

CITY MANAGER'S TRANSMITTAL MEMORANDUM

May 20, 2002

Members of the City Council:

Subject: Preliminary 2002-2003 Budget

INTRODUCTION

Presented for your consideration is the preliminary budget for the fiscal year beginning July 1, 2002. The city of Davis is a public corporation with a preliminary annual budget of \$97.6 million for the 2002-03 fiscal year. This figure represents all expenditures planned by the city including those of the Redevelopment Agency and all internal service charges. The budget serves as the city's primary financial document and its road map to navigate the City Council and staff through the coming fiscal year. It outlines the major priorities and projects that the city will undertake, as well as noting the accomplishments of the past year. It represents approximately 1.1 million hours of staff work that will be dedicated to every program and service the city offers. In addition, it reflects contracts for maintenance and major construction projects, as well as the materials and supplies necessary to undertake our responsibilities.

The City Council will meet on May 29, 2002 with the City Manager and Department Heads to begin developing their goals and priorities for 2002-04. For FY 2001-02 the previous City Council outlined six strategic goals, which helped to frame the city's priorities and actions. These goals are shown below:

- ◆ Initiate and conclude a process that identifies and resolves the city's short and long-term financial issues in order to attain a sustainable operating budget that does not rely on new development.
- ◆ Complete planned facilities and improve existing facilities, as needed, in order to maintain current standards and to maximize availability and usage by the community.
- ◆ Provide policy direction and enhancement to increase environmental awareness, develop a sustainable community and improve the use of our renewable and non-renewable natural resources within the community.
- ◆ Review, approve and amend necessary planning, zoning, and regulatory guidelines to ensure the community values and responsibilities are identified, evaluated and addressed.
- ◆ Work cooperatively with other governmental agencies to resolve issues of mutual concern and benefit for the betterment of government.
- ◆ Review, update and expand the Campaign Finance Ordinance to include expansion of disclosure obligations and consider public financing for volunteer limits of self-financing.

BUDGET PRINCIPLES

In November 1997, the City Council adopted budget principles specifying certain ideals to be incorporated into future budgets. These principles have guided the development of the city's financial plans for the past several years. The principles direct that a budget be developed that:

- ◆ Is sustainable into the future and not a one-time fix;
- ◆ Does not rely on development to support existing operating revenues;
- ◆ Does not erode the capital budget and capital maintenance activities to support operating activities;

- ◆ Maintains reasonable compensation strategies for employees;
- ◆ Invests in tools and training to increase productivity and maintain a high-quality work force.

BUDGET PREPARATION

The 2002-03 preliminary budget reflects essentially the same budget as FY 2001-02. Minimizing cost increases while maintaining our city's current standards of service continues to be a challenge. This preliminary budget should have been the second year preparing the budget using an expenditure control budgeting (ECB) approach. The ECB philosophy begins with a base budget and adds a growth factor based on inflation and increased population. In theory, base budget adjustments allow the city programs to keep pace with increased costs of doing business.

The 2002-03 preliminary budget does not provide additional resources to departments as suggested by the ECB. Because the budget model projections indicate increasing difficulty in maintaining existing service levels, departments were limited to increases only for the following items:

- ◆ Increases in contractual obligations such as service contracts;
- ◆ Additional service demands associated with new facilities being completed;
- ◆ Human resource costs associated with approved Memoranda of Understanding with employee bargaining groups.

The 2001-02 fiscal year budget was planned to be the first year when departments would be able to carry over General Fund savings from the previous fiscal year. The savings carryover augments the ECB philosophy by providing incentive for departments to evaluate current expenditures and plan for future expenditures. Rather than a "use it or lose it" approach, where unexpended resources simply fall back to fund balance, departments were expecting to be able to use unexpended savings from subsequent year resources to better plan expenditures and to save needed funds to plan for a large expenditure where funding would not otherwise be available.

Because the budget model projections continue to indicate difficulty in maintaining service levels, departments were not allowed to retain their savings from subsequent years. All savings realized by departments were returned to the General Fund or other appropriate funds. Departments were directed to prepare their preliminary budgets for 2002-03 fiscal year using the previous year's budget as the base.

MID YEAR BUDGET UPDATE

In the fall of 2001, and in light of projected budget shortfalls, the City Council undertook an outreach effort throughout the city in order to ask the community for assistance in identifying priorities for the city of Davis. Costs of city services (e.g., parks and public safety) continue to increase more rapidly than the revenue. At the same time, new community parks facilities were at different stages of planning and construction. As the city continues to review the community's priorities, the city has been able to more clearly define the course of action that needs to be taken over the coming years. This was an important effort because although growth may be slowing, the demand for quality services and high standards is not.

In January 2002, the Budget Reduction options report was presented to the City Council. The 2001-02 fiscal year budget assumed the passage of Measure S, but as a result of its failure there was a need to balance the budget

by the \$1.3 million in additional revenue that would have been received if it had passed. This was accomplished by transferring FY 2000-01 departmental savings to the General Fund reserve (\$900,000), freezing vacant positions during the current fiscal year (\$250,000) and one time budget reductions spread across departments (\$250,000). Because some of the reductions were a temporary correction to balance the 2001-02 budget, there would result a shortfall of \$500,000 to be addressed, as the FY 2002-03 budget was prepared.

In February 2002 the Council was provided with a mid year budget update. It was reported the June 30, 2001 projected General Fund fund balance of approximately \$4.3 million had increased to approximately \$5.7 million. This increase in fund balance was a result of extraordinary revenue changes along with prudent expenditure practices. The increase in fund balance was approximately \$500,000 additional sales tax and transient occupancy tax due to a new standard set by the Government Accounting Standards Board (GASB 33) which changed the accounting procedures for recognizing revenues. This is a one-time only increase and not a sustainable revenue source.

There were additional property tax and motor vehicle in-lieu revenues of approximately \$500,000. These additional revenues resulted from our local economic activity being stronger than initially anticipated. There was also \$300,000 in savings which resulted from departmental efforts to minimize spending, as well as a continued freeze on hiring unfilled positions citywide.

The mid-year update continued to identify that General Fund revenues are estimated nearly flat growth while projections indicate a decline in residential development resulting in a leveling off of property tax revenues. The slowing economy necessitated a conservative outlook on General Fund revenues (e.g., sales tax, transient occupancy tax and motor vehicle in-lieu revenues) which will continue to be the case in the 2002-03 preliminary budget.

The update also projected that General Fund expenditures were projected to increase due to (1) plans for new facilities, such as Walnut Park and Mace Ranch Park. The Park Maintenance Tax in effect at this time and the proposed Park Tax Renewal (Measure D) would not cover expenses of these facilities maintenance and operations. Other service expansion (e.g., additional police officers and a fourth fire station) will require significant analysis of any ongoing maintenance and operation costs and there will be a need to identify a new revenue source for funding service expansion.

The bottom line still indicates that the city's projected expenditures in February 2002 will continue to outpace revenues and draw down reserves.

CURRENT FINANCIAL CHALLENGES/SITUATION

The city continues to face several challenges in the near future. New development, which has in past years provided funds primarily for one-time, capital expenses, will continue to slow as the city reaches full build out. While this meets the community's goals of slowing growth in the city, it translates into fewer revenue dollars for city expenditure, both capital and general fund expenditures. There continues to be limited opportunity for commercial growth.

In March 2002 Davis voters passed a special tax (Measure D). Measure D is a city parcel tax measure to renew the existing Park Maintenance Tax (Measure M) approved by the voters in 1998. Measure D will generate approximately \$1.3 million annually (the same as Measure M did) to support a portion of costs needed to supply a basic level of maintenance at community parks,

greenbelts, open space, pools and related public facilities. Because Measure D is a special tax it can only be used for the specific purposes referred to above. Measure D automatically expires in four years (June 2006) but can be rescinded by the City Council prior to June 2006 if the voters approve another type of revenue measure to replace Measure D.

The Finance and Economics Commission (FEC) has continued its work to develop viable solutions to the city's short and long-term budget problems. FEC has recommended to the City Council a budget strategy that included 13 different recommendations. Their recommendations included:

1. Initiatives to be pursued by city as partial answers to its on-going financial challenges as part of a comprehensive budget strategy include: economic development to stop sales tax leakage; cooperative efforts with UCD; maximizing volunteer resources of non-profits, neighborhoods and students to provide services and/or cut city costs; and continuing deliberative dialog with the community.
2. Renew Measure M's \$49 parcel tax (four years, no inflator) as Measure D on the City's March 2002 ballot.
3. Replace parcel tax with sales tax and/or utility users tax (UUT) at earliest opportunity.
4. Secure enactment of special legislation authorizing a 1/4 or 1/2-cent sales tax (same as West Sacramento). Place on ballot no later than March 2004 as a majority vote general tax.
5. Complete drafting a model UUT ordinance, and determine developed square footage for all properties lacking that information, in the event that a UUT or square footage parcel tax is needed to supplement city revenues in the future.
6. Incorporate "previous service level commitments and MOU/PERS anticipated increases" into 2002-03 base budget (\$1,021,043).
7. Defer consideration of the following service level increases until after a 1/2 cent sales tax or equivalent revenue measure is approved on or before the March 2004 ballot, financial conditions permitting:
 - ◆ Added police officers
 - ◆ Fire Station #4
 - ◆ Mace Ranch area parks (except for park improvements comparable to initial Walnut Park development.
 - ◆ Walnut Park pool
 - ◆ New greenbelts/streetscape extension
8. Make no General Fund contributions to traffic calming, street maintenance and facility replacement; seek alternative funding for these projects which formerly were funded by Construction Tax.
9. Maintain a 15% reserve in future years for contingencies and economic/State budget uncertainties.
10. Plan for a \$1.4 million in budget cuts for 2002-03 assuming Measure D loses (includes \$100,000 for addition of Mace Ranch Park costs to base budget), plus \$500,000 to continue the required savings from one-time cuts made in 2001-02. If Measure D passes, restore cuts as finances permit before 2002-03 preliminary budget is released. If it fails, incorporate cuts.
11. Long-term financial plan should incorporate additional cuts in future years as needed to meet reserve target.
12. Staff to develop back-up plan in the event State takes away resources for cities in its 2002-03 budget. Assume loss up to State "backfill" of vehicle license fee (VLF) no longer collected, but still paid to local agencies (67.5% of city's VLF revenue); defer implementation pending outcome of State budget.

13. If Measure D loses in March 2002 and/or the VLF or other revenues are cut by the State by August 2002, Council has option to declare emergency under Prop 281, which will allow the city to place UUT on November, 2002 ballot as a majority vote general tax. (Approximately 2% UUT (gas/electric/telephone/cable) needed to replace Measure D, and 3.5% to replace VLF backfill.)

The Commission continues work on the 5-year budget forecasting model and the 5-year capital improvement program. These reports should come before the Council in the near future. The 5-year budget-forecasting model focuses on the General Fund, Park Maintenance Tax and Public Safety Fund. At the time of this report, the forecasting model was projecting a combined deficit for these 3 funds.

The Commission has discussed various alternative revenues that could be considered by the city. These revenues need to be developed because the parks tax will sunset in 4 years and an alternative revenue needs to be in place to continue the same level of service. As a result of interest in the possibility of looking at an increased sales tax, legislation (AB 7) has been introduced which would allow the city to consider placing an increased sales tax measure on the ballot. The legislation would allow a 1/2-cent sales tax or 1/4-cent sales tax to be placed before the voters.

Another alternative revenue the Commission has considered is a utility user tax. Various utilities and various alternate rates of tax have been reviewed by the FEC. Staff has provided the FEC with a number of different scenarios and assumptions and run the budget model to show the impact of each of the different scenarios identified so far. The FEC continues to discuss these alternatives.

The challenge facing the city continues to be that General Fund revenues are estimated to realize flat growth. Projections indicate a decline in new residential development, which will impact property tax revenues and a slowing economy continues, which leads to conservative projections in sales tax, transient occupancy tax and motor vehicle in-lieu revenues. There are future General Fund expenditures projected to increase including new facilities, such as Walnut Park, and Mace Ranch Park. The current projection of park tax revenues will not cover expenses for these facilities maintenance and operations. There continues to be a pent-up need for service expansions including additional police officers and a fourth fire station. These needs cannot be addressed without extensive analysis of ongoing maintenance and operations cost as well as availability of revenues for these needs unless a correction is made.

Although the June 30, 2001 fund balance ended higher than anticipated, the projection is still that the city's current projected expenditures will continue to outpace revenues and will result in drawing down reserves.

Impacts of Proposed State Budget

As we are all aware, the state's fiscal condition, which has gone from an \$8 billion surplus to a \$23+ billion deficit, weighs heavy on all local government. The Governor submitted his May Budget Revision earlier this month. According to the Governor, the budget is "a balance between cuts, borrowing and tax increases." The Governor proposed a combination of spending reductions, revenue proposals, and fund shifts, loans, accelerations, transfers and deferrals to balance the budget. Although the Governor did not "balance the budget on the backs of local governments", local government does not escape without cuts.

The proposed State budget will continue to provide full funding of the Vehicle License Fees (VLF) to cities. Admittedly the VLF is a vital source of revenue for local governments, but there are other areas where the cities could lose. Included in other impacts to the city is the elimination of booking fee reimbursements. The booking fee reimbursements to cities simply reimburse cities for charges imposed by counties per state authorization therefore they do not provide fiscal assistance to cities. It is estimated that booking fee expenditure for 2002-03 will be \$74,000 only \$6,400 of which will be recovered from booked people. This represents an increase from \$60,000 for the current fiscal year or about a \$24 per prisoner increase.

Also included is a new statewide \$75 million annual property tax shift from redevelopment agencies to fund the state's obligation to support schools (ERAF). The property tax shift represents about 13% increase over the \$600 million statewide in city property taxes the state will take in FY 2002-03. The cumulative ERAF property tax shift for the city of Davis to date is approximately \$14.7 million. The impact of this "taking" from the redevelopment agency will result in a more difficult time in providing and constructing affordable housing within the city.

Local governments continue to be concerned about the potential for continuing shifts from the State to local government. In response to this growing concern, a coalition has been formed called LOCAL (Leave Our Community Assets Local). Recently a contingency of local government officials went to Sacramento to talk to legislators and convey that cuts to local government result in real impacts to the services provided to local citizens. LOCAL includes police and fire chiefs, local business people, health, labor, senior citizens and community representatives joined with elected and appointed officials from special districts, counties and cities. The coalition continues to grow and continues to pressure legislators to realize the impacts of cuts to the local governments. This grassroots effort will continue to grow and pressure will continue to be applied to legislators and the Governor.

Since the state budget is not scheduled to be adopted until later in June (although predicted to take longer), it is not possible to know the specific state actions and how they may impact the city until the review process is concluded by the State Legislature and Governor.

Thus as we review the preliminary budget for 2002-03 we should remember that all of the propositions contained therein may change or are subject to change beyond our control.

Respectfully submitted,

James W. Antonen
City Manager