

NEW BUSINESS



AGENDA ITEM 15.1

October 18, 2011

TO: Mayor and City Council

FROM: Susan Mayer, Chief Financial Officer

SUBJECT: **FISCAL YEAR 2011-12 GENERAL FUND BUDGET UPDATE AND AUTHORIZATION TO AMEND THE 2011-12 BUDGET**

RECOMMENDATION

It is recommended that the City Council adopt a resolution amending the Fiscal Year 2011-12 budget.

Summary

This report provides a Fiscal Year 2011-12 General Fund Midyear Budget Update. The City's budget condition continues to be impacted by external factors that challenge our ability to provide current services within available revenues. An action plan is presented to mitigate a \$3 million loss in major tax revenues and to correct the pricing of the Fire Department's overtime budget. This report also summarizes a list of ongoing challenges to the General fund. The City remains committed to addressing challenges as they arise and recognizes its responsibility to continue to adjust costs as necessary to operate within available revenues.

This report and its discussion of revised budget projections support the continuation of the state of fiscal emergency as adopted by Council Resolution 11-0114 on May 17, 2011.

DISCUSSION

Background

The City Council has targeted "Fiscal Sustainability – Getting Our Fiscal House in Order" as one its four goals for 2011. One of the strategic initiatives developed to support this goal was budget monitoring and mid-year reporting.

The last budget update presented to City Council on August 23, 2011 reported several significant events impacting the 2011-12 General Fund budget. The following chart is a summary of current issues and the proposed action plan that enables the City to maintain a balanced 2011-12 budget.

**FISCAL YEAR 2011-12 GENERAL FUND BUDGET UPDATE AND AUTHORIZATION
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**General Fund
Action Plan for Known Budget Impacts
2011-12**

Issues

Property Tax Revenues /Decline in Assessed Valuation	(2,232,600)
State Budget/Loss of Vehicle License Fee Allocations	(1,047,400)
Fire Overtime/Re-pricing to match leave policy	(700,000)
	(3,980,000)

Solutions

New and carryover grant sources	
State Mitigation - Prison Hospital	347,000
Peacekeepers Grant	200,000
Police grants - Carryover from 2010-11 (COPS, JAG)	604,000
Measure W - Budget Plan B Labor Cost Reductions	742,000
	1,893,000
Vacancy Savings (from July 1-Sept)	816,000
Service Reductions, without layoff	196,000
Capital Project cancelations	75,000
Contingency (Draws \$2 million balance to \$1 million)	1,000,000
	3,980,000
Net Impact	-

Issues

Property Taxes – We currently anticipate a 2011-12 General Fund property tax decline of 4.7% from the prior year. The original 2011-12 property tax revenue budget had been developed with an assumption of stabilizing property values. This assumption was developed with input from the City’s contract tax consultant and from direct discussion with the County Assessor as recently as late April. This new information creates a significantly unfavorable \$2.2 million loss of tax revenue from the adopted budget. In our analysis of the current tax roll, we noted that over half of the parcels in the City received Proposition 8 reductions during the year. Individual valuation adjustments averaged a decline of 12.7%. Unfortunately, this is not a one-time revenue loss, but is an ongoing reduction in our revenue base that further signals that the City’s property values have not yet stabilized.

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Vehicle License Fees – As the State adopted its 2011-12 budget, it adopted SB 89 which eliminates the remaining allocation of Vehicle License Fees to local agencies. Made public just hours before the legislative floor votes, the bill shifts Vehicle License Fee revenues to state law enforcement grants. This State action eliminates a significant \$1,047,400 source from the City's General Fund revenue budget.

This Vehicle License Fee loss has been offset by the State with a new restricted COPS grant award of \$480,000. However, the Police Department's COPS Grant Fund budget had already included an estimate for this COPS grant to offset current Police labor costs. The City's COPS Grant Fund does have, however, surplus unallocated grant funds in the amount of \$350,000, rolled forward from 2010-11 operations, that is immediately available to offset 2011-12 labor costs to mitigate a portion of this Vehicle License Fee revenue loss.

Sales and Use Tax – We have received good news on sales tax for the quarter ending June 30, 2011. Initial data released by the Board of Equalization shows a 10% increase compared to the same quarter in 2010. Because much of this June quarterly increase was driven by fuel prices, this increase may not be sustainable for the full 2011-12 year. We are cautiously optimistic that this increase in our sales tax base for the quarter could result in a \$200,000 increase in the annual projection, which had assumed a 3.8% annual increase. We are waiting for detailed quarterly projections by retail segment for trend analysis before formally updating the sales tax revenue projection. However, this is an encouraging trend in an otherwise challenging economic environment.

Fire Overtime – \$700,000 is needed to correct the pricing of the overtime budget within the Fire Department. The Interim Fire Chief has identified an inconsistency between the department's vacation use policy, the supporting overtime budget available to backfill vacation leave, and the vacation cap provision in the newly implemented fire compensation resolution.

Departmental policy has been to limit sworn fire employee vacation leave usage during the year. This policy has created cash flow savings since additional overtime has not been required to back fill for unused vacation time. However, under the terms of the new fire compensation resolution, employees are now subject to a cap on the accumulation of their vacation leave. The department simply must allocate more vacation usage so employees can get within the negotiated caps. The department has proposed modifying its leave usage policy to provide the flexibility for employees to take their vacation time and ultimately stay within the new cap in due time. The new caps provide long-term benefit to the City by avoiding the accumulation of large cash balances that are payable to employees upon retirement or separation. This additional overtime is for backfilling people on more vacation than in the past.

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Present Situation

The combined revenue losses and the re-pricing of fire overtime have created a \$3.98 million shortfall in the 2011-12 General Fund budget. Multiple solutions have been identified to address this shortfall, including new grant resources, unanticipated vacancy savings, service reductions, and a partial use of the General Fund budgeted contingency.

Solutions

Grants – New and carryover grant resources of \$1.9 million have been identified that will offset approximately half of the identified \$4 million shortfall, as follows:

- The City anticipates a new one-time allocation of \$347,000 from the state to mitigate impacts resulting from the construction of a medical care facility for State prisoners. The funds from the State are unrestricted and available to fund General Fund services.
- The Peacekeeper Program has received a \$200,000 Prop. 63 grant from the County. This grant can replace and reduce the budgeted General Fund support for this program.
- The Police Department has identified \$604,000 in grant funds that will carryover from the 2010-11 fiscal year, including the Federal JAG grant and the State COPS grant program. These carryover grant balances can offset 2011-12 Police Department labor costs.
- The total costs of Police and Fire employees allocated to the Measure W Sales Tax Fund will realize \$742,000 in savings due to the implementation of Budget Plan B labor cost savings. This will generate Measure W Fund capacity to absorb additional staff allocations from the General Fund while still operating within the original Measure W staffing plan.

Vacancy Savings – A significant number of employees have left City service over the past few months, including 100 separations at the end of June. While many vacant positions were eliminated, other vacant positions remain funded and will likely be filled through recruiting efforts. During the recruitment period, General Fund vacancies are estimated to achieve \$816,000 from budgeted levels, including \$566,000 of savings in the Police Department. While these savings are one-time and not ongoing, these temporary savings do buy the City time to build a longer-term financial plan and to phase in deeper cost reductions if and when necessary.

Service Reductions – The remaining requirement for budget-balancing service reductions has been minimized by the grant and vacancy saving assumptions

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discussed above. Service reductions are targeted at \$271,000. This includes \$196,000 in reductions from the Public Works Department and \$75,000 in capital project reductions. The reduction in capital project funding will impact available funds for the Riverfront Park improvements, the Philomathean Club renovation and the Animal Shelter HVAC project. These savings can be achieved without employee layoffs. Tree crew and parks workers will shift more of their time to Landscape Maintenance Districts and Gas Tax funded community enhancement services. Other General Fund program departments have contributed to the overall General Fund solution through vacancy savings.

Contingency – The final proposal for re-balancing the 2011-12 General Fund is to utilize half of the budgeted \$2 million contingency. The contingency was intended to be used to mitigate state impacts and revenue losses. Use of part of this contingency will enable the City to maintain a balanced budget and minimize service impacts and employee layoffs during the development of a longer-term financial plan.

We note with caution that a significant portion of these solutions are one-time in nature while the revenue losses and fire costs are ongoing issues. This creates a new \$3.9 million operating deficit going into FY 2012-13. Permanent structural solutions will be needed to rebuild long-term financial stability.

Ongoing Issues

The solutions discussed above address the quantifiable and known budget impacts to the General Fund. However, the General Fund remains at risk for a number of other serious but un-quantified and unresolved issues.

2011-12 Beginning Balance – As discussed in the August 23, 2011 budget report to City Council, staff continues the year-end close process and general ledger analysis in preparation for publication of the City's annual financial statements. We have identified concerns about the recorded value of accounts receivable in a number of City funds and programs. Research and analysis is ongoing. Further, as discussed with City Council at the time of the budget adoption, and again at the August 23, 2011 budget update, the city carries a list of inter-fund loans that are at risk of repayment, and this risk exceeds \$7 million. We anticipate returning to City Council with recommendations for any additional inter-fund transfers that may become necessary to cover the write-down of these receivables and inter-fund loans.

Statewide Elimination of Redevelopment Agencies – The State has passed legislation that limits future Redevelopment Agency activities. A study session held on August 16, 2011 provided the City Council with details about the impact of this State action and options available to the Agency and City as a potential successor organization. This State legislation has been challenged in a lawsuit filed by the California Redevelopment Association that is unlikely to be resolved for some time.

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The City cannot at this point predict what impact the dissolution of its Redevelopment Agency would have on the General Fund of the City. Even without dissolution, the City's Redevelopment Agency has a cash flow risk since current property tax increment revenues are insufficient to cover the annual costs of the redevelopment program as currently configured. Since the budget adoption, we have new information on Redevelopment property tax revenues that show weaker revenues than budgeted.

The Redevelopment Agency cash flow has direct impact on the General Fund. First, the Redevelopment Agency reimburses the General Fund for an allocation of administrative costs. It may no longer have the cash flow to support this reimbursement. We are evaluating the Agency's administration budget to consider its flexibility for further cost reductions. Second, the Redevelopment Agency has short-term and long-term loans from the City that are at increased risk of repayment under the provisions of the new State Redevelopment legislation. We are evaluating each of these loans in order to minimize risk to the General Fund. Finally, the General fund backs two of the three bond issues currently supported by Redevelopment tax increment revenues. Should the Agency be unable to make debt service payments the General Fund would be considered as a source for repayment.

The ultimate impact to the City's General Fund could range from \$2 million to \$6 million through June of 2012. The City is closely watching the State's legal challenge and continues to evaluate the necessary program and budget changes that may become necessary with or without dissolution of the Agency.

County Teeter Program – In response to high delinquency rates on district assessments, the County has proposed a change to its "Teeter" method of tax distribution. Under the current plan, the City receives 100% of all taxes and assessments levied, including substantially all Code Enforcement liens. The County covers the delinquent taxes in exchange for penalties and interest earned in the period in which the delinquent taxes are collected.

- Proposed changes to the Teeter Plan will have particular impact on the City's General Fund Code Enforcement revenues. The City levied approximately \$2.4 million in code enforcement fees, fines, abatement charges, interest, and penalties on the County tax roll for 2011-12. Changes to the County's Teeter Plan began in 2009 when the County imposed restrictions on lien payments by comparing the lien amount on each property to the assessed land value of the property. If the amount owed exceeded the assessed land value, the County reduced the Teeter payment down to or slightly below the assessed value. The Neighborhood Services Section of the Police Department accounted for this restriction in its 2011-12 revenue estimate.

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The County recently notified the City that it has proposed removing all direct assessments from the Teeter Plan in fiscal year 2012-13. The Teeter Plan changes do not mean that this revenue will be lost, only that the County will not pay the City up front for all delinquent fees and fines. On Tuesday, September 23, 2011, the County Board of Supervisors returned this agenda to staff, requesting additional analysis of alternatives.

The risk to the City is for 2012-13. At that time, the City might need to absorb the cash flow, carrying cost and risk of unpaid property assessments. This may add \$2 million to our operating deficit in FY 2012-13. We will continue to monitor County action on this proposal.

Labor Contracts and Fire Arbitration Ruling – Modified labor agreements with cost reductions have been ratified with all groups for 2011-12 except the Stockton Police Officers' Association (SPOA) and Stockton City Employee's Association (SCEA). On June 21, 2011, the City implemented non-voluntary salary and benefit reductions for SPOA and SCEA employees under its May 17, 2011 emergency declaration. On August 9, 2011, Council approved implementation of the City's Last, Best and Final offer with its fire employees, effective July 1, 2011.

On July 22, 2011, the arbitrator in the dispute between the City and the Stockton Professional Firefighters Local 456 ruled with a split decision about employee compensation dating back to the 2010-11 Fiscal Year. The total amount of one-time back pay that the City may have owed as a remedy in this dispute was estimated at a \$4 million impact to the General Fund. The City and its Fire employees continued to negotiate the settlement of this arbitration ruling and reached a tentative agreement that settles this dispute and establishes contract terms through June 2012. The Fire unit has ratified the agreement. City Council is scheduled to consider its approval of the agreement at its October 18, 2011 meeting.

Recap of Ongoing Issues and a Look Ahead to 2012-13 – The ongoing issues discussed above create challenges for the General Fund as it initiates its budget development process for 2012-13. The City has identified and used \$3.98 million in short-term solutions to address current 2011-12 shortfalls. Further, we have discussed accounts receivable valuation risk, inter-fund loan repayment risk in excess of \$7 million, and Redevelopment Agency risk impacts ranging from \$2 - \$6 million through June 2012. Proposed changes to the County Teeter tax distribution policy add \$2 million in Code Enforcement revenue risk beginning in 2012-13. Finally, the City has implemented non-voluntary salary and benefit reductions to its two largest employee groups, SPOA and SCEA, that will need resolution before the City can regain financial sustainability. We have initiated work on an updated long-term financial baseline projection that incorporates these risks to inform our approach for the 2012-13 fiscal year budget.

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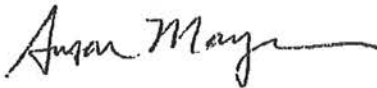
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FINANCIAL SUMMARY

A General Fund action plan has been identified to offset \$3.98 million in 2011-12 losses that have materialized since the original 2011-12 budget adoption on June 21, 2011. The proposed plan and budget amendment addresses known and quantifiable impacts to the budget. As discussed above, a series of additional and significant contingent risks to the General Fund remain outstanding.

The financial information provided in this report supports the continuance of the state of emergency adopted by City Council on May 17, 2011. The measures implemented under this emergency are necessary to generate the cost savings needed to maintain a balanced budget and maintain solvency of the General Fund during fiscal year 2011-12. The City continues to closely monitor its 2011-12 budget and will report to you as conditions change.

Respectfully submitted,



SUSAN MAYER
CHIEF FINANCIAL OFFICER

APPROVED



LAURIE MONTES
DEPUTY CITY MANAGER

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STOCKTON CITY COUNCIL

RESOLUTION APPROVING AMENDMENTS TO THE 2011-2012 ANNUAL BUDGET

The City Council adopted the 2011-2012 Annual Budget on June 21, 2011; and

The City Council received an update on the 2011-2012 Budget on August 23, 2011; and

Fiscal Sustainability is one of the City Council's 2011 goals; and

By the staff report accompanying this Resolution, the Council has been provided with additional information upon which the actions set forth in this Resolution are based; now, therefore,

BE IT RESOLVED BY THE CITY COUNCIL OF THE CITY OF STOCKTON, AS FOLLOWS:

1. The 2011-2012 Annual Budget is amended as shown in Exhibit 1.
2. The City Manager is authorized and directed to take such actions as are appropriate to carry out the purpose and intent of this resolution.

PASSED, APPROVED, and ADOPTED _____ October 18, 2011 _____.

ANN JOHNSTON, Mayor
of the City of Stockton

ATTEST:

BONNIE PAIGE
City Clerk of the City of Stockton

City Atty
Review *BOP*
Date October 6, 2011

General Fund
2011-12 September Midyear Update

	Adopted Budget 6/21/2011 A	Budget Increase/ (Decrease) B	Amended Budget (A + B)
Revenues			
Property Tax Revenues /Decline in Assessed Valuation	46,845,775	(2,232,600)	44,613,175
State Budget/Loss of Vehicle License Fee Allocations	1,047,400	(1,047,400)	-
State Mitigation - Prison Hospital	-	347,000	347,000
Program sources	<u>113,868,138</u>		<u>113,868,138</u>
	<u>161,761,313</u>	<u>(2,933,000)</u>	<u>158,828,313</u>
Expenditures			
<u>Programs</u>			
Police - Grants and Vacancies	84,862,036	(1,690,000)	83,172,036
Fire	39,812,835		40,290,835
Fire Overtime/Re-pricing to match leave policy		700,000	
Measure W - Budget Plan B Labor Cost Reductions		(222,000)	
Public Works - Service Reductions	7,080,990	(196,000)	6,884,990
Economic Development	485,199		485,199
Peacekeeper Program - Grant	328,354	(200,000)	128,354
Arts	36,737		36,737
	<u>132,606,151</u>	<u>(1,608,000)</u>	<u>130,998,151</u>
<u>Program Support/Other Funds</u>			
Library - Vacancy Savings	4,027,759	(50,000)	3,977,759
Recreation - Vacancy Savings	2,807,263	(50,000)	2,757,263
Entertainment Venues	2,441,299		2,441,299
Redevelopment	1,000,000		1,000,000
Marina	732,000		732,000
Capital Improvement - Project Reductions	575,000	(75,000)	500,000
Grant Match (Federal COPS; CHRP)	300,000		300,000
Development Services	150,000		150,000
	<u>12,033,321</u>	<u>(175,000)</u>	<u>11,858,321</u>
<u>Administration</u>			
City Council	521,797		521,797
City Manager	735,926		735,926
City Attorney	913,115		913,115
City Clerk	760,597		760,597
City Auditor	405,801		405,801
Admin Services	3,201,627		3,201,627
Human Resources	1,272,332		1,272,332
Tax Collection and Election	2,310,000		2,310,000
Other Admin / PIO	1,363,178		1,363,178
Vacancy savings	-	(150,000)	(150,000)
Labor Litigation	1,500,000		1,500,000
	<u>12,984,373</u>	<u>(150,000)</u>	<u>12,834,373</u>
<u>Debt Service</u>			
	<u>2,137,468</u>		<u>2,137,468</u>
<u>Contingency</u>			
	<u>2,000,000</u>	<u>(1,000,000)</u>	<u>1,000,000</u>
Subtotal, Expenditures	<u>161,761,313</u>	<u>(2,933,000)</u>	<u>158,828,313</u>
Net Annual Activity	<u>-</u>	<u>-</u>	<u>-</u>