City of Woodland

REPORT TO MAYOR AND CITY COUNCIL

AGENDA ITEM

TO: THE HONORABLE MAYOR
AND CITY COUNCIL

DATE: May 5, 2009

SUBJECT: Presentation of a Budget and Fiscal Policy

Report in Brief

In association with the Council discussion of the General Fund reduction options for the FY 2009-10 budget, staff has sensed the need to present a statement focused on budget and fiscal policies. Such policies have been established in other local government organizations and are typically used to guide the City Council, City Manager and Department Heads in the development of financial plans for all city funds. Among the very important issues summarized in a typical budget and fiscal policy is the level of reserves maintained in all city funds, how these funds are to be used and who has authority over the application of the reserves. Such a policy has not been established in Woodland and staff believes that it is critical to present this policy in order to guide the final development of the FY 2009-10 budget.

The attached Budget and Fiscal Policy is presented for the City Council's review. Staff's proposal is to facilitate discussion of this very important document during the May 5 meeting in order to receive guidance to finalize the document for adoption as part of the FY 2009-10 budget actions on June 16.

Staff recommends that the City Council review the Budget and Fiscal Policy and provide guidance and direction that will facilitate the presentation of this policy for adoption as part of the FY 2009-10 budget on June 16, 2009.

Background

On March 31, 2009 staff presented reduction options for the FY 2009-10 General Fund budget for consideration and discussion by the City Council. These options were summarized into three tiers totaling nearly $7 million. The first tier, totaling approximately $5.4 million, would have required further use of the General Fund reserves totaling $838,000. The second tier provided options totaling nearly $850,000 and the cumulative impact would have essentially balanced the current $6.3 million structural imbalance. The third tier totaled $720,000 and the cumulative impact would have reduced expenditures by nearly $7 million and added $700,000 to the reserves. Unfortunately, the level of program/service level reductions was significant, far ranging and nearly intolerable to many members of the community. In addition, the reductions would have required the involuntary

discharge through layoff of approximately 20 employees. Many of the Woodland residents and City employees who addressed the City Council in response to these options expressed the need to retain these services and save the jobs that would be impacted by the implementation of the reductions.

Following the March 31 meeting, staff reviewed options to implement the reductions necessary to balance the General Fund budget without requiring the involuntary discharge of employees through layoffs. The best option available is the Retirement Incentive Program offered by Cal PERS often referred to as the Golden Handshake. This program offers retirement eligible employees two years of service credit if they enroll during specific time frames established by the agency. The Golden Handshake does not require a cash contribution from the agency; the cost is factored into future retirement rates that become effective two years after the implementation date and the increase is very manageable. Staff immediately began a process of notifying and educating employees regarding this option and twelve (12) retirement eligible employees enrolled by April 27. The impact of the enrollment of these employees is certainly favorable from a fiscal standpoint and may allow the desired level of reductions to be achieved without layoffs or with minimal layoffs.

In addition to retirement incentives, management staff is also seeking compensation reductions from the City's bargaining units through the meet and confer process. Concession from the City's bargaining units in compensation or sharing of benefits will also facilitate significant reductions that would minimize layoffs and deeper cuts in programs and services. The City's bargaining unit representatives are currently meeting with the City's labor negotiators and compensation concessions are number one on the priority list.

The efforts described herein are focused on achieving total reductions of $6.3 million which is equivalent to the First and Second Tier levels. This focus reflects the City Manager's belief that the current level of General Fund reserves should not be further diminished. Based on a $38.7 million operating budget, maintaining the reserves at the present level of $5 million will provide the City with a 13% fund balance which is equal to approximately seven weeks of operating costs.

The fund balance issue has surfaced often during discussions of the City's fiscal challenges. Many residents and employees who commented on March 31 expressed their belief that the current economic conditions merit the use of the reserves in order to preserve programs and jobs. Follow up discussions on the budget with the Chamber of Commerce, Library Board, Parks & Recreation Commission and Commission on Aging have included comments on the appropriate level of reserves. Generally, the City Boards and Commission members are advocates for the programs they represent and urged the City Council and the City Manager to utilize the reserves in order to preserve service levels. Residents, property owners and business representatives who attended two Chamber of Commerce meetings regarding the City's fiscal issues urged the City Manager and City Council to make prudent decisions in order to protect the City's financial stability. All agree that the decisions are difficult and options unpleasant.

The comments received during the March 31 Council meeting, follow up community meetings and discussions between the City Manager and members of the City Council has generated the need to develop a Budget and Fiscal Policy at this time. A Budget and Fiscal Policy provides the foundation for policy guidance on fiscal matters for the City Council, City Manager and Department Heads in

the course of preparing the annual budget. The current lack of a policy for Woodland is making the development of the FY 2009-10 budget more difficult and could potentially place the City in a vulnerable financial position.

Attachment No. 1 is the proposed Budget and Fiscal Policy for the City of Woodland. This policy includes standards for maintaining reserve funds and how the reserve funds are designated in order to address the discussion regarding the appropriate level of reserves. In addition, the policy incorporates most of the Guiding Principles that were introduced to the City Council in December 2007 and have been referenced and reaffirmed on several occasions whenever major budget/fiscal issues are presented. Staff believes that the adoption of the attached Budget and Fiscal Policy will address a deficiency in the City's current financial practices and facilitate financial stability.

Given the importance of this matter, staff proposes to introduce discussion of the attached policy on May 5, receive comments from the City Council and return with the formal approval of the Budget and Fiscal Policy as part of the FY 2009-10 budget adoption on June 16. The following section of this report will present a detailed description of the primary elements.

Discussion

The Budget and Fiscal Policy is intended to guide the City's budget decisions toward maintaining long-tern financial stability, ensure that basis City services are delivered and protect past and future investments in the City's infrastructure and facilities. This policy is intended to apply to all City funds, including the General Fund, Enterprise Funds, Redevelopment Agency and Internal Service Funds. Approval of this policy would require the City Council, City Manager and all appointed officials and employees to apply each element. While certain elements such as the formalization of reserve levels and designations for all City funds are new, other elements should be familiar to the City Council as they are part of the Guiding Principles that have been discussed in association with significant fiscal actions. The following seven elements, referenced in the policy as ***Procedures***, are presented as part of the Budget and Fiscal Policy:

- Reserve Funds
- 10-Year Financial Planning
- Performance Based Budgeting
- Capital Improvement Program
- Internal Service Funds
- Enterprise Funds
- Review and Adopt a Performance Based Budget

The following information will discuss each element. However, the most significant amount of discussion will focus on the Reserve Funds since the community and Council discussion in this area has been significant and has the most potential serious impact on the City's fiscal stability.

Reserve Funds

This element of the policy establishes the prudent level of reserves necessary to support the City operation. In addition, the procedures associated with the reserve funds designate the categories of reserve funds that the City would maintain; these designations are important because they are recognized by authorities such as the Government Accounting Standards Board (GASB) charged with regulation of public finance. It is also important to recognize the value of reserves and why a local government operation should maintain a sufficient level. The following comments are presented as the most important reasons for maintaining adequate reserves:

Natural or Man-made Disasters: One of the lessons that local officials should have learned from events such as Hurricane Katrina is that a city or county impacted by a natural or man-made disaster must rely on its own resources. Reserves provide the insurance that the local government will have the resources necessary to compensate the "first responders" including Police, Fire, Public Works and Building staff who will be working around the clock to help local citizens survive the event and eventually return to their homes or businesses. In addition, reserves will mitigate the extended loss of local revenues, such as sales and property taxes, if the event has a significant and long term impact on a wide residential or business area.

Economic Contingency: The current economic storm that Woodland and all other local governments are currently riding out is a second reason why adequate reserves are critical. Local governments have no control over regional, national and international economic conditions. However, all local governments are impacted by these conditions, especially within the context of the "global economy". In recognition of this fact, many cities have established separate economic contingency reserve funds wherein contributions are made annually in order to deal with the economic downturns on at least a short term basis without significant impact to services.

State Raids on Local Revenues: The potential for the State of California to borrow or otherwise possess local revenues remains a threat despite the 2004 passage of Proposition 1A. Many legislators and their staff continue to view local government as subservient organizations that exist at the discretion of the State. Last year, as California struggled with a monumental deficit and a deadlocked legislature, "borrowing" of property tax was contemplated at an amount estimated at $1.8 million for Woodland. This threat was averted primarily due to extensive lobbying efforts by local elected officials across California. Woodland's Redevelopment Agency did lose $141,000 from the State's outright possession.

Cash Flow: Maintaining adequate reserves also helps the local government meet cash flow requirements without compromising investments. Woodland investment strategy relies on low risk and liquidity and adequate reserves are part of the strategy.

Financial Stability: The final comment is associated with the relationship between the level of reserves and the local government's financial stability. Adequate reserves and a policy that mandates specific reserve levels transmits that the local government is financially stable. This is an important matter for financial institutions and other entities that evaluate the local government's fiscal performance while considering the issuance of bonds for major capital projects.

A recent survey obtained by Finance staff showed that cities had a wide range of formal and informal policies regarding the level of reserves. Smaller cities tended to have a larger percentage of their General Fund held in reserves because of their relatively small operating budgets. Larger cities held a smaller percentage although the level from a cash standpoint was significant. Most cities maintained reserves of 10-15% and many established an additional economic contingency reserve. The combined value of both reserves was approximately 30% of the annual operating budget.

The proposed policy designates three separate reserve funds. These designations include the **Committed Fund Balance, Assigned Fund Balance** and **Unassigned Fund Balance.** The following information further defines the separate fund balance designations and how they work to facilitate fiscal stability.

The **Committed Fund Balance** would be established **as part of the FY 2009-10 budget** in an amount equal to 13% of the specific fund operating expenses. For the General Fund, the 13% means that the existing reserves of $5 million would not be further diminished. This fund balance shall be maintained at all times and may only be utilized if specifically approved by the City Council. If the use of the **Committed Fund Balance** is approved by the City Council, an amount equal to 13% of the operating expenses must be re-established as part of the following Fiscal Year budget adoption in accordance with this policy. The **Committed Fund Balance** must be maintained at 13% of the operating expenses for each year of the 10-Year Plan for each fund.

The City Council may establish a **Committed Fund Balance** at an amount that is less or more than 13% by approving a specific change to the Budget and Fiscal Policy during a regular City Council meeting. However, absent a specific action, minimum reserves equal to 13% of the operating budget of a specific fund must always be maintained. The policy establishes a limit that the City Council consciously imposes on itself in order to facilitate long-term fiscal stability.

The **Assigned Fund Balance** shall be established **as soon as feasible** in an amount equal to a range of 5% - 15% of the specific fund operating expenses in order to address unanticipated financial impacts. These impacts may include state borrowing or possession of local revenues, economic contingencies and natural or man-made disasters. Use of the **Assigned Fund Balance** requires the specific approval of the City Council. If the use is approved, the City Council has the option, based on the availability of revenues to support such action, to replenish the **Assigned Fund Balance** at any amount within the range of 5% - 15% as described herein.

The **Assigned Fund Balance** would essentially function as a contingency fund to cover significant unanticipated financial impacts. Unlike the **Committed Fund Balance,** the **Assigned Fund Balance** would be established **as soon as feasible;** this condition recognizes that the City is not in a position to designate 5%-15% of its operating cost for all funds at the present time. However, the policy

proposes to make the designation of an **Assigned Fund Balance** a fiscal priority. As economic conditions improve and fund revenues in excess of projections are received, the proposed policy will require the City Council and the City Manager to consider the use of the surplus revenue to create the **Assigned Fund Balance** and designating a continuous commitment of annual revenue for this purpose.

The final designation is the **Unassigned Fund Balance.** This designation is the amount within each fund that is in excess of designated operating funds, **Committed Fund Balance** and **Assigned Fund Balance**. The **Unassigned Fund Balance** is essentially surplus funds that can be utilized as working capital to offset the year to year fluctuations within each fund. Similar to the other funds described herein, use of the **Unassigned Fund Balance** must be approved by the City Council. There is no mandated minimum or maximum amount specified for the **Unassigned Fund Balance;** the amount will likely vary from year to year based on annual operating expenses and revenues.

In consideration of the fund balance designations described in this report and within the proposed policy, it is important for the City Council to note that staff reviewed reference material, evaluated other local government policies and discussed this issue with municipal finance consultants. One such consultant was Michael Coleman, a resource who has written dozens of articles on this subject and frequently presents workshops for elected and appointed officials through the League of California Cities. Mr. Coleman's website, www.californiacityfinance.com, is frequently used by public officials seeking reference materials on a wide variety of public finance issues. In response to staff's request, Mr. Coleman sent sample policies regarding reserve fund balances for review in preparation for this report. All of the policies included conditions associated with reserve funds that were similar, if not nearly identical, to the conditions described herein and included in the proposed policy.

10-Year Financial Planning

This element formally establishes the commitment to long term financial planning by requiring the City Manager to present balanced 10-Year Plans with each annual budget. The 10-Year Plans will require the City Manager, Department Heads and Finance staff to review and document revenue and expenditure assumptions, conduct trend analysis, forecast future expenses associated with capital projects and conduct periodic audits of revenues sources such as Transit Occupancy Tax and Sales Tax.

Long term financial planning was implemented last year for most major funds. This practice will continue to be refined as staff improves the capacity to develop revenue and expenditure projections, especially in the capital projects area. The current difficult and uncertain economy has hampered 10-Year Planning because trends are very unusual. However, the commitment to developing excellent 10-Year Financial Plans need to be established in order to facilitate Woodland's long term fiscal stability.

Performance Based Budgeting

This element formally establishes the commitment to Performance Based Budgeting (PBB) that would be effective with the FY 2013-14 budget. The four year time frame recognizes the significant task associated with developing the goals, objectives and related performance measures that will link resource allocation to service levels within the City's annual budget.

The importance of a Performance Based Budget cannot be underestimated. PBB links the annual allocation of resources to the achievement of results that correspond to service levels and defined in measurable terms. A PBB provides data that allows the City Council, City Manager, Department Heads and program managers to shift resources in order to achieve the results that are expressed in both qualitative and quantitative measures. In summary, **PBB is the foundation for building a data driven, results oriented, customer focused and responsive local government organization**.

Capital Improvement Budget

The proposed policy formalizes the commitment to the annual development of a 10-Year Capital Improvement Project (CIP) budget. Staff believes that this a critical element of the proposed policy given the significant infrastructure projects on the horizon, including the Davis Woodland Water Supply Project, sanitary sewer trunk line replacements, waste water discharge issues and Measure E projects. Conformance with the tenants of this element will be challenging. As an example, condition 4.4 of the attached policy will require the City Manager to certify that resources are committed within the 10-Year Financial Plan to adequately maintain and operate facilities commencing in the year the project is completed through the balance of the 10-Year Plan. This condition will require the City to consider the timing of many important projects, including many of the voter approved Measure E projects such as the Library expansion, until resources are identified that will adequately maintain and operate the expanded facilities. Expenses such as replacement of major building components would need to be included in the 10-Year Plan after the facility is completed. However, the alternative to this policy would be to allow the projects to be completed without assurance that resources are available to maintain the City's capital investment.

Internal Service Funds

This element will facilitate the establishment as part of the 2013-14 budget Internal Service Funds with adequate resources to support several internal/administrative operations. Internal Service Funds define the costs associated with the support operations and require that the costs be charged back to the specific program or service that utilizes the service. This practice ensures that the full cost of a program or service is recognized. In addition, the development of 10-Year Plans for Internal Service Funds is intended to hold fund managers accountable for developing accurate forecasts for future expenditures and reviewing alternatives for saving resources. For example, technology managers will be required to forecast the future costs for communications equipment which should generate discussion of alternatives such as competitively bid long term agreements that could save resources.

Enterprise Funds

The proposed policy defines how enterprise funds are to be managed and ensures that all appropriate costs are charged to such funds with the required fees generating sufficient revenues to offset all expenses. In addition, the policy requires proactive management of the enterprise funds so that opportunities for enhanced revenue generation, periodic review of agreements and review of user fees are standard financial practices.

Annual Review and Adoption

The final element requires the City Manager to present a budget to the City Council that meets the standards imposed by the policy. Financial assumptions associated with the 10-Year Plans would be reviewed with the City Council and explained during public hearings that would be conducted annually. The City Council would review and adopt the annual budget as long as it is in compliance with the policy.

Staff believes the proposed Budget and Fiscal Policy will establish a comprehensive approach to facilitating long term financial stability. It is important to note that the proposed policy will not be easy to implement. Developing ten year forecasts, maintaining designated reserve funds and evaluating capital projects to make sure that sufficient operating funds are available when the improvement is completed requires additional work, financial discipline and the willingness to reprioritize expenditures if necessary. The development of the Performance Based Budget itself will require the entire organization to become engaged in developing outcomes for each operational program that will generate hundreds of performance measure that qualify and quantify service levels. However, if the City Council and staff stay focused on the purpose of the proposed policy, the benefits of improved services and a transparent budget process will be realized for the citizens of Woodland.

Fiscal Impact

While there is no direct impact on the General Fund or other City funds associated with the City Council's adoption of this proposed policy, staff believes the Budget and Fiscal Policy will improve the City's long term financial stability.

Public Contact

Posting of the City Council agenda.

Recommendation for Action

Staff recommends that the City Council review the Budget and Fiscal Policy and provide guidance and direction that will facilitate the presentation of this policy for adoption as part of the FY 2009-10 budget on June 16, 2009.

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Mark G. Deven
City Manager

Attachment No. 1 – Proposed Budget and Fiscal Policy

City of Woodland

POLICY AND PROCEDURE

Policy No:	**15-102**	**Effective Date:**	**June 16, 2009**
Division:	**City Manager**	**Distribution:**	**All Departments**
Related Policy:		**Last Revision:**	

SUBJECT **Budget and Fiscal Policy**

POLICY This Policy will guide City budget decisions toward maintaining long-term financial stability, ensure that basic City services are delivered, and protect past and future investments in the City's infrastructure and facilities.

APPLICABILITY This Policy applies to all City of Woodland elected and appointed officials and all employees. Budget and Fiscal Policy are intended to establish a more comprehensive approach to achieving financial stability presently and into the future. This policy is intended to formalize the application of the Guiding Principles introduced in December 2007 for all City funds, including the General Fund, Enterprise Funds, Redevelopment Agency, Capital Improvement Funds and Internal Service Funds. Each year at the time the City budget is considered, the City Council shall review the Budget and Fiscal Policy and conduct a review of the proposed budget for consistency with this Budget and Fiscal Policy. As noted, specific procedures will require a long term commitment in order to become fully implemented.

APPROVALS			
Name	**Date**	**Name**	**Date**
Associations			
Director			

PROCEDURES

1.0 Reserve Funds

1.1 Reserve funds will be designated in the following terms:

1.1.1 ***Committed Fund Balance:*** Established to maintain self imposed limitations to facilitate financial stability of each operating fund and the City organization;

1.1.2 ***Assigned Fund Balance:*** Established to reflect the intended use of resources primarily associated with unforeseen events that have a financial impact on the City organization;

1.1.3 ***Unassigned Fund Balance:*** The working capital that can be utilized to offset the year to year fluctuations between operating revenues and expenses within a specific fund.

1.2 The ***Committed Fund Balance*** shall be established **as part of the FY 2009-10 budget** in an amount equal to 13% of the specific fund operating expenses. This fund balance shall be maintained at all times and may only be utilized if specifically approved by the City Council. If the use of any or all of the ***Committed Fund Balance*** is approved by the City Council during any fiscal year, than in the following Fiscal Year budget adoption the ***Committed Fund Balance*** must be restored to an amount equal to 13% of the operating expenses in accordance with this policy. The City Council may establish a ***Committed Fund Balance*** at an amount that is less or more than 13% of operating expenses by approving a specific change to the Budget and Fiscal Policy during a regular City Council meeting. The ***Committed Fund Balance*** must be maintained at the level adopted by City Council for each year of the 10-Year Plan for each fund.

1.3 The ***Assigned Fund Balance*** shall be established **as soon as feasible** in an amount equal to a range of 5% - 15% of the specific fund operating expenses in order to address unanticipated financial impacts. These impacts may include state borrowing or possession of local revenues, economic contingencies and natural or man-made disasters. Use of the ***Assigned Fund Balance*** requires the specific approval of the City Council. If the use is approved, the City Council has the option, based on the availability of revenues to support such action, to replenish the ***Assigned Fund Balance*** at any amount within the range of 5% - 15% as described herein.

1.4 The ***Unassigned Fund Balance*** is the amount within each fund that is in excess of designated operating funds, Committed Fund Balance and

Assigned Fund Balance. The ***Unassigned Fund Balance*** is essentially surplus funds that can be utilized as working capital to offset the year to year fluctuations within each fund.

2.0 10-Year Financial Planning

2.1 The City Manager will present a budget (Capital and Operating) that is balanced over the 10-year planning period for all funds.

2.2 Utilize the 10-Year Plan as the basis for making long-range financial planning decisions.

2.3 Develop and maintain a revenue monitoring and forecasting system to assist in trend analysis and revenue forecasting for the 10-year planning period.

2.4 Document all assumptions for revenue and expenditure forecasts each year.

2.5 Establish a financial plan for the Redevelopment Agency that ensures a positive cash balance at the end of the life of the Agency.

2.6 Seek reimbursement for State and Federal mandated programs and projects.

2.7 Produce fee schedules that recapture the cost of providing programs and/or services at a level consistent with Council Policy.

2.8 Conduct periodic audits for sales tax (point-of-sale), franchises and concessions, and transient occupancy tax (TOT).

2.9 Carefully review and discourage grants that may expand or add services without reliable replacement revenue after the grant period ends.

3.0 Performance Based Budgeting (PBB)

3.1 **Effective with the FY 2013-14 budget,** establish the PBB as the City Council's service delivery policy document.

3.2 Establish a PBB that measures service levels, efficiency and effectiveness.

3.3 Follow the principles of outcome management in utilizing the PBB.

3.4 Ensure all costs (direct and indirect) are charged against each program budget.

3.5 Measure work efficiency and effectiveness to ensure an optimal allocation of human and fiscal resources to budget approved services and programs.

3.6 Ensure all operating programs have measurable performance objectives which identify the service and level of service, and the resources required to accomplish the objectives.

3.7 Complete year-end reports and audits to measure the work accomplished against what was planned at the beginning of the fiscal year and evaluate future service levels.

4.0 Capital Improvement Program

4.1 Develop a 10-year plan for CIP.

4.2 Seek grants for needed capital projects which can offset use of other City funds; these funds can then be utilized for other needed projects.

4.3 Develop the capacity to maintain capital improvements to the level required to adequately protect the City's capital investment and to minimize future maintenance and replacement costs.

4.4 Include resources required to maintain and operate new capital improvements commencing the year the project is completed and continuing through the balance of the 10-Year Plan.

4.5 Ensure capital budgets contain all costs to complete the project (design, right-of-way, construction, inspection, contract management and contingency).

4.6 Ensure all proposed projects in the 10-Year Plan have a viable source of funding for both construction and maintenance.

4.7 Fund projects proposed for Enterprise programs by revenues derived from user fees.

4.8 Encourage pay-as-you-go financing of capital improvements where feasible.

5.0 Internal Service Funds

5.1 **Effective with the FY 2013-14 budget,** develop Internal Service Funds for Workers' Compensation, Risk Management, Storm Water, Fleet Maintenance and Replacement, Technology Maintenance and Replacement (including all computer/software and communications equipment), Building Maintenance and Replacement, and Miscellaneous/Office Equipment Maintenance and Replacement.

5.2 Develop a 10-year financial plan for all Internal Service Funds.

5.3 Develop projections that include cost of operation, maintenance and replacement in the 10-year financial plans.

5.4 Develop the capacity to charge all costs (operation, maintenance and replacement) associated with each Internal Service Fund to the appropriate user department.

5.5 Develop the capacity to maintain equipment and facilities to the level required to adequately protect the City's investment and to minimize future maintenance and replacement costs.

6.0 Enterprise Funds

6.1 Maintain a 10-year financial plan for all Enterprise Funds.

6.2 All costs associated with providing administrative support (finance, personnel, legal, etc.) shall be charged to the appropriate Enterprise Fund.

6.3 The cost of each enterprise shall be completely offset by user charges and fees derived from the enterprise activity. Costs shall include operating, maintenance, capital, debt service, contingency and administrative costs.

6.4 Periodically review and adjust user fees in order to avoid large one-time fee increases.

6.5 Periodically review concession agreements, lease agreements and all other revenue generating agreements in order to determine if the City is receiving a return that reflects the market for similar agreements.

7.0 Review and Adopt a Performance Based Budget

7.1 The budget will be adopted as shown in the operating and Performance Based Budget document annually.

7.2 Full review of revenue assumptions and preparation of the Capital Improvement Program and Ten-Year Plans on all funds will be done annually.

7.3 The City Council will hold public hearings and formally approve a budget for the City annually.