund Reserve Balance.

➤ FY08 and FY09 Capital Project Budget

The City Manager and staff also conducted a comprehensive review of all projects contained in the approved FY08 and FY09 Capital Budget. Staff reviewed priorities and cash flow requirements for each respective year and are recommending various changes which reduce capital project appropriations by \$12 million. See attached exhibits (Exhibit One and Two) for extensive list of proposed capital project budget changes and modified capital appropriations by fund, respectively.

The major impacts to capital projects include delaying construction of the Spring Lake Fire Station, deferring the City Hall Expansion Project, canceling the construction of Replacement Well #22 and deferring new Well #25, and deferring or cancelling several road projects. Among the cancelled projects are the E. Main St. Bikeway, Kentucky/Cottonwood Traffic Signal, and the Lincoln/Cottonwood Traffic Signal. The signalization projects may be re-programmed at a later date, as new development or traffic volumes warrant.

In addition to the \$14 million in proposed reductions, staff is recommending the addition of \$2 million in new projects. These projects include:

- Fire Station #2 Repairs, which consists of repairs to the concrete driveway, which is broken into sections and needs to be replaced (unrelated to the new construction)
- Fire Station #3 maintenance repairs to building columns and the ramp.
- Replace Street Lights: will replace old series lighting between Elm & Third. These types of street lighting circuits are a safety concern and need to be replaced.

- Surface Water Project Planning & Permits, which provides funding for the continuation of the water right application, securing permits, and initial design work on this continuing project.
- Water Meter Installation – Phase I installation of meters for houses built after January 1, 1992. This project is required for the City to be in compliance with AB2572.

Due to time constraints, these new projects have not yet been reviewed by the Planning Commission for conformance to the General Plan. Staff is seeking Council approval subject to Planning Commission determination of conformance at their next meeting scheduled December 6, 2007.

Staff anticipates development of a ten-year capital project budget package in the spring, which would include appropriations for FY09 and FY10 with tentative planning for the subsequent eight years. This ten-year CIP is expected to greatly enhance the planning and budgeting process.

Fiscal Impact

The information presented herein is focused on the anticipated \$2.658 million operating deficit in the FY08 General Fund Operating Budget and the \$12 million deficit in the FY08 Capital Budget. The mid-year adjustments proposed are intended to only address the immediate fiscal challenge. As stated previously, these one-year strategies do not address the ongoing structural deficit in the General Fund.

As a reminder, the FY08 adopted General Fund budget contained a structural operating deficit of \$717,000 (covered by one-time savings realized from the FY07 budget). The budget was based on a fragile balance of prioritized City services and did not include several significant unfunded initiatives such as the City's \$50 million unfunded OPEB liability or deferred maintenance requirements on existing city facilities (e.g. City Hall, Police Station, Fire Stations, Community Senior Center, Municipal Services Center). Additionally, absent an alternative funding source for storm drain operations, General Fund resources will have to fund storm drain operational deficits (annual estimate of \$800,000).

As staff prepares the FY 09 Operating Budget and develops a FY 2009- FY 2018 10-year Plan, it is highly likely some level of service and program reductions will be proposed. Consideration of these issues will be necessary to correct the structural deficit as described herein and prevent future need for significant mid year adjustments. Staff will seek guidance from the City Council during the December 11 Council Retreat.

Public Contact

Posting of the City Council agenda.

Alternative Courses of Action

1. Approve the FY 08 budget adjustments for operating and capital programs as described herein.
2. Direct staff to develop alternative budget adjustments for operating and capital programs.

Recommendation for Action

Staff recommends that the City Council approve Alternative No. 1.

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List attachments