City of Woodland

REPORT TO MAYOR AND CITY COUNCIL

AGENDA ITEM

TO: THE HONORABLE MAYOR
AND CITY COUNCIL

DATE: December 15, 2009

SUBJECT: Status Report on the Fiscal Year 2010 General Fund and Update on the Development of the Fiscal Year 2011 Budget

Report in Brief

The FY 2010 General Fund budget was adopted by the City Council last June after consideration of a significant number of strategies to reduce a nearly $7 million deficit. Final adoption required the reduction of 69 positions, several programs and implementation of furloughs by employees in order to reduce compensation by approximately 5%.

Unfortunately, these strategies have fallen short of achieving the structural reductions needed to sustain City operations. The recessionary economy further declined in the second quarter of 2009 which caused City sales tax to fall below the revised projections. In addition, the City's sales tax consultant has advised staff that sales tax trends across the region suggests will be reduced below the FY 2009 level. This analysis has required staff to review the FY 2010 sales tax estimates and revise projections downward by approximately $990,000. In addition, other City revenues are falling short of projections and overtime in the Fire Department is trending to over-expend by $400,000. As a result, staff estimates that mid-year adjustments of approximately $2 million are necessary to maintain the current level of the City's General Fund reserves.

Finally, staff has also identified several related long term fiscal issues that will impact the development of the FY 2011 budget and updated 10-year Financial Plan. It is important to summarize these issues for the City Council, community and employees so that the fiscal challenges faced by Woodland are well understood. Developing strategies to address these issues now will help the City reach long-term fiscal sustainability despite the impact of the current recessionary economy. Failure to recognize the significance of these issues and delay in developing strategies will have the opposite impact.

Staff recommends that the City Council receive the status report on the Fiscal Year 2010 General Fund and update on the development of the Fiscal Year 2011 budget and direct staff to prepare mid-year adjustments to address the current deficit and strategies to address the long-term fiscal issues as described herein.

Background

On June 16, 2009, the City Council adopted the FY 2010 General Fund budget and updated 10-year Financial Plan that included strategies to achieve $6.8 million in expenditure reductions. This action culminated three months of intense review that included budget workshops, presentations at community meetings and internal meetings between the City Manager's Office and City departments in order to balance the General Fund budget. In summary, the City Council approved actions that reduced operating expenditures by approximately $5.5 million to address the loss of General Fund revenues due to the current recessionary economy. The Council also approved a contingency plan to further reduce the General Fund by approximately $1.3 million if the City's bargaining units were unable to reach agreement on compensation concessions equal to the contingency plan that were necessary to balance the General Fund. On September 1, the City Council approved labor agreements that reduced compensation by nearly $1 million based on the City Manager's recommendation that strategies could be developed to meet the remainder of the shortfall. The concessions agreed to by the bargaining units included furloughs that reduced salaries by approximately 4.6% and employee cost sharing for medical insurance that maintained the cost to the City at 2009 levels. The combined impact of these concessions was compensation reductions of 5%.

The City Manager and a team of Finance and Human Resources staff began meeting following the approval of the labor agreements to review the City's financial situation and develop strategies to address the $300,000 shortfall. Staff believed that a close review of mid-year expenditures and adjustments would resolve the outstanding balance.

In the course of reviewing the City's financial situation, staff looked closely at the final FY 2009 revenues and expenditures. Unfortunately, sales tax which had declined significantly in the last quarter of 2008 and first quarter of 2009 continued the rapid descent to a 20% year over year decrease in the second quarter (April-June) of 2009. As a result, the final FY 2009 sales tax was $8,827,891, a reduction of nearly $500,000 from the estimate that was revised when the FY 2009 mid-year adjustments were approved. This would have had a significant negative impact on the City's General Fund reserves if not for the fact that City departments further reduced spending that nearly offset most of the reduction.

The FY 2009 reduction in sales tax requires staff to revaluate the FY 2010 sales tax estimate and revise the projections downward by $990,000. This revision is based on the sales tax consultant's analysis that the trend of declining sales tax will continue through the end of 2010. In addition, other City revenues staff is closely monitoring are falling short by $350,000. These sources include the Fire/emergency response recovery fees, Motor Vehicle In-Lieu fees, and sale of City land. Finally, Fire Department overtime is trending to over-expand by $400,000 due to a combination of the impact of furloughs on minimum staffing requirements, vacant positions and staff members on approved extended leaves. The combined impact of the revenue shortfall and Fire overtime is approximately $1.7 million. When this amount is added to the $300,000 shortfall staff intended to address at mid-year, the total imbalance is approximately $2 million.

As the Council is aware, long range financial planning is a critical component of the City's effort to achieve fiscal sustainability in this challenging economic climate. Staff reviewed the current financial situation and identified related long-term fiscal issues that need to be addressed over the course of the next 10-30 years. It is important to project the current situation over the long term because the reduced revenue established a new and, unfortunately, lower revenue base from which the General Fund will recover. The fiscal issues need to be recognized as significant challenges that can be overcome if the City is willing to develop strategies to address them over the long term. ***If the City is unable to address these issues, the General Fund will be in a chronically imbalanced condition that will impair the efficient and effective operation of programs and services well into the future.***

The following section of the report will summarize the actions in progress to address the current year deficit and the potential strategies that will be proposed for the City Council's consideration in early 2010. In addition, the long term fiscal issues will also be discussed in order to provide the City Council, the community and City employees with the context for considering the strategies to address the current year deficit and develop the FY 2011 budget and updated 10-year Plan. Consideration of the context is critical because the impact of the current recessionary economy on the General Fund is severe and will not be overcome for the next 5-10 years. ***In fact, staff believes that the review of the information described in the balance of this report needs to be the foundation for developing a restructured organization that is focused on providing Woodland residents and businesses a "baseline" for the highest priority services. These "baseline services" must be recognized as the highest priorities that can be financially supported over the long term.*** Therefore, many services that are currently provided and/or were provided until last year will no longer be available unless City priorities are revised and/or new revenue sources are identified.

Discussion

Addressing the Current Year Deficit

Staff is reviewing several strategies to address the current year deficit. These strategies include across the board percentage reductions in operating expenditures, maintaining vacant positions and transferring currently filled General Fund staff into vacant non-General Fund positions.

Staff is also reviewing the use of one-time reserve funds and similar options. These options are limited; as the Council may recall, the FY 2009 mid-year deficit of $2.7 million was partially addressed by use of a $1.4 million reserve fund. In any case, very close review of options to utilize one time funds will be completed.

Given the limited options, it will be the City Manager's most unpleasant responsibility to consider two actions that will impact employees in association with the proposed mid-year adjustments. The first action will be to formally ask bargaining units to consider additional compensation reductions. As the Council is aware, all bargaining units approved agreements of 1-3 years retroactive to July 1, 2009; therefore, reopening of the agreements to discuss compensation reductions in light of the City's fiscal situation requires mutual consent.

Depending on the receptivity of the bargaining to this request, the second action will be to prepare a plan for the involuntary discharge of employees through layoffs. Implementation of layoffs will be limited to those employee associations which do not include provisions within their Memoranda of Understanding prohibiting such action. It is too early to determine how many employees will be affected and the City Council and employees must be assured that all other options will be considered before layoffs are proposed.

Finally, the City Manager, Fire Chief, Fire Mid-Managers and Firefighters Association are actively discussing strategies to reduce Fire overtime. The range of options include suspension of furloughs, placing limits on the number of employees that can be off at the same time and reducing fire staffing to below the 12-person minimum required by the Firefighters Association MOU. It is important to note Fire Mid-Management and the Firefighters Association do not support a reduction in staffing below the minimum level due to operational and safety impacts.

The City Manager is currently meeting with City department heads and the Finance/Human Resources team to review all of the available strategies. Mid-year adjustments need to be proposed and implemented as soon as possible to have a positive impact on the current year. Staff will return to the City Council with the proposed mi-year adjustments in February 2, 2010.

Summary of Major Fiscal Issues

As stated previously herein, staff has identified twelve (12) major fiscal issues that impact the City's fiscal sustainability. The description that follows herein is not intended to cause panic or despair within the community and the organization. It is intended to provide justification for a reevaluation of the City's fiscal priorities and overall operation. In short, the City of Woodland cannot continue to conduct business as it has in the past and present and City operations must change. Local government must grow smaller with the highest priority services receiving the funding adequate to be delivered in an excellent manner. Employees must understand that the dynamics affecting local government are changing and compensation such as salary and benefits will be impacted.

Based on the revaluation of the FY 2010 sales tax, the minimum reductions needed for the FY 2011 budget that would maintain General Fund reserves is estimated at $3 million. This amount would decrease if staff and the City Council are able to implement mid-year 2010 reductions that are ***structural and would remain as part of the FY 2011 budget.***

Recession

The current recessionary economy is expected to last through 2010 and perhaps into 2011. If the recession lasts into 2011, that means local government revenues will begin a recovery in 2012. Woodland should expect to remain in a reduction or (at best) stable condition with conservative revenue projections until FY 2012-13 at the earliest.

It is simply impossible for Woodland to address the fiscal imbalance within the General Fund without implementing further reductions in staff and services. In addition, these reductions will not be achieved through additional Golden Handshakes or attrition. Downsizing an organization in response to these strategies is not effective and efficient in the long run. ***The most effective and efficient way to downsize the organization is to understand what the community's highest priorities are and reallocate resources and restructure staffing in order to meet those needs. This could and likely will mean that employees will need to be discharged through layoffs.***

Case studies on successful local government organizations often show that an organized process for identifying a community's highest priorities generates the best results in terms of citizen satisfaction and efficient/effective operation. This process can take many forms including workshops, telephone surveys and focus groups. In some cases a variety of methods are used to make sure that the results are balanced and consistent with the Council's priorities. Similar to issues such as green waste, the Council could also appoint a citizen committee to study the issues supported by staff. In any case, the priority identification process does not rely on how many people or special interest groups can turn out during Council budget workshops. It relies on a focused process of information gathering and organized decision making.

Staff believes community engagement needs to play the key role in reallocating Woodland's limited General Fund resources in a manner that meets the community's highest priorities. By implementing community engagement, staff and the City Council can be confident that the resources are allocated in the most efficient, effective and highest priority manner.

In addition to community priority identification, staff is moving forward with the development of a Performance Based Budget this fiscal year. By June 30, program goals stated as outcomes, service objectives and performance objectives for every City program will be identified. This process will also help Woodland achieve efficiency and effectiveness.

State Take of Funds

As the Council is aware, the result of the State budget has caused Woodland to lose $1,346,850 from the General Fund and $675,000 in RDA funds for FY 2009-10. The General Fund loss is a borrowing of property tax under the provisions of the 2004 Proposition 1A that the State is constitutionally required to repay in three years. The RDA amount is a seizure that will not be repaid and an additional amount estimated at $140,000 is scheduled to be seized in FY 2010-11.

The General Fund loss would have required the Council to choose between further reductions, use of reserves that would have dropped the balance below 10% or borrowing from other funds with repayment scheduled to coincide when the State's repayment occurred. Fortunately, the passage of SB 67 on October 15 wherein the State securitized the borrowing allowed the City to meet the obligation without implementing one of these alternatives.

The RDA take is being legally contested by the California Redevelopment Association and legal counsel from both organizations has expressed optimism that the State's take will be overturned. The officials urged Agencies to not pay the State until the last possible minute which is mid-May 2010. If the legal challenge is unsuccessful, the RDA can meet this seizure with its current fund balance without impacting operations or use of the bonds. However, it is important to note that staff is being careful in allocating RDA and Housing Set-Aside funds this year in order to preserve the fund balance. Staff believes that reinvestment of the bond proceeds should focus on improving tax increment and the Agency needs to support the League and CRA in order to stop the State from future seizures.

Although the final approved budget for the State did not include seizure or borrowing of Gax Tax funds, it was an option considered throughout the budget process. Staff believes the State may look to this funding source to balance future budgets. In addition, the State's current fiscal year deficit of nearly $21 billion suggests that other local government revenues will be at risk now or in the immediate future. Unless a legislative or voter initiated remedy to State raids is enacted, local governments must remain cognizant of threats emanating from the Governor and/or the Legislature.

Long Term Capital Program

The FY 2009-10 budget process focused almost exclusively on the General Fund reductions. This year, staff will need to focus on the 10-year CIP in order to address the long term structural deficit that has been generated by years of internal borrowing, pledging development impact fees to meet external debt service payments and the downturn of the economy. The impact of these conditions increases the debt within the 10-year CIP from the current level of $20 million to $30 million.

There are several strategies that will need to be considered to work out of this significant deficit. As an example, the City's sale of land assets, including the 128 acre parcel near CR 102 between Beamer and Kentucky is one potential source of income that could be used to address the problem. A similar sale of the City's 180 acre parcel on CR 102 at CR 25A could help meet the balance of this deficit. In addition, updating the General Plan could allow the City to revise the Major Projects Financial Plan by utilizing updated development assumptions and spreading capital projects over a longer planning horizon. Finally, close review of the CIP that would include the deletion or delay of projects. The likely solution will need to consider a combination of the strategies presented herein.

OPEB Liability

During FY 2008-09 Finance staff worked with an actuarial consultant to update the City's future Other Post Employment Benefits (OPEB) liability. When last forecasted two years ago, the liability was estimated at $49 million. ***The result of the updated study shows, unfortunately, that the future liability has increased to $56 million.*** This increase has occurred despite the fact that the City has implemented a "two tier" system wherein any employee hired after July 1, 2006 is not eligible for the benefit.

The results of the study were presented to the City Manager in September and from a broad perspective the reason for the increase is associated with the increased retirements in 2007 and 2008. These retirements load more eligible employees into the system despite the fact that the numbers of future eligible employees are limited. If the City Council has questions regarding the results of this study, it would be beneficial to invite the actuarial consultant to present the information at a future Study Session.

In reviewing options to meet this liability previously, staff felt the sale of surplus property was the most preferred strategy. However, given the long term debt for the capital program described herein, the actuarial study shows that prefunding the liability by establishing an irrevocable trust and making additional annual payments over 30 years of $1.8 million for all funds will decrease the liability to $36 million. Of the $1.8 million, approximately 60% or $1 million would be charged against the General Fund.

Meeting this liability as described above would require ***additional General Fund reductions over the $3 million described previously by approximately $1 million.*** In addition, options that would use some of the proceeds from the sale of City land could be implemented in combination with the annual payments. In any case, staff believes that a plan needs to be developed to address the liability in order for the City to be evaluated favorably by rating agencies when considering bond issuance.

CalPERS/Pension Increases

As has been reported in local and regional media sources, CalPERS lost significant value from their investment portfolio as a result of the stock market losses in 2008 and 2009. Some estimates have suggested that the investments declined by 25%.

While staff believes that CalPERS will recover from this loss over the long term, the short term impacts on the State and local government members will be significant. The annual cost to maintain the defined benefit pensions offered by CalPERS will certainly rise and member agencies or employees will be assessed the increases.

The League of California Cities led by the City Manager's Department is reviewing this issue and discussing options to facilitate limits on pension costs. These limits would likely require employees to share the burden of the cost increases in order to maintain the current level of retirement benefits. If the League fails to act, there is a very good chance that California voters will be presented with options to address the issue. Staff understands that two initiatives have been presented to the State Attorney General's Office for summary and title that would essentially reduce benefits and increase the retirement age for all new employees hired after July 1, 2011.

Implementation of the Budget and Fiscal Policy

Prior to the City Council's approval of the Budget and Fiscal Policy on June 16, Woodland did not have a Council approved document that guided staff in the development of the annual budget. Important issues such as fund balance reserve levels, reserves for various assets and the format for presenting a budget were left up to the City Manager and his/her staff.

The new Policy provides an excellent framework for meeting the City's fiscal goals and providing long term fiscal stability. However, the Policy will require a level of "fiscal discipline" that Woodland has not previously implemented. To illustrate further, if this Policy had been in place four years ago, the timing for Phase II of the Community & Senior Center and Sports Park may have been delayed. These assets were constructed with bond proceeds that may not have been issued as early as 2007 following the 2006 approval of Measure E because the Policy encourages "Pay As

You Go" financing and the identification of resources to operate and maintain facilities prior to completing construction.

Beginning in FY 2013-14 the Policy will require reserve funds in technology, facilities, fleet and similar internal services to be established. Staff will need to work hard in order to identify the resources to meet these requirements. In order to do this, new revenue sources will need to be identified or reprioritization of existing General Fund expenditures will need to occur unless the City Council elects to revise the Policy. Staff would not recommend any changes to the Policy.

Flood Mitigation

One of the City Council's most important concerns is the mitigation of the flood threat to Woodland and the nearby rural areas affected by Cache Creek. The impact of this threat on Woodland's economy is well documented by the $2.4 million residents and business owners pay for flood insurance, the millions of square feet of unoccupied industrial buildings in the northeast area and delayed development of Woodland Park.

The City Council's excellent decision to jointly fund a focused effort to address this issue is beginning to produce results. Through the FloodSAFE Yolo Pilot Program, Woodland is engaged with two local agencies, the US Army Corps of Engineers (USACE) and State Department of Water Resources (DWR) in an effort to resolve this problem. Data generated through this program has allowed staff to challenge assumptions regarding storm and flood impacts to the point that a revised flood map has been developed and sent to FEMA for their review. If approved by FEMA, up to 66% of Woodland homes and businesses currently shown as in the flood plain will be removed, saving property owners millions in annual flood insurance payments.

The 10-year CIP identifies approximately $11 million in flood mitigation projects primarily focused on protecting City assets such as the East Main Pumping Plant, North Canal Pumps and South Canal Pumps. If the solution that has been developed involving the construction of an outfall channel and conveyance of flood waters directly into the Yolo Bypass is approved and funded by the USACE and DWR, the $11 million could be saved and therefore applied to the CIP structural deficit described previously. If the solution is approved and no funding is provided, the $11 million could be applied toward the cost of a flood mitigation project assuming a strategy to address the structural deficit is developed. In any case, flood mitigation ***must*** continue to be a high priority because Woodland's long term economic health depends on it.

Utility Enterprise Funds

The Council is well aware of the issues associated with the Water and Sewer Enterprise Funds. These issues include impacts of deferred maintenance, increasing regulatory requirements, commitment to the Surface Water Project and citizen's concern with increased rates to pay for the projects. Following the water rate increase approved by the City Council on November 3, staff is working to implement a focused program to outreach, inform and educate Woodland ratepayers regarding the issues associated with their water utility system through the Water Rate Advisory

Committee. This process will also enable staff to better understand the ratepayer's concerns and priorities as future projects are considered.

In addition, a strategy will need to be developed to address the $2.4 million deficit in the Storm Drain Enterprise Fund as well as the annual subsidy from the General Fund to Storm Drain activities. At some point Woodland ratepayers will need to consider a rate increase under the Proposition 218 mail-in ballot process which was rejected in August 2007. Staff will be looking at options to decrease General Fund support of the Storm Drain program which could have undesired consequences for localized flooding.

Transportation Funding

As Council is aware, a 10-year Plan for the transportation program was developed and provided as part of the City Council's consideration of the budget. Staff developed this projection in order to address the diminishing level of Transportation Development Act (TDA) funds. The first priority for the use of TDA funds is transit activities. As Yolo County's population continues to grow, a larger share of these funds will be used for transit purposes, such as expanding bus routes. Based on projections reviewed with YCTD staff, Woodland's share of TDA funds is expected to diminish from the 2010 amount of $764,276 to $183,526 by 2019.

In order to maintain the present level of road maintenance funding, the City would need to backfill with another source. The 10-year Plan shows one of the sources of the backfill as Measure E funds which Council approved utilizing a maximum of $750,000 annually through FY 14 and then utilizing $800,000 annually beginning in FY 15. However, additional backfill funds will be needed beginning in FY 15 and for the remainder of the 10-Year Plan. If Measure E funds are unavailable, staff will need to find an alternative funding source in order to maintain local streets and roads at the current level. In addition, consideration of a third sales tax initiative will likely need to include a larger share for transportation funding if Woodland is to maintain a safe, effective and efficient circulation system.

Measure E

There are two challenges facing staff in association with development of the FY 2010-11 capital budget and the allocation of Measure E funds. The first challenge is the "over subscription" of Measure E projects. Simply stated, there are too many projects with too high of a cost for the balance of Measure E revenue projected for the remaining eight years. The second challenge is that certain projects, such as the Library Expansion, require the identification of operating resources prior to scheduling if staff and the City Council intend to comply with the new Budget and Fiscal Policy. At this point, resources to operate and maintain the expanded facilities have not been identified and therefore projects that add operating costs have not been scheduled.

Resolving these issues will require a reprioritization of projects and reallocation of operating resources. For example, staff will need to develop cost projections to operate and maintain the expanded library and factor that into the General Fund 10-year Plan, perhaps at the expense of another activity if new resources cannot be identified. Understanding the community's highest priorities would be a very important part of the process.

The language included in the ballot measure required that a Council approved spending plan be updated on a bi-annual basis. An update will be required in 2010; staff anticipates that this update will occur simultaneously with the ten-year CIP annual update.

Special Fund Deficits

There are certain funds that have deficits which further exacerbate the City's overall financial condition. Some of these deficits have been in place for many years and strategies for addressing the issue have not been developed or, if developed, not implemented. These include the following funds and deficits:

- Cemetery - $110,000
- Dubach Park - $589,000
- Fire Suppression District - $1.915 million
- Landscape & Lighting Districts – Unknown annual subsidy from the General Fund

Staff believes that a strategy to address these deficits needs to be developed and inserted into the City's long range financial plan. Maintaining these deficits without a strategy in place to address them is not appropriate. Additionally, the City's independent auditors require explanations for and disclosure of fund deficits in the City's annual financial statements. This disclosure includes accumulated deficits and the City's remedy for the balances; anything that can't be cured within one year may require long-term commitment of other internal resources.

Formation of Special Districts

Following the contentious City Council meetings regarding the budget, the Library Board asked the Yolo County LAFCO Board to study options for forming a special district consistent with the City's incorporated boundaries. According to Library Services Director Sandy Briggs, the Board's purpose is to investigate the feasibility of separating from the City and forming its own local government organization. Sandy has stated that the Board is in the investigation phase and is not convinced that this is an appropriate action.

It is important for the City Council to recognize the implications associated with the formation of a separate Library District in Woodland. If such a District is formed, LAFCO would decide, based on a formula, the allocation of Woodland's property tax to the newly formed entity. Staff has asked LAFCO to provide an estimate and has been assured that the information is forthcoming. In addition, the formation of another layer of local government is hardly the right thing to do from an efficiency standpoint. The new District would need to conduct its own elections and all of the administrative capacity currently provided by the City, including purchasing, insurance, legal advice, etc.

Staff believes the Council and the community need to be kept informed of the Library Board's actions and the LAFCO Board's consideration. Unfortunately, very few people pay close attention to the deliberations of a LAFCO Board when it is not engaged in a contentious annexation process. In addition, staff has learned that the Library Board's actions are being watched by the Parks & Recreation Commission. Members of that Commission have not contacted LAFCO yet although they are receiving updated information regarding the process.

Revenue Based Mitigation of Major Fiscal Issues

Recently, the Library Board through the Library Services Director asked the City Attorney to provide analysis of funding measures that could be considered for the Library. The City Attorney's analysis could be applied toward most activities supported by the General Fund, including the Library, Parks & Recreation and Public Safety. The memo summarizing the funding measures is included as Attachment #1.

The memo points out that there are generally three types of revenue measures that the City could implement: a general tax, special tax, or a general obligation bond. Imposing or increasing general or special taxes requires voter approval, as does issuing a general obligation bond. Specifically, all general taxes must be approved by 50% of the voters while special taxes require a two-thirds vote. The specific types of general or special taxes the City could impose are discussed in the attachment.

Formation of an assessment district is discussed in the City Attorney's memo as not a particularly good alternative for the Library. However, an assessment district may be applicable on a citywide basis for funding of landscaping and lighting. In fact, many cities have formed citywide Lighting and Landscaping (L&L) districts since the benefits to property owners can be easily quantified and assessed. Woodland has contemplated the formation of such a district in the past in order to consolidate the various separate L&L districts, including Streng Pond, North Park, Gibson Ranch and Spring Lake. While an estimate regarding the favorable financial impact of a citywide L&L would need to be updated, previous estimates have suggested that up to $2 million of additional revenue would become available. Consideration of this strategy may increase in importance as a way of offsetting the long term loss of transportation funds and allow the Gas Tax to be used for road maintenance instead of street lighting.

In consideration of the revenue based mitigation measures described herein, it is important for staff and the City Council to consider two matters. First, Woodland residents and business owners will be facing a 20% increase in water rates effective January 1 which will be followed by additional 20% increases effective July 1 during the next three years. The justification for the rate increases is well documented and was discussed extensively on November 3 when the Public Hearing associated with the rate increase was held. The financial impact associated with the rate increases may cause some Woodland residents and business owners to state their lack of support for additional assessments or taxes. Second, the current recessionary economy and related impacts such as 12% unemployment and flat or reduced income levels may make it difficult to generate public support for additional fees and assessments regardless of the high priority a program or service may hold.

While the community's tolerance for a tax or assessment must be considered, the significant expenditure reductions may require further investigation of revenue based strategies described herein. Should the City Council provide direction to investigate one or more of the tax/assessment options described in the City Attorney's memo, staff would certainly provide more detailed information.

Community Engagement

As stated previously, staff believes community engagement is essential in considering resource allocation priorities. A process needs to be initiated in early 2010 and substantially completed within a 60-day timeframe so that the results can be considered as the FY 2011 budget is prepared.

Therefore, it is proposed that the City implement a public outreach process to solicit meaningful input from the community on budget priorities. The process will kick off with 10 Stakeholder Interviews with key opinion leaders, to be conducted in concurrence with research for the Woodland-Davis Clean Water Agency. Based in part on findings from those interviews, the City will develop an internet-based survey that asks residents to rank budget priorities and provide suggestions for efficiencies in operations. At the same time, the City will schedule presentations to public opinion leadership groups, following which attendees will be asked to complete a paper version of the internet-based survey. These groups will include community based organizations, service clubs and similar civic associations. Finally, the City will conduct four focus groups with randomly recruited residents who are representative of the City's diverse demographics. One focus group will be specifically for Spanish-language speakers. To reduce costs, two focus groups will be conducted in conjunction with those being done for the Woodland-Davis Clean Water Agency. To the extent possible, each research activity will incorporate and build upon findings from prior activities. The sum total of the public opinion research effort – to be detailed in a summary document – will enhance the City's outreach to residents and better inform staff and the City Council as options are considered for the FY 2011 budget and updated 10-year Financial Plan.

Concluding Comments

There are many challenges associated with the City's current and future fiscal condition. These challenges must be addressed in a direct and assertive manner in order to provide Woodland with a fiscally sustainable future. The journey to fiscal sustainability will not be easy and there will be many changes to the City organization in the process. However, the residents of Woodland deserve the organization's very best effort in this endeavor.

Fiscal Impact

As stated previously, the information presented herein summarizes a FY 2010 deficit of approximately $2 million and estimates that $3 million will need to be reduced from the FY 2011 budget. If the FY 2010 reductions are structural and can be incorporated into the FY 2011 budget, the $3 million reduction estimate should be reduced.

Public Contact

The City Council agenda was posted. The City Manager also met with the representatives of all Woodland employee associations on December 7 and conducted citywide employee meetings on December 8.

Recommendation for Action

Staff recommends that the City Council receive the status report on the Fiscal Year 2010 General Fund and update on the development of the Fiscal Year 2011 budget and direct staff to prepare mid-year adjustments to address the current deficit and strategies to address the long-term fiscal issues as described herein.

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Mark G. Deven
City Manager

Attachment: City Attorney Revenue Memo

BEST BEST & KRIEGER LLP
ATTORNEYS AT LAW

MEMORANDUM

ATTORNEY WORK PRODUCT
ATTORNEY-CLIENT PRIVILEGE

TO: Sandy Briggs, Library Services Director, City of Woodland

FROM: Best Best & Krieger LLP

DATE: November 16, 2009

RE: Library Funding Options

BACKGROUND INFORMATION

The City of Woodland is currently evaluating its options for raising revenue for the Woodland Public Library. As a municipal library, the library is operated by an appointed board of trustees. However, funding for the library comes out of the City's general fund, with the board having no control over the amount of funding allocated. In light of the current economic climate, the City has reduced library funding. To ensure the City's library remains a valuable resource for City residents, the City is evaluating its options for increasing library funding.

QUESTION PRESENTED

What revenue measures may be enacted to increase library funding?

BRIEF ANSWER

Generally, there are three types of revenue measures that the City could implement: a general tax, special tax, or a general obligation bond. Imposing or increasing general or special taxes requires voter approval, as does issuing a general obligation bond. Specifically, all general taxes must be approved by 50% of the voters while special taxes require a two-thirds vote. The specific types of general or special taxes the City could impose are discussed below. Although assessments are an alternative means of generating revenue for public facilities, it is unlikely that an assessment district could be created to fund the library.

ANALYSIS

FREE USE OF MUNICIPAL LIBRARIES

As an initial matter, municipal libraries are subject to special rules that prevent the City from imposing user fees on patrons to fund library services. In light of the public nature of municipal libraries, Education Code section 18960 requires that municipal libraries remain free to "inhabitants and nonresident taxpayers." Unless a patron violates a library rule or regulation, he or she may not be charged for using library services. Accordingly, the City cannot simply impose a user fee to increase library funding.

PROP. 218 REQUIREMENTS

A. General and Special Taxes.

Before examining specific types of available funding mechanisms, it is important to note the substantive and procedural limitations imposed by Proposition 218. Among other things, Prop. 218 limits the power of local governments to impose taxes, which are classified as either general or special. (Cal. Const., article XIIIC, §§ 1-2.) Prop. 218 distinguishes between a general and special tax based on the purposes for which the revenue raised will be used. A general tax funds "general governmental purposes." (Cal. Const., article XIIIC, § 1(a).) By contrast, revenue from a special tax supports "specific purposes." (Cal. Const., article XIIIC, § 1(d); See Government Code, § 53717 [authorizing cities to impose special taxes consistent with Prop. 218 for library services].)

Prop. 218 imposes unique procedural requirements on the enactment of general and special taxes. General taxes must be approved by a two-thirds vote of the City Council and a majority vote of the voters. An election on a general tax must be consolidated with the regularly scheduled general election for City Council members unless the City Council unanimously declares an emergency.

Special taxes must be approved by a majority of the Council and a two-thirds majority of the electorate. (Government Code, § 53724.) An election regarding a special tax may be consolidated with a general, primary or regularly scheduled local election. However, the election may also be held on any other date permitted by law. In this case, the City must pay for the cost of the election.

These different voter thresholds create challenges for local agencies. On one hand, it is numerically easier to obtain a simple majority vote. On the other hand, it may be easier to generate sufficient public support for a special tax as voters can identify with a clearly identifiable purpose for the levy (i.e., public safety, a library or a sports arena). To avoid this problem, local governments sometimes utilize the "Measure A and B" approach. In this case, the local agency places two measures before the voters: Measure A – a general tax and Measure B – an advisory measure requesting the local legislative body use funds raised by Measure A for a specific purpose. As you may remember, Sacramento County recently used this approach in its attempt to secure funding for a new Sacramento Kings arena.[1] It is important to remember that while this approach may help garner voter support, the advisory measure is not legally binding. Even if the City passed a general tax increase with a corresponding advisory measure requesting that funds be used for the library, a future City Council could decide that funds should be allocated differently.

B. Assessments.

Prop. 218 also constrains local governments' ability to impose special assessments. (Cal. Const., article XIIID, § 2.) An assessment is defined as "any levy or charge upon real property by an agency for a special benefit conferred upon the real property." To qualify as a special benefit, the property must receive a benefit from the service being funded that is above and beyond the general benefits conferred on all property within the City or to the public at large. (Cal. Const., article XIIID, § 2(i).)

The California Supreme Court recently clarified what qualifies as a "special benefit" under Prop. 218. In *Silicon Valley Taxpayers Association v. Santa Clara County Open Space Authority* (2008) 44 Cal.4th 431, the court considered whether an "open space" assessment complied with Prop. 218. The court concluded that it did not, in part, because the assessment did not provide a special benefit to the assessed parcels. The benefits of the assessment, namely preserving open space and corresponding recreational and qualify of life benefits, were benefits enjoyed by the public at large and not special benefits accruing to the assessed parcels.

In the present case, an assessment is probably not a viable potential revenue source for the library. The benefit from the library received by the parcels that would be subject to the assessment is most likely not any different from the general benefit received by all parcels within the City or by the general public. While not necessarily legal support for the conclusion that library services may not be funded by an assessment, a California Library Association fact-sheet regarding 2004 library-related local ballot measures identified a number of proposed tax increases to fund library services but not a single proposed assessment for these purposes.[2] In fact, two of the proposed taxes were parcel taxes designed to replace expiring assessments.[3] This is likely due to the issues identified above. Accordingly, the City would most likely be limited to imposing a general or special tax to fund library services.

[1] These measures were known as Measure Q and R. (See http://www.smartvoter.org/2006/11/07/ca/sac/meas/.) While the measures were soundly defeated in that case, the underlying approach is still valid.

[2] See http://www.cla-net.org/events/newsletter/oct04_measures.php. However, one of the measures was related to an assessment to pay for bonds used to finance library facilities under the state Library Bond Act of 2000. This would not be applicable in the present case. Similarly, the Mello-Roos Community Facility District Act of 1982 allows community facility districts ("CFD") to provide library services if a special tax is approved by the district's voters. (Government Code, § 53313(c).) It is important to note that the City could not form a CFD to provide library services at their current level. CFDs may not be formed to supplant services that are already provided to the district. (Government Code, § 53313.)

[3] These were Measure X in the City of Sacramento and Measure S in San Jose. (See http://www.cla-net.org/events/newsletter/oct04_measures.php.)

POTENTIAL REVENUE SOURCES

In light of the constraints noted above, below is a discussion of each of the potential revenue measures the City may consider enacting to support the library. Unless otherwise noted, each of the following measures could be imposed as a general or special tax.

A. Transactions and Use Tax (Sales Tax).

A transactions and use tax is a tax that increases the sales tax within the City. There are actually two components to sales tax. The first is the standard state sales and use tax. This is currently 8.25%, .75% of which the City receives. The second is a local transactions and use tax.[4] Under the auspices of a special statute that applies only to Woodland, the City currently imposes a .50% transactions and use tax. (See Revenue and Taxation Code, § 7286.52.) The City could increase the transactions and use tax in .25% increments up to 2% total. (See Revenue & Taxation Code, §§ 7251.1, 7262.3.) Accordingly, the City could increase the transactions and use tax up to an additional 1.5% to fund the library.

B. Utility Users Tax.

The City may impose a tax on utilities such as gas, electricity, telephone, water and cable television. (Government Code, § 37100.5.) This tax is actually paid by the utility customer and may be targeted at specific types of utilities or levied on all utilities (i.e., telephone, electricity or both).

C. Transient Occupancy Tax.

The City may tax a person staying thirty (30) days or less in hotels, motels and similar lodgings, including mobile homes. (Revenue and Taxation Code, § 7280 *et seq*.) Although the tax is collected by the operator, the tax is imposed on the guest.

D. Parcel Tax.

The City may levy a parcel tax to support the library. A parcel tax is an annual tax which is based on either a flat per parcel rate or rate which varies depending on use or size and/or number of units on each parcel. (See Government Code, § 53087.4.) Prop. 218 most likely requires that a parcel tax be adopted as a special tax. (Cal. Const., article XIIID, § 3.)

E. Business License Tax.

The City could impose a business license tax on businesses operating within the City. (Gov. Code, § 37101; Bus. & Prof. Code, §§ 16000 *et seq*.) A business license tax is different from a business license fee. A fee compensates the City for its costs of issuing and administering a business license program and is not intended to raise revenue for the City. A business license tax is imposed to raise revenue. Currently, the City's municipal code authorizes the City to impose both business license fees and taxes. (See WMC, §§ 13-1-7; 13-1-15.) While

[4] Please note that a transactions and use tax is actually calculated slightly differently from a sales and use tax. Basically, the jurisdiction where the sale took place always receives the sales and use tax. However, the jurisdiction where the goods are delivered to the customer receives the transaction and use tax.

it is not entirely clear, it appears that the City currently imposes a combined business license fee and tax. The applicable business "fee" for most businesses increases as the number of employees or amount of annual revenue increases. For example, the City currently imposes a $52 per year fee on retail businesses within $100,000 or less in annual gross sales and $762 per year for retail businesses with sales of $4,000,001 or more. Under the definitions noted above, any portion of the applicable fee for each that exceeded the City's actual cost of administering the business license program would be a business license "tax." As it seems unlikely that the City's actual costs of administering the business license program for large retailers are $710 more than for small retailers, the City is likely currently imposing a business license tax. The City could increase this tax to generate revenue for the library.

F. Municipal Occupations Tax.

While the City may not levy an income or payroll tax, it may levy a tax upon employees measured by their gross income received within the City. (See Revenue & Taxation Code, § 17041.5.) If the City decides to impose this tax, it must ensure that the tax does not discriminate against non-residents. (Government Code, § 50026.) The tax should also not be graduated or allow deductions typical of an income tax. (*Weekes v. City of Oakland* (1978) 21 Cal.3d 386.)

In *Weekes*, the city imposed a "business license fee" that required all employees to pay one percent of all income earned in the city in excess of $1,625 per quarter with a credit for self-employed persons paying the traditional business license tax imposed on businesses within the city. The court determined that the tax was not an income tax but a valid municipal occupations tax. Essentially, the court concluded it was similar to a traditional business license tax. Instead of taxing businesses based on their gross receipts, the city taxed employees based on their gross income. The "business license fee" was a valid tax on the privilege of working within the city.

These types of taxes are relatively rare. Traditional business license taxes are much more common. However, the City could at least theoretically impose a municipal occupations tax.

G. Development Tax.

The City could levy a development tax. This is a tax on the privilege or activity of development and/or the availability or use of municipal services. The tax is generally imposed only on new construction. The tax rate is generally based on number of units, number of bedrooms or square footage.

It is important to remember that a development tax is different from a development impact fee. These fees are generally imposed to fund the cost of City infrastructure and services that the proposed development will require. (See *Centex Real Estate Corp. v. City of Vallejo* (1993) 19 Cal.App.4th 1358, 1364.) By contrast, a development tax is a tax on the privilege of allowing development to raise general revenue for the City. (*Centex*, at p. 1364.) For example, in *Centex*, the city imposed a development tax of $3,000 per residential unit and $.30 per square foot for nonresidential properties. The city also imposed various development impact fees. The court noted that the development tax was separate and distinct from the development impact fees.

As with municipal occupations taxes, development taxes are relatively rare. In light of the current real estate market, the City may face stiff opposition to any measure that taxes the cost of development. However, the City is empowered to levy this type of tax and revenue from it could be used to fund the library.

H. Other Excise Tax.

The City may also impose almost any other excise tax. An excise tax is essentially any tax, except a poll or property tax. The distinguishing feature of an excise tax is that the obligation to pay the tax is based upon the voluntary action of the person taxed in performing the act, enjoying the privilege or engaging in the occupation which is the subject to the tax. (See *Pesola v. City of Los Angeles* (1975) 54 Cal.App.3d 479.)

Accordingly, an excise tax is not a specific type of tax but a category of taxes. Sales and use taxes, business license taxes, utility user taxes, transient occupancy taxes, and development taxes are all types of excise taxes. For example, a development tax is an excise tax because the developer is required to pay the tax based on his or her voluntary decision to develop property. In addition, one relatively common type of excise tax not specifically discussed above is an admissions tax. An admissions tax is a tax imposed on consumers for the privilege of attending a show, performance, display or exhibition. The tax rate is generally based on either a flat rate per ticket, a percentage of the admission price, or on a sliding scale. Generally, the tax is included in the price of the ticket, collected by the ticket seller and remitted by the seller to the City.

CONCLUSION

We hope this memorandum has been helpful in explaining the various types of potential revenue measures the City could enact to fund library services. Please let us know if you have any questions or need any further assistance.

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